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## HOUSE COMMITTEE ON FINANCE

### TESTIMONY REGARDING SB 2660 SD 3 HD 1 RELATING TO COLLEGE SAVINGS PROGRAMS

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**  
**DATE: MARCH 31, 2008**  
**TIME: 2:00PM**  
**ROOM: 308**

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This bill proposes a deduction from gross income for contributions made to 529 College Savings Plans. The Senate Committee on Education amended this measure by establishing a per account deduction limit of \$75,000.

The Senate Committee on Economic Development & Taxation and Committee on Ways & Means made technical amendments to the measure and amended the effective date.

The House Committee on Higher Education amended the measure by increasing the deduction amounts, providing a recapture provision for unqualified distributions, among other nonsubstantive amendments.

The Department of Taxation (Department) **supports** this measure; **however prefers the approach taken in the Administration measure, SB 3000**. The Department also **requests amendments** in order to lower the revenue impact of this measure.

#### I. **529 PLANS, GENERALLY**

Section 529 of the Internal Revenue Code allows states to sponsor programs that allow contributions to qualifying educational accounts that grow tax-free for purposes of financing certain qualifying education costs. Hawaii's 529 college savings plan is vested in Chapter 256, Hawaii Revised Statutes, and is overseen by the Department of Budget & Finance. However, an individual is not limited to choosing Hawaii's 529 plans. Taxpayers can choose any open program across the fifty states.

529 plans allow invested amounts to grow tax free, with no tax consequences when the funds are withdrawn for a qualifying purpose. Although the federal government does not provide any tax

credits or deductions for amounts invested, many states offer tax credits or deductions for contributions to 529 plans within their state. With the high costs of post-secondary education, it is important that investment vehicles with tax benefits be provided for those saving for college.

## II. TECHNICAL COMMENTS ON THIS MEASURE

**THE DEPARTMENT PREFERS SB 3000, WHICH IS LIMITED TO HAWAII PLANS**—The Department prefers the approach taken in SB 3000 because it limits the deduction to only to those investing in Hawaii's 529 plans. As noted above, taxpayers are not limited to their own state's plan in setting up a 529 account. Opening the deduction to all 529 accounts dramatically increases the cost of the deduction to the State. The Department strongly believes that SB 3000 is superior to this bill in that it seeks to grow Hawaii's TuitionEDGE 529 plan and the Administration's amount has already been factored into the Executive Budget.

**UNWORKABLE PER-ACCOUNT LIMIT**—The measure provides that the limit on contributions to a 529 plan is \$75,000 per account. The Department suggests that this per account limit is unworkable, since a taxpayer merely needs to set up a new account (even at the same institution) to avoid the per account limit. The Department suggests that any limit be applied at the taxpayer level, rather than at the account level. The annual cap at the taxpayer level, as currently provided in the measure, should be sufficient.

**PROHIBITED DEPOSITS**—The Committee may also want to consider adding recapture provisions that specify any "circular" use of account funds will be precluded from qualifying for the deduction. For example, if an account holder withdraws funds from the account and uses those funds to "re-deposit" funds, no deduction should be allowed for the "re-deposit."

## III. REVENUE ESTIMATE

This bill's revenue impact is indeterminate because this bill authorizes the tax deduction for Hawaii taxpayers investing in any state's 529 program.

The Department has no way of estimating how many residents invest in a 529 program across the nation; however, the loss would be substantially higher than \$2.8 million annual revenue impact estimated for the Administration bill (SB3000) because the tax deduction is limited to taxpayers investing in the Hawaii 529 plan only.

TESTIMONY BY GEORGINA K. KAWAMURA  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE HOUSE COMMITTEE ON FINANCE  
ON  
SENATE BILL NO. 2660, S.D. 3, H.D. 1

March 31, 2008

RELATING TO COLLEGE SAVINGS PROGRAMS.

Senate Bill No. 2660, S.D. 3, proposes to provide a state income tax deduction for contributions to any qualified tuition program established pursuant to Section 529 of the Internal Revenue Code. The Bill proposes a tax deduction of up to \$10,000 for taxpayers filing individually and up to \$20,000 for married couples filing joint returns, heads of households, or surviving spouses. In addition, the bill proposes to establish a \$75,000 cap on the total tax deduction that may be claimed per college savings account.

The Department of Budget and Finance supports the intent of this bill, which is consistent with the Administration's Bill that provides individuals an incentive in the form of a State tax deduction for contributions to the State of Hawaii's 529 College Savings Program called "HI 529."

However, we strongly oppose allowing the State tax deduction for contributions to any qualified 529 plan. Rather than encourage Hawaii residents to invest in other states' plans, we would like to see Hawaii's plan grow, because with the growth of Hawaii's plan, there is opportunity for our plan participants to benefit from lower program fees. The third party program administrator, Upromise Investments, Inc., is contractually required to reduce the annual account maintenance fee assessed to participants from \$20 to \$15 upon the program's

assets reaching \$100 million, reduce the fee from \$15 to \$10 upon the program's assets reaching \$125 million; and further reduce the fee from \$10 to \$5 upon the program's assets reaching \$150 million. Hawaii's HI 529 College Savings Program is a "direct sold" plan as opposed to an "advisor sold" plan. Typically lower costs are associated with direct-sold plans; as advisor-sold plans generally assess an advisor fee or commission to the plan owner.

