

March 11, 2008

## Testimony in Support of SB 2660

**To:** Chairman Jerry Chang  
Higher Education Committee  
The House of Representatives

**From:** Donn Ariyoshi

**Re:** Senate Bill 2660 - 529 College Savings Plan in Hawai`i

**Aloha! 529 College Savings Plans are excellent programs for Hawai`i families for many reasons. These programs allow families to save and invest for their college costs, which continue to rise 2x the rate of inflation.**

- **The 529 College Savings Plans allow for the owner (parents, grandparents and great grandparents) to contribute (within the allowable limits) into an account naming a child as the beneficiary (for future higher education costs).**
- **The 529 College Savings Plans allow assets to grow in a tax deferred account. Since the federal tax law allows the owners to contribute a 5 year accelerated gift, time becomes an advantage allowing for college savings to grow faster than otherwise.**
- **Distributions to fund student's expenses at higher educational institutions are TAX FREE, whether the college is in or outside of Hawai`i and whether it is public or private. The plan owner pays neither income tax nor capital gains taxes when applied toward certain college costs.**
- **These plans are flexible and can be used by generations to follow. Once the original beneficiary completes his or her college program and if there are still assets left in their plan account, then the owner may designate a new owner (one of his/her children) so they can name a grandchild (the original owner's great grandchild) as the next beneficiary who may then benefit from the plan.**

**The federal tax code provides that a state may set up such a plan and nearly every state, including Hawai`i, has done so. These plans have no residency requirement so anyone can use the HI 529 Plan and any Hawai`i family can use any plan they choose and they often do.**

**The INTENT of the Legislature to offer a tax deduction to owners contributing to 529 College Savings Plan is WONDERFUL! Hawai`i families will truly benefit from such a break. We also feel this will create awareness of college expenses (a later expense that could be addressed early) and will encourage Hawai`i to plan ahead lessening a financial burden to many.**

After several Senate committees have received testimony on SB2660, we are concerned by the proposal by some for the tax deduction to not be available to contributions of all 529 College Savings Plans. We strongly feel that this restriction, making only certain contributions to the HI 529 College Savings Plan tax deductible, may be too restrictive. There are many plans available to Hawai`i residents and not allowing for contributions to all such plans to be deductible, restricts Hawai`i families of the full benefit of the 529 program. This could reduce the benefit of the 529 program and smear the good intent of the Legislature.

We would like to clarify matters and address specific points raised by opponents of SB2660 as is, with its intent to allow families of Hawai`i to save and invest in the plan of their choice.

First, testimony was submitted that this bill encourages the people to invest in 529 college savings plans *other than the HI plan. That is not true.* Rather, this bill gives Hawaii families the choice and allows them to enjoy the same HI State tax benefits whether they choose the HI 529 Plan, or not. It encourages families to save, regardless of which plan they choose and encourages even those who may not be attracted to use the HI Plan.

Second, all investors are different. Since investors have different time horizons, since investors have different objectives, since investors have different risk tolerances, and since investors are experiencing a volatile market, then investors need ADVICE. If an investor has a non-advised plan, how do they construct their asset allocation and decide on fund selection?

Third, testimony was submitted that the growth of the HI Plan, supported by a deduction to the HI plan only, gives participants the opportunity to enjoy lower fees. *This is not true.* If a Hawaii family saving for college wants only lower fees, they can use the Utah plan which uses the same investment firm as the HI Plan for 1/3 of what the HI Plan charges or even the NY plan which has the same program and investment managers and pay only 2/3 of the management fees that the HI Plan charges. Further, there is no obligation by the HI plan or its manager to lower management fees if the HI plan grows.

Fourth, testimony was submitted by the State Budget Department that there would be no accountability if SB2660 passes as is indicating that only the HI Plan manager is obligated to furnish such Department with geographic and socioeconomic data. *This is not true.* The HI Plan application does not request any geographic and socioeconomic data and the HI Plan manager is not obligated to request such information of its participants.

Fifth, testimony was submitted by the State Budget Department that keeping the deduction "in-state" would "provide for a more controlled tax impact". *This is not true.* It is difficult to predict what the fiscal impact is to be regardless of whether the deduction is limited or opened up. The Budget Department indicates that the stated fiscal impact is based on only existing HI Plan participants, which they are attempting to significantly increase. Whether the contributions are to the HI Plan or another college savings plan, the resulting fiscal impact resulting from the deduction will be the same. Further, their recommendation is to increase the proposed deduction for contributions to the HI Plan only of \$10,000 and \$20,000 for joint filers annually two-fold resulting in a much greater fiscal impact than SB2660, as is.

**Sixth, testimony was submitted by that “the State does not have control over how other plans are marketed within Hawaii.” *This is not true.* 529 college savings plans are “municipal fund securities” whose sales are regulated by the HI Department of Commerce & Consumer Affairs, in addition to Municipal Securities Rulemaking Board, the Financial Industry Regulatory Authority as well as the Securities Exchange Commission.**

**We would like to see passed a bill that maintains the intent of the Legislature and maintains the full benefit of 529 College Savings Plans for our families in Hawai`i and we believe that SB2660 SD3 achieves this.**

**Question – Do we want to give a tax deduction to only those families who choose the HI Plan that offers no professional advise and offers no choice of mutual fund families, as being proposed by the State Administration OR do we want to give a tax deduction to all families who save for college in the best way they choose, with or without professional advice, as proposed in SB 2660?**

**If you have further questions, please call me at 525-6909 or email me at [donn.ariyoshi@morganstanley.com](mailto:donn.ariyoshi@morganstanley.com).**

**Mahalo Nui Loa,**

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

The following proposed amendment consists of two changes to SB2660 now before the House HED Committee.

First, there is inserted a reference to "taxpayer" in the limitation of the deduction of \$75,000 per college savings account. This insert does not change the intent of this provision inserted by the Senate EDU Committee, to place a cap on deductions taken, but allows the taxpayer to actually adhere to this provision. Since there could be several taxpayer contributors to a single college savings account, under the current language, they could unknowingly violate this provision by collectively deducting more than \$75,000 as they would likely not know what other contributors to the same account had made or deducted. With this insert, they have the information necessary to comply - i.e., their own records and information so they may be able to track such contributions and deductions.

Second, there is inserted a provision that obligates the taxpayer who deducted their contribution to add back to their taxable income the deduction they took if the funds are withdrawn and not applied to qualified higher educational expenses or in the case of the death or disability of the beneficiary or should the beneficiary receive a scholarship award and the funds are therefore not required for such expenses. These exceptions are consistent with federal Internal Revenue Code to avoid penalties for withdrawals from a 529 college savings account.

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 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 such deduction taken under this paragraph (h) shall be subject to recapture in the taxable year or years in which any distribution or any other withdrawal is made from a savings account in connection with a qualified tuition program for any reason other than:

(A) To pay qualified higher education expenses;

(B) As a result of the beneficiary's death or disability;  
or

(C) As a result of receiving a scholarship and as long as the aggregate amount of distributions or withdrawals made pursuant to this sub-subparagraph (C) do not exceed the amount of the scholarship provided during such tax 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, 2050; 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.