NOTICES OF EXEMPT RULEMAKING

The Administrative Procedure Act requires the *Register* publication of the rules adopted by the state's agencies under an exemption from all or part of the Administrative Procedure Act. Some of these rules are exempted by A.R.S. §§ 41-1005 or 41-1057; other rules are exempted by other statutes; rules of the Corporation Commission are exempt from Attorney General review pursuant to a court decision as determined by the Corporation Commission.

NOTICE OF EXEMPT RULEMAKING

TITLE 7. EDUCATION

CHAPTER 3. COMMISSION FOR POSTSECONDARY EDUCATION

PREAMBLE

1. Sections Affected — **Rulemaking Action**

Sections Affected	Rulemaking Action
R7-3-501	Amend
R7-3-505	Amend
R7-3-506	Amend

2. The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):

Authorizing statute: A.R.S. § 15-1852(C)

Implementing statute: A.R.S. § 15-1873 et seq.

3. The effective date of the rules:

February 10, 2000

4. A list of all previous notices appearing in the Register addressing the proposed rule:

Notice of Rulemaking Docket Opening: 5 A.A.R. 1172, April 23, 1999

Notice of Proposed Rulemaking: 6 A.A.R. 114, January 7, 2000

5. The name and address of agency personnel with whom persons may communicate regarding the rulemaking:

Name: Verna Allen, Executive Director

Address: 2020 N. Central Avenue, Suite 275
Phoenix, Arizona 85004

Telephone Number: (602) 229-2595

Fax Number: (602) 229-2599

6. An explanation of the rule, including the agency's reason's for initiating the rule:

R7-3-501, R7-3-505, and R7-3-506 will amend the procedures for implementing the Arizona Family College Savings Program through financial institutions as a public-private partnership. The amendments will provide further detail regarding qualified withdrawals and non-qualified withdrawals. In addition, certain definitions have been added and certain existing definitions clarified. These rules will establish a uniform and consistent manner in implementing the Arizona Family College Savings Program. Most of these changes are done at the request of the U.S. Department of Treasury.

7. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

Not applicable

8. The summary of the economic, small business, and consumer impact:

a. An identification of the proposed rulemaking: Arizona Family College Savings Plan, R7-3-501, R7-3-505, and R7-3-506, adopted pursuant to A.R.S. § 15-1873 et seq.

b. An identification of the persons who will be directly affected by, bear the costs of, or directly benefit from the proposed rulemaking: Persons directly affected are account holders, beneficiaries, and financial institutions.

c. An analysis of the probable costs and benefits from the implementation and enforcement of the proposed rulemaking on the Commission, and on any political subdivision or business directly affected by the proposed rulemaking: The Commission will bear administrative costs in keeping track of the information received from the financial institutions and enforcing the penalties for non-qualified withdrawals. The financial institution's will bear the burden of ensuring that substantiation is provided for withdrawals.

d. The probable impact of the proposed rulemaking on employment in business, agencies, and political subdivisions of this state affected by the proposed rulemaking: None.

e. A statement of the probable impact of the proposed rulemaking on small business: Some financial institutions are small businesses and will need to bear administrative costs in implementing and maintaining the Program.

f. A statement of the probable effect on state revenues: Additional funding for the Commission will be needed to implement the program.

g. A description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed rulemaking: Due to the nature of the various statutory requirements, less intrusive or less costly alternatives were not available.

9. A description of the changes between the proposed rules, including supplemental notices, and final rules (if applicable):

Not applicable

10. A summary of the principal comments and the agency response to them:

On February 7, 2000, the Commission held a public hearing to consider comments regarding the proposed rules for the Arizona Family College Savings Program. Prior to the February 7 public hearing, the Commission received substantial input from interested third parties, the two financial institutions contracted to implement the Arizona Family College Savings Program, the Oversight Committee, the Ad-Hoc Committee, the Internal Revenue Service, the Department of Treasury, and the Commission. Staff from the Commission held a public meeting with the financial institutions and Oversight Committee regarding the proposed rules on September 2, 1999. Staff from the Commission held a public meeting with the financial institutions and Ad-Hoc Committee regarding the proposed rules on September 29, 1999. Input from the financial institutions, the Oversight Committee, and the Ad-Hoc Committee were considered and used in drafting the proposed rules. The Commission also discussed the proposed rules at its regular meetings on May 5, 1999, June 1, 1999, September 8, 1999, November 3, 1999, and December 15, 1999.

11. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

Not applicable

12. Incorporation by reference and their location in the rules:

Not applicable

13. Was this rule previously adopted as an emergency rule?

Not applicable

14. The full text of the rules follows:

TITLE 7. EDUCATION

CHAPTER 3. COMMISSION FOR POSTSECONDARY EDUCATION

ARTICLE 5. ARIZONA FAMILY COLLEGE SAVINGS PROGRAM

Section
R7-3-501. Definitions
R7-3-505. Account Balance Limitations
R7-3-506. Withdrawals; Reporting of Non-qualified Withdrawals; Penalties

ARTICLE 5. ARIZONA FAMILY COLLEGE SAVINGS PROGRAM

R7-3-501. Definitions

A. "A.R.S." means Arizona Revised Statutes.

B. "Cash" means currency, bills and coin in circulation, or converting a negotiable instrument to cash by endorsing and presenting to a financial institution for deposit. An automatic transfer, cashier's check, certified check, money order, payroll deposit, traveler's check, personal check, and wire transfer will be treated as cash. Deposits will also be accepted by credit card.

C. "Code" means the Internal Revenue Code.

D. "Commission" means the Commission for Postsecondary Education as defined in A.R.S. § 15-1871.

E. "Committee" means the Family College Savings Program Oversight Committee as defined in A.R.S. § 15-1871.

F. "Direct the investment" means specifying or attempting to specify the particular financial instruments (such as certificates of deposit) or ownership interests (such as stock certificates or interests in mutual funds) either individually, or within a fund family or other group of financial instruments or ownership interests held as an investment group, into which the account holder's contributions or earnings will be invested. Direct the investment does not mean selecting an initial type of investment program if more than 1 program is offered.

G. "Higher education institution" means a higher education institution as defined in A.R.S. § 15-1871(7), provided that, solely for the purposes of determining whether a withdrawal or distribution is subject to a penalty under R7-3-506, the term shall not include any institution that is not also an "eligible educational institution" as defined in Code § 529(e)(5).

~~G~~H. "Negotiable instrument" means negotiable instrument as defined in A.R.S. § 47-3104.

R7-3-505. Account Balance Limitations

A. For each designated beneficiary, the balance in all qualified state tuition programs, as defined in § 529 of the Code, shall not exceed the lesser of:

1. The product (rounded down to the nearest multiple of $1,000) of 7 and the average 1 year's undergraduate tuition, fees, room and board at independent 4 year higher education institutions as measured and last published by the College Board's Independent College 500 Index; or
2. The cost in current dollars of qualified higher education expenses the account holder reasonably anticipates the designated beneficiary will incur.

B. Any excess balances with respect to a designated beneficiary shall be promptly withdrawn as a non-qualified withdrawal or transferred to another account in accordance with A.R.S. § 15-1875(F).

C. Each year, the Commission shall review the amount set forth in subsections (A)(1) and (2).

D. Persons making a contribution~~s~~ to an account~~s~~ shall certify, that as to the account's designated beneficiary, and to the best of the contributor's knowledge the contribution shall not cause the balances in all qualified state tuition programs, as defined in § 529 of the Code, ~~do not~~ to exceed the account balance limitations described in subsections (A)(1) and (2).

R7-3-506. Withdrawals; Reporting of Non-qualified Withdrawals; Penalties

A. An account owner may withdraw funds from an account at any time. The designated beneficiary of an account shall not have any authority to withdraw funds from an account unless the account is structured to give the designated beneficiary such right of withdrawal upon matriculation or upon incurring qualified higher education expenses.

~~**B.** Pursuant to A.R.S. §§ 15-1875 (H), (I), and (J), the Commission has authority to assess penalties for non-qualified withdrawals. In order to make a withdrawal, the account holder or the account holder's designee must complete a certification, on a form approved by the Commission, declaring that the funds will be used for the purposes set forth in A.R.S. § 15-1871. If an account holder fails to certify that a withdrawal is qualified, or if a financial institution has reason to believe that a withdrawal is non-qualified, the financial institution shall withhold from such withdrawal an amount equal to 10% of that portion of that withdrawal which constitutes income under § 72 of the Code. The amount of said withholding shall be remitted to the Commission within 7 calendar days from the date of the withholding. The financial institution shall report any such withholding, in writing, to the Commission within 3 business days, including identification of the account holder, beneficiary, date of withdrawal, amount of withdrawal, and a brief description as to why the financial institution believes the withdrawal to be non-qualified. The financial institution shall notify the account holder and beneficiary, in writing, of any such withholding.~~

B. Withdrawals

1. Qualified Withdrawals.
   In order to make a qualified withdrawal, the account holder or the account holder's designee must complete a certification, on a form approved by the Commission, declaring that the funds will be used for the purposes set forth in A.R.S. § 15-1871(11). In addition to the certification, a withdrawal shall be deemed qualified only if:
   a. The financial institution is provided with a copy of an invoice from the higher education institution, and the distribution is made directly to the higher education institution; or
   b. The financial institution is provided with a copy of an invoice from the higher education institution, and the distribution is made in the form of a check payable to both the designated beneficiary and the higher education institution; or
   c. Within 30 days following the withdrawal, substantiation that the withdrawal was actually expended for qualified higher education expenses is submitted to the financial institution.
2. Withdrawal Based on Death, Disability, or Scholarship

A penalty-free withdrawal may be made as a result of the designated beneficiary's death, disability, or scholarship, if written substantiation thereof is provided. Such written substantiation must come from a party other than the designated beneficiary or the account owner. In the case of a scholarship, the withdrawal may not exceed the amount of the scholarship.