Testimony submitted to the Senate Committee on Economic Development and Taxation's hearing on the bill on February 12, 2008, inferred that restricting the state tax deduction benefit to the State's 529 plan would not allow Hawaii families the benefit of being able to invest in "any" of the other state's 529 programs. On the contrary, this would not preclude any Hawaii resident from investing in any 529 plan that their financial advisor recommends. They could still open an account in any state's 529 plan that their financial advisor recommends. However, the advantage of the state tax deduction would only be available to residents who invest in a Hawaii 529 plan account.

Of equal importance are the following additional reasons that the state tax incentive should remain with Hawaii's plan only:

1. Accountability. It would be difficult to effectively monitor and administer a program that provides a State tax benefit for contributions made to other state's 529 programs. There would be no effective policy measurement as the other state's program managers would not be able to provide necessary data to Hawaii. In contrast, the program manager for Hawaii's plan is contractually required to provide data and statistics on the program as well as geographical and socio-economic data. This data could then be used to ensure that the program is reaching a broad-base of families from a wide-range of income levels.

2. Responsible tax policy. Keeping the deduction to the “in-state” plan would provide for a more controlled tax impact. If the state tax deduction benefit were opened up to any 529 program, there would be no means on which to base a projection of the tax impact. Also, Hawaii’s program manager is contractually required to provide data necessary for the State’s Tax Department to monitor whether the tax benefits are being abused. While Standing Committee Report No 2533 stated that the Committee on Economic Development and Taxation received a fiscal impact statement from the Department of Taxation estimating the revenue impact of Senate Bill No. 2660, S.D.1, at \$1,000,000 annually, the estimate was based on the number of current participants in the Hawaii program only. The estimate did not include or address the potential revenue loss for all Hawaii residents investing in “any” 529 Program.

In response to the proposed \$75,000 cap on the total tax deduction that may be claimed per account, we believe that such a limitation would be a disincentive to continue contributions or participation in the HI 529 Program once an account owner reaches the cap. The incentive provided should realistically enable account owners to pay for future tuition expenses. In the August 2007 issue of Money Magazine, the estimated cost for four years of tuition, room and board at a public college is estimated to be \$125,000 by 2022; and closer to \$300,000 for a private college.

We are also pursuing an additional statutory change to allow anyone to contribute into a HI 529 account. Currently, only the account owner is allowed to contribute into a HI 529 account, preventing for example, grandparents from contributing directly into a grandchild’s account. We would like to change this restriction and will work with this Committee or

subsequent committees on providing the necessary statutory language changes as this bill progresses through the legislative process.

Therefore, while we support the intent of Senate Bill No. 2660, S.D. 3, we recommend the language that provides for a state tax deduction benefit for contributions made to Hawaii's 529 program only, and no cap on the total deduction.

Thank you for this opportunity to provide testimony on this measure.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** INCOME, Deduction for college savings program

**BILL NUMBER:** SB 2660, HD-1

**INTRODUCED BY:** House Committee on Higher Education

**BRIEF SUMMARY:** Amends HRS section 235-7 to provide that the annual deductions from gross income for contributions to a qualified tuition program established pursuant to IRC section 529 shall be: (1) up to \$10,000 for individual taxpayers; (2) up to \$10,000 for married couples filing separately provided that each spouse may claim a deduction up to \$10,000; and (3) up to \$20,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing as surviving spouses; but not more than the amount contributed during the taxable year; provided that the aggregate deduction amount shall not exceed \$75,000 per college savings account. If any amount of the deduction exceeds a taxpayer's taxable income for a year, the excess deduction may be used as a deduction against the taxpayer's taxable income in subsequent years until exhausted.

The amendments made to HRS section 235-7 shall not be repealed when that section is reenacted on January 13, 2013, pursuant to Act 166, SLH 2007.

**EFFECTIVE DATE:** Upon approval; applicable to tax years beginning after December 31, 2050

**STAFF COMMENTS:** The legislature by Act 81, SLH 1999, established a college savers program on the state level to allow taxpayers to save for a child's college education by participating in a state college savings program. This plan is patterned on the rules governing such plans established under Section 529 of the federal Internal Revenue Code. Under that section, contributions made to such qualified programs receive no special tax treatment but the law specifies that when the distribution is made from the account for the beneficiary, the amount in excess of the contribution is taxable as part of the beneficiary's income. There is no benefit or incentive for the contributor since the contribution is made with after tax dollars. This proposal would digress from the federal law and allow contribution amounts to be exempt from state taxation.

It should be remembered that it has long been the intent of the state legislature to maintain conformity between Hawaii's income tax law and the federal Code to insure that administration and compliance costs will be minimized. Given that there is no similar provision on the federal level, this proposal would create yet another difference in the definition of income for state income tax purposes.

