

06-016

REQUEST

Re: Private Letter Ruling request regarding the Utah state income tax deductibility of certain contributions to and disbursements from Utah Educational Savings Plan accounts.

Dear TP REPRESENTATIVE:

On behalf of the SAVINGS PLAN, I request an expedited private letter ruling concerning whether the Utah state income tax deduction is allowed for certain types of contributions to and withdrawals from SAVINGS PLAN accounts.

Background

As you know, SAVINGS PLAN is Utah's official tax-advantaged college savings plan created pursuant to Section 529 of the Internal Revenue Code of 1986, as amended ("Section 529", and a "529 plan" generally). SAVINGS PLAN was established in 1996 by the Utah State Legislature in *Utah Code Annotated* ("UCA") 53-B-8a. The Legislature also granted a Utah state income tax deduction for contributions to SAVINGS PLAN in UCA 59-10-114.

The United States Congress authorized the creation of 529 plans through the Internal Revenue Code because it recognized that favorable tax treatment was crucial to encourage citizens to save for the future college expenses of their children and grandchildren. The Utah State Legislature endorsed the creation of a Utah 529 plan, SAVINGS PLAN, and recognized that an educated populace was important if the State of Utah were to remain competitive in the global marketplace. It is no accident that both the federal and state income tax codes have played a role in the creation and expansion of 529 plans generally and the success of SAVINGS PLAN specifically.

Please note that UCA 53B-8a 114 reflects this legislative intent by providing for liberal interpretation of the law regarding SAVINGS PLAN. It is SAVINGS PLAN understanding based on the legislative history and plain meaning of the statutes that the Utah State Legislature intended to encourage our Utah residents and taxpayers to save for the costs of higher education in a tax favored manner. In addition, the Legislature's authorization of a state tax deduction for Utah taxpayers for contributions to SAVINGS PLAN represents its intent to give preferential tax treatment to such contributions. Only contributions to SAVINGS PLAN qualify for a Utah state income tax deduction. Contributions to non-SAVINGS PLAN 529 plans do not qualify for the deduction. At this time, 26 other states plus the District of Columbia offer a state tax deduction to their taxpayers for contributions into their own 529 plans. Only one state, Maine, offers a state tax deduction to its taxpayers who contribute to any state's 529 plan.

SAVINGS PLAN respectfully requests your review of the following situations that affect the state tax treatment of certain contributions to or disbursements from SAVINGS PLAN accounts. With respect to each matter, we have posted a situation, the tax question(s) presented, and a preferred response. In all cases, the questions posed relate to the tax impact on individual taxpayers (as opposed to trusts or corporations).

1. Rollovers into SAVINGS PLAN from another 529 plan

Situation 1:

SAVINGS PLAN account owner who is a Utah taxpayer previously invested in a 529 plan of another state and now wishes to roll over the money from that non-SAVINGS PLAN 529 plan into SAVINGS PLAN. No deduction was claimed when the original contribution was made to the non-SAVINGS PLAN 529 plan.

Question:

Is the rollover into SAVINGS PLAN considered a contribution eligible for the Utah state income tax deduction? If so, is the entire contribution eligible for the state income tax deduction or is only the basis portion (not the earnings portion) of the contribution eligible? Does the answer depend on when the account owner established and contributed funds to the non-SAVINGS PLAN account?

Preferred response:

Consistent with the legislative intent to encourage Utah taxpayers to save for college and make contributions through SAVINGS PLAN, the Tax Commission will allow rollovers from other 529 plans to SAVINGS PLAN to be eligible for the Utah state income tax deduction in the tax year that the rollover funds are received and recorded by SAVINGS PLAN. The amount rolled over into SAVINGS PLAN that qualifies for a state tax deduction will be subject to that calendar year's dollar limits. This decision is not dependent on when the account owner established and contributed funds to the non-SAVINGS PLAN account.

Situation 2:

A non-Utah taxpayer previously invested in a 529 plan of another state but moves to Utah during the current tax year and now wants to rollover the money from the non-SAVINGS PLAN 529 plan into SAVINGS PLAN. This new Utah resident may have previously received a state income tax deduction for his contributions on his non-Utah state income tax return. However, upon rolling over his funds from the non-SAVINGS PLAN 529 plan to SAVINGS PLAN he may be subject to recapture of any deductions previously claimed on prior non-Utah state income tax returns.