3. Non-Qualified or Unsubstantiated Withdrawals
Pursuant to A.R.S. §§ 15-1875 (H), (I), and (J), the Commission has authority to assess penalties for non-qualified withdrawals. If an account holder fails to certify that a withdrawal is qualified or penalty-free, as defined in R7-3-506(B)(1) and (2), above, or if a financial institution has reason to believe that a withdrawal is non-qualified, the financial institution shall withhold from such withdrawal an amount equal to 10% of that portion of that withdrawal which constitutes income under § 72 of the Code. If an account holder seeks to make a withdrawal in accordance with R7-3-506(B)(1)(c) and does not provide the required substantiation at the time of the withdrawal, the withdrawal shall be limited so that the balance remaining in the account is sufficient to pay the 10% of earnings penalty. If the financial institution is not provided with the required substantiation within 30 days, the withdrawal shall be treated as a non-qualified withdrawal, the penalty shall be assessed at that time, and the financial institution shall withdraw the penalty from the account.
   a. If the withdrawal has not been declared, by the party making the withdrawal, to be non-qualified, the amount of any penalty shall be remitted to the Commission with the financial institution's 1st monthly report following the date that the withdrawal is determined to be non-qualified. If the withdrawal has been declared to be non-qualified, the amount of said withholding may be remitted to the Commission with the financial institution's required monthly report.
   b. If the withdrawal has not been declared, by the party making the withdrawal, to be non-qualified, the financial institution shall report any such withholding, in writing, to the Commission with the financial institutions's 1st monthly report following the date that the withdrawal is determined to be non-qualified. The report shall include identification of the account holder, beneficiary, date of withdrawal, amount of withdrawal, and a brief description as to why the financial institution believes the withdrawal to be non-qualified. If the withdrawal has been declared to be non-qualified, the report may be submitted to the Commission with the financial institution's required monthly report. The financial institution shall notify the account holder and beneficiary, in writing, of any withholding.
   c. If a qualified withdrawal is made from an account in any calendar year, within 60 days after the end of such year and within 60 days after the end of the following year, any designated beneficiary who received a partial or total refund from the higher education institution attended by the designated beneficiary or the higher education institution that the designated beneficiary had expected to attend shall provide to the financial institution a signed statement identifying the amount of any refunds received. In addition, the designated beneficiary shall provide an explanation as to what portion, if any, of the refund is allocable to a qualified withdrawal. If all or a portion of a refund is allocable to a qualified withdrawal, the designated beneficiary (or the account owner) may provide the financial institution with substantiation of qualified higher education expenses for which the refund was used or substantiation that the refund was made by reason of scholarship, or the death, or disability of the designated beneficiary. To the extent that a refund allocable to a qualified withdrawal was not used to pay qualified higher education expenses or made on account of death, disability, or scholarship of the designated beneficiary, it shall be considered a non-qualified withdrawal subject to the penalty described in R7-3-506(B)(3). The financial institution shall withdraw the penalty from the account from which the original qualified withdrawal was made, if sufficient funds are available in the account, or bill the designated beneficiary for the penalty, if sufficient funds are not available in the account.

4. Substantiation Procedures
Before treating any withdrawal as qualified or penalty-free based on substantiation provided, the financial institution shall review the substantiation to confirm that substantiation is provided for the amount of a withdrawal that the account owner or designated beneficiary asserts is qualified or penalty-free, that the substantiation complies with the program rules, and, in the case of a withdrawal to pay qualified higher education expenses, that the substantiated expenditures are of a nature and in amounts that can be treated as qualified higher education expenses. The financial institution may seek additional information from the account owner, the designated beneficiary, or the higher education institution before approving or rejecting substantiation, and the financial institution may seek guidance from staff of the Commission. If the financial institution determines that substantiation is inadequate, it shall promptly notify the account owner and defer making any distribution with respect to any inadequately substantiated request until proper substantiation is provided or the account owner instructs the financial institution to make the requested distribution and either withhold the penalty from the distribution or from other funds in the account.

C. The account holder may dispute any withholding made by a financial institution under subsection (B) by submitting written notice, to the Commission, within 30 days from the date of such withholding. The Commission shall make a written determination regarding the dispute within 30 days of the receipt of its notice from the account holder. If the account holder disagrees with the Commission's determination, the matter shall be adjudicated in accordance with A.R.S. § 41-1092 et. seq.