If it is the intent of the legislature and administration to encourage families to set money aside for their children's higher education, the deduction, as proposed, is regressive in that it favors those at the high end of the income scale who probably would have the discretionary income to set aside funds and punishes those at the bottom end of the income scale as those families are less likely to put the maximum aside to qualify for the deduction. Inasmuch as the proposed deduction is a back door expenditure of tax dollars, it would be far more efficient for lawmakers to set up a subsidy program that would provide a

SB 2660, HD-1 - Continued

sliding scale of percentages to subsidize or “match” contributions made to a qualified college savings account where the percentage of the match would be inversely graduated. Thus, those lower income families with less discretionary income would see their small contributions matched at a higher percentage while those higher income families would see the match phase-out after a certain level of contribution is made. This would take the onus of administering the program out of the tax department and places it within the financial institutions who would benefit from the use of the money. This would also insure that the contributions are made to a local institution that would participate in the state matching program. This would be far more efficient and accountable than utilizing the tax system to encourage parents to save for their children’s college education.

It is interesting to note that well-intended actions on the part of the legislature may sometimes miss the target. This measure proposes to encourage individuals to make contributions to a college savings account by allowing the amount to be deducted from taxable income. For parents this might be an incentive but for grandparents who are receiving pension income but who are probably in a better position to make such contributions, there is no incentive as pension income is exempt from state taxation. If this measure is approved, will lawmakers come back next year to somehow allow seniors to make such contributions?

Digested 3/31/08



TESTIMONY BY PATRICK W. MCKEON  
CHIEF COMPLIANCE OFFICER, UPROMISE INVESTMENTS, INC.  
PROGRAM MANAGER FOR HI529 – HAWAII'S COLLEGE SAVINGS PROGRAM  
TO THE HOUSE COMMITTEE ON FINANCE  
SENATE BILL NO. 2660, S.D. 3, H.D. 1

March 31, 2008

Representative Marcus R. Oshiro, Chair  
Representative Karen Leinani Awana  
Representative Della Au Belatti  
Representative Tom Brower  
Representative Mele Carroll  
Representative Faye P. Hanohano  
Representative Sharon E. Har  
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Representative Michael Y. Magaoay  
Representative Gene Ward

Representative Marilyn B. Lee, Vice-Chair  
Representative Joey Manahan  
Representative John Mizuno  
Representative Bob Nakasone  
Representative Karl Rhoads  
Representative Roland D. Sagum  
Representative James Kunane Tokioka  
Representative Colleen Rose Meyer  
Representative Kymberly Marcos Pine

RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS PROGRAM.

**Introduction**

Thank you for the opportunity to provide testimony relating to S.B. 2660, which would provide a state income tax deduction for contributions to any state-sponsored qualified tuition program established pursuant to Section 529 of the Internal Revenue Code. Upromise Investments, Inc. (Upromise) currently serves as Program Manager for HI529 – Hawaii's College Savings Program, with responsibility for coordination of services to the State of Hawaii and its college savers, including marketing, recordkeeping, administration, investment management, and client services.

Upromise recognizes that determination of tax and other public policies with respect to HI529 remains the discretion and responsibility of the State. As Program Manager for HI529, we hope that the following testimony provides helpful information as the Committee considers this bill, including additional context on the recent enhancements to the State's college savings program, as well as observations on state tax incentives related to 529 plans, consistent with our experience as a service provider to the 529 industry.

**Overview of Services and Recent Enhancements for Hawaii's College Savings Program**

Upromise began providing services to HI529 in November of 2007, after being selected as Program Manager through a competitive RFP bidding process administered by the State of Hawaii's Department of Budget and Finance. The State and Upromise worked together to transition services for HI529 from the previous Program Manager, and in the process, introduced a number of significant enhancements, including:

- An immediate cost reduction of more than 20% for all Program participants, with commitments to further reduce price as the program grows

- An expanded investment line-up featuring high-value, low-cost options from The Vanguard Group, a trusted leader in mutual fund investing
- Significantly increased client service functionality, including full online account opening and account maintenance
- Marketing capabilities focused on reaching all audiences, including novice investors, middle-income families, and even lower-income households
- Additional savings opportunities through the free Upromise Rewards Service, which provides college savings back on families' everyday spending

### **Reaching College Savers of All Demographics**

Upromise has worked successfully with state partners to offer high-value, low-cost "Direct-sold" 529 programs to the full range of college savers – from novice investors that include middle- and even lower-income families to more sophisticated participants. "Direct-sold" plans, like HI529, are offered directly to participants without sales commissions or other Advisor fees.

"Advisor-sold" 529 programs are plans through which participation is driven largely by financial Advisors working with their clients. Typically, individuals who work with financial Advisors tend to be more affluent and sophisticated investors, who are willing to pay more for the advice and guidance of an Advisor. As a result, Advisor-sold 529 programs are on average more expensive than programs that are Direct-sold.

### **Upromise Experience with 529 State Tax Incentives**

Upromise provides 529 plan services to 11 state partners, and administers over 1.5 million college savings accounts. As a service provider solely dedicated to the 529 industry, Upromise has a mission that mirrors the goal of our state partners: to make college more affordable and accessible for all American families, regardless of income or other demographics.

