TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

EPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224 200232035

Date: MAY 16 2002

UIL 529.00-00

Contact Person:

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legend

M =
N =
P =
Q =

Dear Sir or Madam:

This is in response to M's request for a ruling that the tuition program it administers as a savings program, is a qualified tuition program and is exempt from federal income tax under section 529 of the Internal Revenue Code (the "Code").

M is a body corporate and politic and a public instrumentality of state N. M is responsible for the administration of numerous state programs such as: mortgage insurance program; revenue obligation securities program; municipal securities approval program; N small business loan insurance program; N veteran's small business loan insurance program; natural resources financing and marketing program; economic recovery loan program; and a number of student financial assistance programs funded from state appropriated funds, as well as for operation as the guaranty agency in the state for purposes of the federal Stafford student loan programs.

M's Board of Directors consists of fifteen members established under the state N authorizing legislation (the "authorizing legislation"). These members include the N state Treasurer (the "Treasurer"), the Commissioner of Economic and Community Development, one natural resources commissioner designated by the N state Governor (the "Governor") and 12 members appointed by the Governor subject to confirmation by the Legislature.

Under the authorizing legislation, M, among its other activities, administers the State tuition program (the "Program"), and, further, administers the funds and investments (the "Program Fund") associated with the Program. The Program Fund is held by the Treasurer. The

Treasurer invests Program assets under the direction and with the advice of an advisory committee, P.

The chief executive officer of M is the chief administrative officer of M. He/she is appointed by the Governor and subject to confirmation by the Legislature. The chief executive officer supervises the administrative affairs and technical activities of M in accordance with the rules and policies established for M.

The Program is established under the authorizing legislation to encourage the investment of funds to be used for education expenses at institutions of higher education. The authorizing legislation mandates that the Program and the Program Fund, established as a nonlapsing fund held by the Treasurer on behalf of participants and designated beneficiaries, are directed and administered by M. Pursuant to the authorizing legislation, M has established rules (the "Program Rules") for the implementation of the Program. The Program documentation as a whole establishes the obligations of the parties that includes: the identification (including taxpayer identification number) of the participant and designated beneficiary; investment of deposits to provide sufficient, but not excess, funds for qualified higher education expenses; obligations of M, the participant, and designated beneficiary; a statement of fees and penalties which may be assessed; and, reporting requirements.

P, a seven member advisory committee, is made up of the Treasurer and of individuals appointed by the Governor. The authorizing legislation authorizes the Treasurer to invest and reinvest the Program Fund for the benefit of the Program under the direction of and with the advice of P. The authorizing legislation authorizes M, with the advice of P, to direct the Treasurer to invest the money in the Program in appropriate investments, and to provide investment options to participants. The authorizing legislation requires that the Program Fund be invested in a reasonable manner to achieve the Program's objectives. In accordance with the authorizing legislation, the Program Fund is segregated from all other funds held by the Treasurer. In accordance with the authorizing legislation, M and the Treasurer entered into "An Amended and Restated Program Management Agreement" (current management agreement) with Q, a public brokerage firm, to provide certain management, administrative, and investment advisory services to the Program.

The management agreement provides that Q, on behalf of M, will prepare and deliver to each participant monthly or quarterly statements showing: (i) contributions made during the preceding period; (ii) total contributions made during the calendar year and the immediately preceding period; (iii) the value of the account at the end of the period; (iv) withdrawals made during the period; and (v) such other information as required by law. The management agreement further provides that Q shall prepare and file participant and designated beneficiary Form 1099 and other tax reporting information relating to accounts and account transactions as may be required by section 529 of the Code or regulations thereunder, if any, or any state tax code.

M has recently amended the Program to authorize the appointment of additional investment advisors. Such amendment also establishes a form of sub-advisory agreement to be entered into among each sub-advisor, M and Q. To date, M has entered into sub-advisory

agreements with three different investment advisors besides Q. The provisions of each applicable sub-advisory agreement and those of the current management agreement establish substantially the same degree of M control over the investment advisory services which such sub-advisors perform with respect to the Program as exists with respect to Q's performance of such services.

Under the Management Agreement, Q, with respect to accounts offered by it including accounts invested in portfolios to which sub-advisory agreements apply, is responsible for filing Form 1099 and other tax reporting information with the Internal Revenue Service and for providing account statements to participants, to M, the Treasurer, and other parties entitled to such information. The sub-advisory agreement does not relieve Q of this responsibility under the current management agreement.

The Program Rules allow persons entering into a participation agreement to make contributions to the educational savings account which is established thereunder for the purpose of meeting qualified higher education expenses of a designated beneficiary. A participant or designated beneficiary may not direct the investment of any amounts credited to an account as stated in the Program Rules. In accordance with a participation election, the investment of amounts contributed to each account will be determined at the time of initial investment. A participant may make a new investment in any portfolio regardless of the various portfolios invested in previously. The Participant also may change investment selection with respect to existing balances once per calendar year without changing the designated beneficiary, and at the time the designated beneficiary of an account, or affected portion thereof, is changed to a new designated beneficiary, provided when there is a change in the designated beneficiary, the new designated beneficiary must be a member of the family of the old beneficiary within the meaning of section 529(e)(2) of the Code.

