



STATE OF KANSAS

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Richard A. Hurst, Esq.  
Mary Berman, Esq.  
Monice Rosenbaum, Esq.  
Internal Revenue Service  
Attn: CCPA:LPD:PR (REG 127127-05)  
Room 5203  
POB 7604 Ben Franklin Station  
Washington, DC 20044

Re: REG-127127-05 Advance Notice of Proposed Rulemaking Guidance on Qualified Tuition Programs under Section 529

Dear Mr. Hurst, Ms. Berman and Ms. Rosenbaum:

As the Kansas State Treasurer, I have the privilege of administering our state's Qualified Tuition Program under Section 529. This office appreciates the opportunity to comment on the Treasury Department's Advance Notice of Proposed Rulemaking (the "ANPR") for Qualified Tuition Programs under Section 529. My office administers Learning Quest, Learning Quest Advisor and The Schwab 529 QTP's offered in the State of Kansas and nationally. Our plans provide families with the opportunity to save for higher education on a tax-advantaged basis. Our plans have more than 114,000 accounts, with assets valued at \$1.975 billion as of February 29, 2008.

As a state-issuer of municipal fund securities issued under Section 529, we are a member of the College Savings Plans Network ("CSPN"), an affiliate of the National Association of State Treasurers ("NAST"). I also currently serve as the President of the NAST. As an active member of CSPN, my office supports the comment letter submitted to you on March 6, 2008 by W. Daniel Ebersole, Chairman of CSPN and Treasurer of the State of Georgia (the "CSPN Comment Letter"). We fully endorse the CSPN Comment Letter and hope that you will consider carefully the many points it addresses.

We are opposed to any abusive uses of Section 529 plans, and we hope to work with you through CSPN to assure that future regulations appropriately prevent potential abuses. We also hope you will consider carefully any administrative burdens that might be imposed on qualified tuition programs by future regulations designed to prevent perceived abuses that may not exist at all. Our average account size of just over \$17,000 suggests that the participants are using our program for its designed purpose – to save for the future costs of higher education thereby reducing debt they would otherwise incur to provide the opportunity and advantages of higher education to their children.

In my opinion, one of the challenges faced by this industry is explaining the tax rules for these accounts to consumers in simple language that they can understand while also complying with regulatory requirements. I am concerned that further complicating the tax code will require disclosure statements even more extensive than those currently required. At some point, consumers may grow weary of wading through all the disclosures and choose not to take advantage of the income tax benefits provided by these products because they can't understand the product.

Kansas is one of a few states that offer a matching grant program for low income account owners who save for their children's future. Kansas has chosen to fund this program with general tax revenues rather than through additional fees charged to account owners. Although matching grant programs are not specifically addressed in the Advanced Notice, I would like to take this opportunity to discuss the tax consequences for this type of program as they are related to the topics raised by the Advanced Notice. When we started our matching grant program in 2006, we had discussions with staff at Treasury who provided informal guidance, but we were told that Treasury would not issue private letter rulings for Qualified Tuition Plans to address these issues. It is my hope that these issues could be addressed by the agency through regulations now while it is considering other regulations affecting these plans.

#### Description of Various Existing Matching Grant and Gift Programs

Several governmental entities, often the instrumentality of the State that administers the state Section 529 program have instituted programs of matching incentives to encourage their citizens to make contributions to a Section 529 savings plan. These matching incentives are developed to encourage residents, particularly low income residents, to aspire to a college education and to gain knowledge of the benefits of saving and investing. States that offer some kind of grant include: Alaska, Florida, Illinois, Kansas, Maine, Louisiana, Michigan, Minnesota, and Oklahoma. Additionally, some entities deemed tax exempt under section 501(c)(3) have also determined to encourage college savings by making contributions to Section 529 accounts on behalf of individuals to encourage saving for college. The most prominent of these endeavors is the gift of the Harold Alfond Foundation to the children of the State of Maine, which envisions providing \$500 to every child born in Maine who opens a Section 529 account starting in 2009. While this effort may be the most well known, the Center for Social Development is making contributions to Section 529 accounts to children in Oklahoma as part of an academic study, funded by a group of foundations.

The dilemma when setting up these programs is whether the state or 501(c)(3) entity's matching contributions should be treated as an "earnings bonus" under Section 529 or as a scholarship under Section 117. Section 529 appears to provide more flexibility because qualified withdrawals can be used for a broader range of college expenses than those offered by Section 117. Section 529 also gives the account owner the authority to select the investment option and change the beneficiary. Neither of these options appears to be allowed under Section 117.