Upromise contributes to this mission by providing 529 technology and client services designed to make it as easy as possible for a family to get started saving. Upromise's 529 system has been designed so that in 10 minutes or so, a busy parent or grandparent – who has just a few free moments in the day – can open a 529 account, establish an automatic investing plan from their bank account, or contribute through payroll deduction at work, enroll in the Upromise Rewards Service for additional savings (if desired), and put their college savings strategy on auto-pilot.

Upromise has observed the positive effect that a state income tax deduction can have in providing a significant incentive for getting started and staying engaged with a college savings strategy. The majority of Upromise's state partners provide a state tax deduction on contributions made to the home state's 529 plan. These deductions range from \$5,000 per year for one state to an unlimited deduction on annual contributions for another.

Across 529 plans administered by Upromise, state plans that provide a state tax deduction experience significantly higher participation in comparison to those that do not. In addition, Upromise has observed in-state participation significantly increase after the introduction of a state tax deduction for state plans that previously did not offer any incentive on contributions. For example, annual contributions by state residents more than doubled, on average, for the two

Upromise-administered state plans that recently implemented a state tax deduction for 529 contributions.

### **Considerations in Providing a Tax Deduction on Contributions to Any State's 529 Plan**

The Committee may want to consider certain potential consequences if Hawaii were to provide a State income tax deduction on contributions to any state 529 plan:

- 1. Reduced control over how 529 plan information is marketed within Hawaii.** Currently, the State has control and oversight over how HI529, as a municipal security sponsored by the State of Hawaii, is marketed and distributed to Hawaii residents. The State reviews and approves all Program materials and outreach efforts, and can help ensure that the Program's marketing tactics are consistent with the State's overall goal of helping all residents save for college.

A State tax deduction only for HI529 would effectively increase this influence over how 529 plans are marketed within the State, by further underscoring HI529 as the 529 plan designed specifically for Hawaii residents. By instituting a tax incentive to further encourage Hawaii families to consider their home state's plan first, the State can help ensure that Hawaii residents are presented with 529 information and disclosure that was designed for them, with control and oversight by the State.

The State does not have control over how other states' plans are marketed within Hawaii. In a scenario where a State tax deduction were available on contributions to any state's 529 plan, the State may, in effect, reduce its influence over how 529 plan information is presented to Hawaii residents and would not be able to control the promotion of HI529 as a low cost alternative with special benefits. This consideration may be especially relevant at a time when the marketing and distribution practices of the 529 industry are under scrutiny, particularly with respect to the sale of out-of-state plans to in-state residents.

- 2. Potential negative effect on State's goal of helping Hawaii families of all demographics save for college.** Providing a State income tax deduction on contributions to any state's 529 plan would not necessarily advance the State's goal of helping all Hawaii families save for college, particularly middle- and even lower-income families. There is the potential that other state 529 plans would leverage the deduction primarily to market to more affluent investors – i.e., individuals that traditionally work with financial Advisors – leaving the State of Hawaii to market HI529 to the rest of the population. This loss of 529 plan assets to other states' plans potentially could have a significant impact on the scale advantages of HI529, as described below.

Upromise recognizes the value and role of an Advisor to certain investors and has developed technology and client service functionality that can be deployed in service to HI529 in order to enable Hawaii-based Advisors to stay engaged with their clients' college investing activity. This functionality includes the ability to receive duplicate account statements and the potential to view client accounts online.

**3. Reduced participation and scale for HI529, which impacts pricing and benefits for Hawaii residents.** HI529 benefits from contractual commitments to further reduce the cost to Hawaii participants as the Program grows, reflecting the economies of scale associated with increased Program assets as well as Upromise's history of continuing to drive down costs for state partners and plan participants. A State tax deduction on contributions to any state's 529 plan would potentially result in reduced scale and/or slower growth for HI529, which may impact the State's ability or timing to offer further cost reductions and other benefits to Hawaii 529 Program participants.

Again, thank you for the opportunity to provide these observations. Upromise is pleased to be of service to Hawaii in helping to achieve the State's objectives for college savings, and looks forward to continuing to work with the State to enhance HI529 and to help all Hawaii families save for college.



**SIFMA**<sup>®</sup>

Securities Industry and  
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March 31, 2008

The Honorable Marcus R. Oshiro  
Chairman, House Finance Committee  
Hawaii State Capitol, Room 306  
415 South Beretania Street  
Honolulu, HI 96813

The Honorable Marilyn B. Lee  
Vice Chair, House Finance Committee  
Hawaii State Capitol, Room 434  
415 South Beretania Street  
Honolulu, HI 96813

RE: S.B. 2660, S.D. 3, H.D. 1 Relating to College Savings Programs

Dear Chairman Oshiro and Vice Chair Lee:

The Securities Industry and Financial Markets Association (SIFMA)<sup>1</sup> is writing to express its strong support for S.B. 2660 (SD3, HD1). This legislation would allow Hawaii residents who contribute to any qualified 529 plan to deduct the amount of that contribution – up to a maximum of \$20,000 per year per married couple filing jointly – from their gross income for state tax purposes.