Currently, the Program consists of various investment options called "portfolios" which are described in the Program description, which is incorporated by reference into the participation agreement, and are designed to meet different needs of designated beneficiaries. Fixed allocation portfolios offer account owners a choice of fixed allocations among debt, equity and cash equivalent investments in mutual funds or other investments selected by the Program. Active allocation portfolios offer automatic periodic reallocations among such debt, equity and cash equivalent investments based on the age of or anticipated date of intended use by the designated beneficiary. As provided in such agreement, a participant's initial investment selections with respect to a designated beneficiary may be limited to a single portfolio or may include two or more such portfolios. Upon receipt of each contribution, the account will be credited with a specified number of portfolio units which represent full and fractional interests in the Program assets corresponding to the portfolio to which the account has been assigned. The participant's investment in different portfolios for any one beneficiary will be treated for tax reporting purposes as a single account.

M's Program Rules provide that contributions to the Program can only be made in cash in accordance with section 529(b)(2) of the Code. The participation agreement provides that payments to accounts may be made as a lump sum, installment payment or payroll deduction, and may be made by check or electronic funds transfer.

M defines the term "Institution of Higher Education", in its Program Rules, to mean an institution which is described in section 481 of the Higher Education Act, and which is eligible to participate in a program under Title IV of such Act. Such institutions generally are accredited post-secondary educational institutions offering credit toward the attainment of associate, baccalaureate, graduate level or professional degrees or another recognized post-secondary credential.

The Program Rules as identified in the preceding paragraph define the term "Qualified Higher Education Expenses" as:

1. The costs of tuition, fees, books, supplies and equipment required for the enrollment or attendance of a beneficiary at an institution of higher education; and

2. The reasonable costs of room and board of a beneficiary incurred while attending an eligible institution of higher education and enrolled at least half time, provided that the costs of room and board shall not exceed the maximum room and board allowance set forth in federal requirements.

The authorizing legislation provides that no person may pledge any interest in an account as security for a loan or other debt.

The program rules will provide that total contributions to an account may not exceed the aggregate amount to be projected to be necessary to pay qualified higher education expenses of the beneficiary to attend: (i) five years of undergraduate enrollment based on the average highest cost private colleges in New England, as published by the College Board, or if the College Board does not publish such data, by any other similar organization selected by the chief executive officer of M; (provided, that in no event shall such amount exceed five times the actual amount then necessary to pay qualified higher education expenses of the beneficiary if enrolled as an undergraduate student in the most expensive program at a high cost private university in New England selected by the chief executive officer of M); and (ii) two times the actual amount then necessary to pay qualified higher education expenses of the beneficiary if enrolled as a graduate student in the most expensive program at a high cost private university in New England selected by the chief executive officer of M. M may announce a lower maximum contribution amount. A contribution to an account will be prohibited if the contribution would cause the total of all Program account balances maintained on behalf of a designated beneficiary to exceed the total amount necessary to pay qualified higher education expenses, limited as described in the first sentence of this paragraph.

Pursuant to the authorizing legislation, assets of the Program Fund, all Program earnings and income from operations are exempt from all taxation by the State or any of its political subdivisions. The authorizing legislation further provides that account deposits, transfers to successor participants, designations of successor designated beneficiaries, credits of earnings to an account and distributions from an account which are used for the purpose of paying qualified higher education expenses of a designated beneficiary do not subject the participant, the estate of the participant or the designated beneficiary to State income tax or estate tax

liability. However, the program rules provide that M may collect any penalties which remain unpaid as a set-off against the State income tax refund.

Section 529(a) of the Code provides for the exemption from federal income tax of qualified tuition programs.

Section 529(b)(1) of the Code provides that the term 'qualified tuition program' means a program established and maintained by a State or agency or instrumentality thereof or by 1 or more eligible educational institutions-

(A) under which a person-

(i) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary, or

(ii) in the case of a program established and maintained by a State or agency or instrumentality thereof, may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account, and

(B) which meets the other requirements of this subsection . . . (following paragraph omitted).

Section 529(b)(2) of the Code provides that a program shall not be treated as a qualified tuition program unless it provides that purchases or contributions may only be made in cash.

Section 529(b)(3) of the Code provides that a program shall not be treated as a qualified tuition program unless it provides separate accounting for each designated beneficiary.

Section 529(b)(4) of the Code provides that a program shall not be treated as a qualified tuition program unless it provides that any contributor to, or designated beneficiary under, such program may not directly or indirectly direct the investment of any contributions to the program (or any earnings thereon).