States or 501(c)(3) entities relying on the 529 model have developed programs based on the following principles<sup>1</sup>:

1. A Section 529 Account must be opened listing the child as the designated beneficiary, so that the parent or other adult has an opportunity to receive statements and to see the growth of the funds in the account. Programs vary as to whether the listed account owner is the family member or the state or 501(c)(3) entity.
2. The child's family is required or encouraged to make contributions to the account.
3. The funds provided by the state or charity may be deposited in a separate account in the state's or charity's name for the beneficiary, or in an account in the account owner's name with restrictions that only allow the matching funds to be used for Qualified Higher Education Expenses as allowed under Section 529. If the funds are placed in the same account as the family's contributions, restrictions are imposed to ensure that the matching funds are only withdrawn for QHEE. Additional restrictions usually require forfeiture of the state's matching contribution if the account owner makes a nonqualified withdrawal of his/her contributions or closes the account. In many cases, the state or charity has the sole right to identify the investment option for the gifted funds.
4. If the matching funds are placed in an account owned by an individual, there would not be an income tax consequence for the gift at the time the state or charity makes a contribution to the account because any individual account owner cannot withdraw the state's matching contribution. At the time, there is a significant risk of forfeiture and the transfer of funds is not complete. The transfer becomes complete only when the funds are used for QHEE; therefore, the matching grant and its earnings are excluded from gross income as distributions for QHEE under section 529(c)(3).
5. When calculating the earnings ratio for all accounts under the beneficiary's Social Security Number, the matching funds are treated as earnings on the 1099Q because they were not contributed by the beneficiary or other family members. This makes withdrawals tax free when used for QHEE.

Our matching grant program, Kansas Investments Developing Scholars, follows the above model. We place the state's matching contribution in an account owned by the account owner, but require them to prove to our office that they have incurred Qualified Higher Education Expenses before the matching dollars can be withdrawn. A nonqualified withdrawal of their contributions results in a forfeiture of the state's contribution. Our philosophy was to give participants as many 529 account owner rights and responsibilities as possible in order to educate them about investing. More details about the program can be found at [www.KansasStateTreasurer.com/kids](http://www.KansasStateTreasurer.com/kids).

On the other hand, several states have set these accounts up as scholarships to the designated beneficiary under Section 117. This choice usually brings with it the following restrictions:

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<sup>1</sup> The listed principles may differ from state to state with some states adopting some principles, but not others.

1. The matching or scholarship funds are usually placed in an account owned by the state or 501(c)(3) entity. This requires the state or charity to select the investment option and designate the beneficiary.
2. Funds can only be withdrawn with the approval of the state or charity and can only be spent on items that qualify as scholarships under Section 117.

Treatment of Section 529 contribution from a Governmental Entity or a 501(c)(3)

We would like guidance in the form of a safe harbor in the final regulations for the administration of such gift or matching grant opportunities.

In particular, we would like assurance that:

1. If a governmental or 501(c)(3) entity has sufficient controls in place to assure that the funds do not vest to the account owner until used for QHEE, there are no income tax consequences to the account owner or the designated beneficiary at the time of the initial contribution by the state or 501(c)(3).
2. If the gift or grant is forfeited according to the program terms, the state or charity does not incur any penalty upon such forfeiture. Also, the state or 501(c)(3) entity would be exempt from any tax imposed on earnings. Finally, the forfeiture would not have income tax consequences for either the account owner or the beneficiary. This is equivalent to the treatment that would occur if the funds had been contributed to a currently allowed 529 scholarship account with either single or multiple designated beneficiaries.
3. The proposed limitations on entities as account owners will not limit the ability of governmental or 501(c)(3) entities to open scholarship accounts because of a limitation on the ability of persons other than individuals to open a Section 529 account, nor would it limit the ability of such entities to make contributions to Section 529 accounts.

I appreciate this opportunity to share our thoughts and concerns before your agency issues proposed regulations. I look forward to working with you through NAST and CSPN to find ways to address estate and gift tax concerns without overly burdening plan administrators with cost that must be passed on to consumers or making these products even more complicated and confusing to the average consumer.

Sincerely,



Lynn Jenkins, CPA  
Kansas State Treasurer

cc: Michael Desmond