Saving for your children's college education can be a daunting task. The College Board reports that the current price tag for **one year** of undergraduate education is \$13,589 for public institutions and \$32,307 for private institutions. Multiply that number by four years, and parents and students are facing total college costs that currently range between roughly \$54,000 and \$130,000. Furthermore, college costs are only going up. Over the last five years, after adjusting for inflation, total costs have increased 40% at four-year public colleges and 30% at four-year private colleges and universities. In light of these numbers, a U.S. Commerce Department report that the personal savings rate of Americans in 2006 (the last year for which data is currently available) has dropped to negative 1% is particularly troubling.

Paying for college requires extensive planning and saving. Many entities, including Kiplinger's and savingforcollege.com, believe that 529 plans are the best college savings vehicle. A major reason why these plans are so attractive is that the Economic Growth and Tax Relief Reconciliation Act of 2001 makes earnings on 529 plans free from federal tax so long as they

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<sup>1</sup> The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

are used for qualified education expenses. In addition, most states- including Hawaii – have followed the federal government's lead and don't tax 529 earnings.

S.B. 2660 (SB 3, HD 1) is good public policy because it gives Hawaii residents an additional incentive to save for college. Residents who contribute to any qualified 529 plan would be permitted to deduct contributions of up to \$20,000 per married couple filing jointly from their state taxable income. We note that earlier versions of the legislation supported a deduction of \$5,000 per individual/\$10,000 per married couple filing jointly. SIFMA supports either version so long as it applies to contributions to any qualified 529 plan. We applaud you for advancing legislation that further encourages Hawaii residents to save for the education needs of their children.

As you undoubtedly know, an educated population provides tremendous benefits to the state. According to the U.S. Census Bureau, people with bachelor's degrees earn over 70% more on average than those with only a high school diploma, and the earnings gap between a high school and a college graduate is more than \$1,000,000 over a lifetime. In addition, a College Board report entitled "Education Pays" concluded that college graduates not only make more but they also have lower levels of unemployment, are less likely to depend on social programs, and have lower smoking and incarceration rates.

For the reasons stated above, SIFMA encourages the Committee to support S.B. 2660 (SD3, HD1). Please feel free to contact me at 212-313-1311 or my lobbyists, Red Morris and John Radcliffe, at 808-531-4551 if you have any questions.

Sincerely,



Kim Chamberlain  
Managing Director & Counsel  
State Government Affairs

March 31, 2008

## TESTIMONY

SB 2660, S.D. 3, H.D. 1 – Responding to Questions about the HI 529 Plan.

From: Donn Ariyoshi

**Background:** SB2660, now before the House Finance Committee, provides for a HI State tax deduction of \$10,000 or \$20,000 jointly for contributions to ANY qualified state college savings plan established under Section 529 of the Internal Revenue Code.

**Q:** Why allow a HI State tax deduction for contributions to out-of-state (other states) 529 college savings plans?

**Q:** Other states collect an asset-based or fee on their 529 plan so, why offer a tax deduction supporting the revenues of other states paid for by Hawai`i families? Why encourage Hawai`i families to invest outside of Hawai`i?

These are good questions, but they are detracting from the intent and integrity of SB 2660 and distracting from understanding the benefit of a college savings plan for our children.

Here's why:

The purpose of SB2660 is to encourage Hawai`i families to start saving and investing for college and graduate school as costs have increased dramatically, and continue to do so. The people of Hawai`i now have, and will have, regardless of the outcome of SB2660, the ability to choose the college savings plan of their choice to use. Many will rely on financial advisors and some will attempt to pursue picking a plan that is right for them by themselves. The goal is to encourage Hawai`i families to save and invest in a plan they choose!

Every savings/investment plan has fees that are necessary to administer their plan. Some of these fees are used to cover costs incurred by the company that is the program administrator and often a portion of these fees are used to offset the costs incurred by the state that oversees such plan or by the states for related purposes. It is not clear why the State of Hawai`i or the families of Hawai`i could be better off if all the fees that they pay for the management of a 529 college savings plan they choose all goes to the private company or if a portion goes to the responsible state administrator. The HI plan, for example imposes on each account an asset-based fee of .75% and a \$20 per account fee. For some reason, the Department of Budget and Finance elected not to use some of these fees to cover their costs and all such fees go to Upromise, the company that manages the HI Plan, which is located out of state in Massachusetts. Other out-of-state plans have greater and some have lesser

fees. The HI Plan invests in Vanguard funds and there are many other plans that invest in Vanguard funds but charge participants, whether they are Hawai`i families, or others, far less. For example, the NY 529 plan, also administered by Upromise, also uses the same Vanguard funds but charges .55% and NO account fee. Likewise, many may wish to use a 529 plan recommended by their advisor based on certain features not available in the HI 529 plan but then they could lose the State tax deduction.

It should also be noted that currently the people of Arizona, Kansas, Pennsylvania and Maine may deduct from their own state taxable income what they contribute to the HI Plan, if they decide the HI Plan is best for them and contribute to the HI Plan. Other states considering offering a tax deduction as proposed in SB 2660 are Connecticut, Missouri and North Carolina. Why should not Hawai`i families likewise have the same option?