Section 529(b)(5) of the Code provides that a program shall not be treated as a qualified tuition program if it allows any interest in the program or any portion thereof to be used as security for a loan.

Section 529(b)(6) of the Code provides that a program shall not be treated as a qualified tuition program unless it provides adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary.

Notice 2001-55, I.R.B. 2001-39 I.R.B. 299 provides that a program does not violate section 529(b)(4) of the Code if it permits a change in the investment strategy selected for a designated beneficiary's account once per calendar year, and upon a change in the designated

beneficiary of the account. The Notice provides that, to qualify under this special rule, a program must allow participants to select only from among broad-based investment strategies designed exclusively by the program. In addition, the program must establish procedures and maintain records to prevent a change in investment options from occurring more frequently than once per calendar year or upon a change in the designated beneficiary of the account. The Notice provides that section 529 programs and their participants may rely on the Notice pending the issuance of final regulations under section 529.

M's Program was established pursuant to legislation enacted by N's state legislature. The authorizing legislation mandates the Program and the Program Fund, in the form of a nonlapsing fund to be directed and administered by M and held by the Treasurer on behalf of participants and designated beneficiaries.

Pursuant to the authorizing legislation, M has established Program Rules and implemented the participation agreement to govern the operation of the Program Fund. P, a seven-member investment advisory committee, was created to provide advice to M on the operation of the Program and the investment of the Program Fund. Pursuant to authorizing legislation, M and the Treasurer entered into a program management agreement with Q, a public brokerage firm, to provide certain management, administrative, and investment advisory services to the Program.

M's Board of Directors consists of fifteen members established under the authorizing legislation including the Treasurer, other state officials appointed by the Governor, and 12 individuals appointed by the Governor and confirmed by the legislature.

M provides for the operation of a savings program as described in section 529(b)(1)(A)(ii) of the Code for the purpose of meeting the qualified higher education expenses, as defined in section 529(e)(3) of the Code, of designated beneficiaries, within the meaning of section 529(e)(1) of the Code. M's Program was established pursuant to legislation enacted by N's state legislature. M's Board of Directors consists of officers or officials of the state or persons appointed by the Governor of the state. The income on the contributions to an account are exempt from N's state income tax to the extent used to pay qualified higher education expenses of the designated beneficiary, thereby giving the state a financial stake in the program. As noted above, the N state Treasurer serves as a Director of M. N has demonstrated that it sets the terms and conditions of the Program and is actively involved on an ongoing basis in the administration of the Program.

M's Program Rules provide that contributions to the Program can only be made in cash in accordance with section 529(b)(2) of the Code. The participation agreement provides that payments to accounts may be made as a lump sum, installment payments, or payroll deductions and may be made by check or electronic funds transfer.

M will maintain a separate account for each designated beneficiary and will provide reports to the participants at least annually showing account activity for the relevant period pursuant to section 529(b)(3) of the Code. The reports will include the value of each account and the activity in the account, including distributions made from the account.

Pursuant to section 529(b)(4) of the Code, M's Program Rules ensure that participants and designated beneficiaries will not have the power, directly or indirectly, to direct the investment of earnings or contributions to the Program. M's investment advisor and sub-advisors will have the responsibility for making investment decisions and developing investment strategies for funds held by the Program subject to M's approval. Investment in the Program is limited to the investment options offered by the Program and further limited by restrictions placed on changes of investment strategy imposed by the Program Rules and participation agreement.

M permits a participant to change the investment strategy selected for a designated beneficiary's account once per calendar year, and upon a change in the designated beneficiary of an account if the new beneficiary is a family member. The ability to select, prior to making a contribution, from among various investment options offered by the Program, to change the investment strategy selected for a designated beneficiary's account once per calendar year, or to change investment options offered by the Program when there is a change in the designated beneficiary, as described herein, does not constitute the power to directly or indirectly direct investments as described in section 529(b)(4) of the Code.

Consistent with section 529(b)(5) of the Code, M's authorizing legislation does not permit the program participants or designated beneficiaries to use the account as security for a loan.

M's Program Rules limit contributions so that the total investment in all accounts for a designated beneficiary do not exceed the amount projected to be necessary to pay qualified higher education expenses of the beneficiary to attend five years of undergraduate enrollment based on the average highest cost private colleges in New England and two years of graduate enrollment at a high cost private university in New England, as described herein. M will maintain records to ensure that the amounts contributed on behalf of each designated beneficiary are not in excess of the funds required to meet the qualified higher education expenses of the beneficiary pursuant to section 529(b)(6) of the Code.

Based on the above, we rule that M meets the requirements for exemption from federal income tax as a qualified tuition program described in section 529 of the Code.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

There are no final regulations for section 529 of the Code. Please be advised that the validity of this ruling may be affected by the issuance of final regulations as well as any transitional rules contained therein.

Pursuant to a power of attorney on file with this office, we are sending a copy of this ruling letter to your attorney.

Sincerely,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3