SB2660 is providing families in Hawai`i with (1) encouragement to save and invest in a college savings plan of their CHOICE, (2) different investment options and venues available as tools to construct a good plan, and (3) advice to design a good plan to meet their needs and objectives. Let us not be distracted from our intent and goodness of a college saving plan for Hawai`i families. Let do it right!

Mahalo,  
Donn Ariyoshi



March 25, 2008

**Supporters of Senate Bill 2660**

**Donn R. Ariyoshi  
The McRoberts/Strada Team  
Morgan Stanley**

**Gwen Pacarro  
Senior Vice President  
Hawai`i Complex Manager  
Morgan Stanley**

**Stephen Jobe  
Vice President, Director 529 Plans  
Morgan Stanley**

**Financial Planning Association  
Hawai`i Chapter**

**College Savings Foundation  
New York**

**Securities Industries and Financial Markets Association  
New York, Washington, London and Hong Kong**

**Chris Pike  
Branch Manager  
Wedbush Morgan**

**Jarrett Kovics  
Sr. Vice President  
Hawai`i Complex Manager  
Smith Barney**

**Wesley Yamamoto  
Senior Vice President – Complex Manager  
Wachovia Securities**

**Sean Satterfield  
Director, Complex Manager-Hawai`i  
UBS Financial Services Inc**

**Report Title:**

*College Savings Programs*

**Description:**

*Provides an annual maximum deduction against taxable income for contributions made to a section 529 college savings program. (SB2660 HD1)*

THE SENATE  
TWENTY-FOURTH LEGISLATURE, 2008  
STATE OF HAWAII

**S.B. NO.** 2660  
S.D. 3  
H.D. 2

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# A BILL FOR AN ACT

*RELATING TO COLLEGE SAVINGS PROGRAMS.*

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

SECTION 1. In 1996, Congress enacted Section 529 (with respect to qualified state tuition programs) of the Internal Revenue Code of 1986, as amended, authorizing tax-deferred college savings plans now referred to as "529 Plans." Section 529 authorizes states to establish these programs to assist and encourage families to set aside funds for future higher education expenses.

Most states that assess an income tax offer some kind of in-state tax deduction or credit for contributions as an incentive for their residents to participate in these college savings programs. To encourage Hawaii families to save for college in the plan of their choice and to

increase their participation in these programs, this Act provides a state income tax deduction for contributions to any qualified program. This income tax deduction shall apply to program contributions made in calendar year 2008 and beyond.

SECTION 2. Section 235-7, Hawaii Revised Statutes, is amended to read as follows:

**"§235-7 Other provisions as to gross income, adjusted gross income, and taxable income.** (a) There shall be excluded from gross income, adjusted gross income, and taxable income:

- (1) Income not subject to taxation by the State under the Constitution and laws of the United States;
- (2) Rights, benefits, and other income exempted from taxation by section 88-91, having to do with the state retirement system, and the rights, benefits, and other income, comparable to the rights, benefits, and other income exempted by section 88-91, under any other public retirement system;
- (3) Any compensation received in the form of a pension for past services;
- (4) Compensation paid to a patient affected with Hansen's disease employed by the State or the

United States in any hospital, settlement, or place for the treatment of Hansen's disease;

- (5) Except as otherwise expressly provided, payments made by the United States or this State, under an act of Congress or a law of this State, which by express provision or administrative regulation or interpretation are exempt from both the normal and surtaxes of the United States, even though not so exempted by the Internal Revenue Code itself;
- (6) Any income expressly exempted or excluded from the measure of the tax imposed by this chapter by any other law of the State, it being the intent of this chapter not to repeal or supersede any express exemption or exclusion;
- (7) Income received by each member of the reserve components of the Army, Navy, Air Force, Marine Corps, or Coast Guard of the United States of America, and the Hawaii national guard as compensation for performance of duty, equivalent to pay received for forty-eight drills (equivalent of twelve weekends) and fifteen days of annual duty, at an:

- (A) E-1 pay grade after eight years of service;  
provided that this subparagraph shall apply  
to taxable years beginning after December  
31, 2004;
  - (B) E-2 pay grade after eight years of service;  
provided that this subparagraph shall apply  
to taxable years beginning after December  
31, 2005;
  - (C) E-3 pay grade after eight years of service;  
provided that this subparagraph shall apply  
to taxable years beginning after December  
31, 2006;
  - (D) E-4 pay grade after eight years of service;  
provided that this subparagraph shall apply  
to taxable years beginning after December  
31, 2007; and
  - (E) E-5 pay grade after eight years of service;  
provided that this subparagraph shall apply  
to taxable years beginning after December  
31, 2008;
- (8) Income derived from the operation of ships or  
aircraft if the income is exempt under the  
Internal Revenue Code pursuant to the provisions  
of an income tax treaty or agreement entered into

by and between the United States and a foreign country; provided that the tax laws of the local governments of that country reciprocally exempt from the application of all of their net income taxes, the income derived from the operation of ships or aircraft that are documented or registered under the laws of the United States;

- (9) The value of legal services provided by a prepaid legal service plan to a taxpayer, the taxpayer's spouse, and the taxpayer's dependents;
- (10) Amounts paid, directly or indirectly, by a prepaid legal service plan to a taxpayer as payment or reimbursement for the provision of legal services to the taxpayer, the taxpayer's spouse, and the taxpayer's dependents;
- (11) Contributions by an employer to a prepaid legal service plan for compensation (through insurance or otherwise) to the employer's employees for the costs of legal services incurred by the employer's employees, their spouses, and their dependents;
- (12) Amounts received in the form of a monthly surcharge by a utility acting on behalf of an affected utility under section 269-16.3 shall not

be gross income, adjusted gross income, or taxable income for the acting utility under this chapter. Any amounts retained by the acting utility for collection or other costs shall not be included in this exemption; and

- (13) One hundred per cent of the gain realized by a fee simple owner from the sale of a leased fee interest in units within a condominium project, cooperative project, or planned unit development to the association of apartment owners or the residential cooperative corporation of the leasehold units.

For purposes of this paragraph:

~~["Fee simple owner" shall have the same meaning as provided under section 516-1; provided that it shall include legal and equitable owners;~~

~~"Legal and equitable owner", and "leased fee interest" shall have the same meanings as provided under section 516-1; and~~

~~"Condominium project" and "cooperative project" shall have the same meanings as provided under section 514C-1.]~~

"Condominium project" and "cooperative project" shall have the same meanings as provided under section 514C-1;

"Fee simple owner" shall have the same meaning as provided under section 516-1; provided that it shall include legal and equitable owners; and

"Legal and equitable owner", and "leased fee interest" shall have the same meanings as provided under section 516-1.

(b) There shall be included in gross income, adjusted gross income, and taxable income:

(1) [~~unless~~] Unless excluded by this chapter relating to the uniformed services of the United States, cost-of-living allowances and other payments exempted by [~~section 912~~] Section 912 (with respect to exemption for certain allowances) of the Internal Revenue Code, but [~~section 119~~] Section 119 (with respect to meals or lodging furnished for convenience of employer) of the Internal Revenue Code nevertheless shall apply; and

(2) [~~unless~~] Unless expressly exempted or excluded as provided by subsection (a)(6), interest on the



obligations of a State or a political subdivision thereof.

(c) The deductions of or based on dividends paid or received, allowed to a corporation under [~~chapter 1, subchapter B,~~] Chapter 1, Subchapter B, Part VIII of the Internal Revenue Code, shall not be allowed. In lieu thereof there shall be allowed as a deduction the entire amount of dividends received by any corporation upon the shares of stock of a national banking association, qualifying dividends, as defined in [~~section 243(b)~~] Section 243(b) (with respect to dividends received by corporations) of the Internal Revenue Code, received by members of an affiliated group, or dividends received by a small business investment company operating under the Small Business Investment Act of 1958 (Public Law 85-699) upon shares of stock qualifying under paragraph (3), seventy per cent of the amount received by any corporation as dividends:

- (1) Upon the shares of stock of another corporation, if at the date of payment of the dividend at least ninety-five per cent of the other corporation's capital stock is owned by one or more corporations doing business in this [~~State~~] state and if the other corporation is subjected

to an income tax in another jurisdiction (but  
subjection to federal tax does not constitute  
subjection to income tax in another  
jurisdiction);

- (2) Upon the shares of stock of a bank or insurance company organized and doing business under the laws of the State; and
- (3) Upon the shares of stock of another corporation, if at least fifteen per cent of the latter corporation's business, for the taxable year of the latter corporation preceding the payment of the dividend, has been attributed to this ~~[State.]~~ state.

However, except for national bank dividends, the deductions under this subsection are not allowed when they would not have been allowed under ~~[section 243]~~ Section 243 (with respect to dividends received by corporations) of the Internal Revenue Code, as amended by Public Law 85-866, by reason of ~~[subsections]~~ Subsections (b) and (c) of ~~[section]~~ Section 246 (with respect to rules applying to deductions for dividends received) of the Internal Revenue Code. For the purposes of this subsection, 1 fifteen per cent of a corporation's business shall be deemed to have been attributed to this ~~[State]~~ state if fifteen per cent

or more of the entire gross income of the corporation as defined in this chapter (which for the purposes of this subsection shall be computed without regard to source in the [~~State~~] state and shall include income not taxable by reason of the fact that it is from property not owned in the [~~State~~] state or from a trade or business not carried on in the [~~State~~] state in whole or in part), under section 235-5 and the other provisions of this chapter, shall have been attributed to the [~~State~~] state and subjected to assessment of the taxable income therefrom (including the determination of the resulting net loss, if any).

(d) (1) For taxable years ending before January 1, 1967, the net operating loss deductions allowed as carrybacks and carryovers by the Internal Revenue Code shall not be allowed. In lieu thereof, the net operating loss deduction shall consist of the excess of the deductions allowed by this chapter over the gross income, computed with the modifications specified in [~~paragraphs~~] Paragraphs (1) to (4) of [~~section~~] Section 172(d) of the Internal Revenue Code, and with the further modification stated in paragraph (3) hereof; and shall be allowed as a deduction in

computing the taxable income of the taxpayer for the succeeding taxable year;

- (2) (A) With respect to net operating loss deductions resulting from net operating losses for taxable years ending after December 31, 1966, the net operating loss deduction provisions of the Internal Revenue Code shall apply; provided that there shall be no net operating loss deduction carried back to any taxable year ending prior to January 1, 1967;
- (B) In the case of a taxable year beginning in 1966 and ending in 1967, the entire amount of all net operating loss deductions carried back to the taxable year shall be limited to that portion of taxable income for [~~such~~] the taxable year which the number of days in 1967 bears to the total days in the taxable year ending in 1967; and
- (C) The computation of any net operating loss deduction for a taxable year covered by this subsection shall require the further modifications stated in paragraphs (3), (4), and (5) of this subsection;

- (3) In computing the net operating loss deduction allowed by this subsection, there shall be included in gross income, the amount of interest which is excluded from gross income by subsection (a), decreased by the amount of interest paid or accrued which is disallowed as a deduction by subsection (e). In determining the amount of the net operating loss deduction under this subsection of any corporation, there shall be disregarded the net operating loss of [~~such~~] the corporation for any taxable year for which the corporation is an electing small business corporation;
- (4) No net operating loss carryback or carryover shall be allowed by this chapter if not allowed under [~~section~~] Section 172 of the Internal Revenue Code;
- (5) The election to relinquish the entire carryback period with respect to a net operating loss allowed under [~~section~~] Section 172(b)(3)(C) of the Internal Revenue Code shall be operative for the purposes of this chapter; provided that no taxpayer shall make such an election as to a net operating loss of a business where [~~such~~] the net

operating loss occurred in the taxpayer's business prior to the taxpayer entering business in this [~~State,~~] state; and

- (6) The five-year carryback period for net operating losses for any taxable year ending during 2001 and 2002 in [~~section~~] Section 172(b)(1)(H) of the Internal Revenue Code shall not be operative for purposes of this chapter.

(e) There shall be disallowed as a deduction, the amount of interest paid or accrued within the taxable year on indebtedness incurred or continued[~~7~~]:

- (1) [~~to~~] To purchase or carry bonds the interest upon which is excluded from gross income by subsection (a); or
- (2) [~~to~~] To purchase or carry property owned without the [~~State,~~] state, or to carry on trade or business without the [~~State,~~] state, if the taxpayer is a person taxable only upon income from sources in the [~~State,~~] state.

(f) Losses of property as the result of tidal wave, hurricane, earthquake, or volcanic eruption, or as a result of flood waters overflowing the banks or walls of a river or stream, or from any other natural disaster, to the extent of the amount deductible, under this chapter, not

compensated for by insurance or otherwise, may be deducted in the taxable year in which sustained, or at the option of the taxpayer may be deducted in equal installments over a period of five years, the first such year to be the calendar year or fiscal year of the taxpayer in which ~~such~~ the loss occurred.

(g) In computing taxable income, there shall be allowed as a deduction:

- (1) Political contributions by any taxpayer not in excess of \$250 in any year; provided that ~~such~~ the contributions are made to a central or county committee of a political party whose candidates shall have qualified by law to be voted for at the immediately previous general election; or
- (2) Political contributions by any individual taxpayer in an aggregate amount not to exceed \$1,000 in any year; provided that ~~such~~ the contributions are made to candidates as defined in section 11-191, who have agreed to abide by the campaign expenditure limits as set forth in section 11-209; and provided further that not more than \$250 of an individual's total contribution to any single candidate shall be deductible for purposes of this section.

(h) The following annual deductions from gross income shall be allowed for contributions to a qualified tuition program established pursuant to Section 529 (with respect to qualified state tuition programs) of the Internal Revenue Code:

- (1) Up to \$5,000 for individual taxpayers, but not more than the amount contributed during the taxable year;
- (2) Up to \$5,000 for married couples filing separate returns, but not more than the amount contributed during the taxable year; provided that each spouse may claim a deduction of up to \$5,000; and
- (3) Up to \$10,000 for married couples filing joint returns, individuals filing as the head of the household, or individuals filing as surviving spouses, but not more than the amount contributed during the taxable year;

provided that the aggregate deduction amount per taxpayer shall not exceed \$75,000 per college savings account. If the amount of the deduction exceeds the taxpayer's taxable income for the taxable year in which the contribution is made, the excess deduction may be used as a deduction against the taxpayer's taxable income in subsequent tax years until the excess deduction is exhausted. Any amount



withdrawn from a college savings account and not used for a qualified tuition program shall be added to the taxpayer's taxable income for that year; provided that this requirement shall not apply to withdrawals made as a result of the beneficiary's death or disability, or of receiving a scholarship, except that withdrawals made during the year do not exceed the total amount of scholarship funds received in that year."

SECTION 3. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 4. This Act shall take effect upon its approval and apply to taxable years beginning after December 31, 2007; provided that amendments made to section 235-7, Hawaii Revised Statutes, by this Act shall not be repealed when that section is reenacted on January 1, 2013, pursuant to section 3 of Act 166, Session Laws of Hawaii 2007.