Questions:

Is the rollover into SAVINGS PLAN considered a contribution eligible for the Utah state income tax deduction? If so, is the entire contribution eligible for the state income tax deduction or is only the basis portion (not the earnings portion) of the contribution eligible? Does the answer change if the account owner previously received a state income tax deduction for the contribution to the non-SAVINGS PLAN 529 plan?

Preferred response:

Consistent with the legislative intent to encourage Utah taxpayers to save for college and make contributions through SAVINGS PLAN, the Tax Commission will allow the total amount of the rollover from non-SAVINGS PLAN 529 plan into to be eligible for the Utah state income tax deduction in the tax year the rollover funds are received by SAVINGS PLAN. The amount rolled over into SAVINGS PLAN that qualifies for a Utah state income tax deduction will be subject to that calendar year's dollar limits.

2. Rollovers Into SAVINGS PLAN from Coverdell ESAs or a Qualified U.S. Savings Bond (Interest on Series EE Bonds Issued January 1990 and Later and Interest on Series I Bonds)

Situation 3:

Under Section 529 (see also the enclosed IRS Publication 970), contributions from the proceeds of Coverdell Education Savings Accounts (a "Coverdell ESA") and certain U.S. Savings Bonds (specifically, Series EE and Series I) are permitted on a tax-free basis if the funds are deposited in a 529 plan within 12 months of liquidation of the Coverdell ESA or the U.S. Savings Bonds. Federal tax law requires that the account owner furnish a breakout between basis and earnings when depositing these moneys into a 529 plan. Of the states that allow a state tax deduction for contributions to their 529 plan, SAVINGS PLAN is not aware of any state that does not allow such contributions to be deductible for state income tax purposes.

Questions:

Are rollovers of liquidated funds from a Coverdell ESA or qualified U.S. Savings bonds eligible for the Utah state income tax deduction?

Preferred Response:

Contributions to SAVINGS PLAN that are rollovers of liquidated Coverdell ESAs or qualified U.S. Savings Bonds are eligible for the Utah state income tax deduction.

3. Rollovers Out of SAVINGS PLAN Into Another 529 Plan

Situation 4:

On occasion, SAVINGS PLAN account owners withdraw funds for purposes other than qualified higher education expenses. Federal and state tax laws are clear that in the tax year of an unqualified disbursement, the earnings portion of the disbursement must be included in taxable income (UCA 59-10-114) and, from a state tax perspective, previously claimed Utah state income tax law is silent on whether rollovers from SAVINGS PLAN to a non-SAVINGS PLAN 529 plan (which, if done on a timely basis, are allowable without federal tax penalty) should be treated as unqualified disbursements for state income tax recapture purposes.

Question:

When a Utah account owner and taxpayer roll over funds out of SAVINGS PLAN and into a non-SAVINGS PLAN 529 plan, must the Utah account owner and taxpayer recapture any Utah state income tax deductions claimed in a prior year? If so, how should the taxpayer calculate the amount subject to recapture?

Preferred response:

To be consistent with allowing a rollover into SAVINGS PLAN as eligible for the Utah state income tax deduction, any rollovers out of SAVINGS PLAN should be subject to recapture of any Utah state income tax deduction previously claimed in a prior year. The recapture amount should be equivalent to a pro-rata amount of the deduction previously claimed.

As stated earlier in this letter, 26 other states and the District of Columbia offer a state tax deduction for their own 529 savings plan. If you would like state specific information on the deduction, please let me know. We will be happy to provide the information if it enhances your review of our request.

Should you disagree with our proposed responses, we respectfully request that your rulings apply prospectively beginning as of January 2, 2007.

As you consider the questions we have posed and the preferred responses we have provided in this submission, please do not hesitate to contact me for clarification or additional information. I am also e-mailing this request so as to provide you with an electronic copy to assist you in your response to our request. Thank you for your consideration.

Sincerely,

NAME
TITLE

Cc: 2ND TP REPRESENTATIVE, DIVISION

August 3, 2006

NAME
ADDRESS

Re: Private Letter Ruling 06-016
Tax deductions for contributions to a SAVINGS PLAN account

Dear NAME,

This letter is in response to your request for tax guidance. This letter ruling is not intended as a statement of broad Tax Commission policy. It is an interpretation and application of the tax law as it relates to the facts presented in your request letter. If the facts are not correctly described in this letter ruling, please let me know so we can assure a more accurate response to your circumstances.

Analysis and Ruling

Utah law authorizes tax-advantaged contributions to college savings accounts under the SAVINGS PLAN. Utah Income Tax law allows a tax deduction for contributions to a Higher Education Savings Incentive Program. The deduction is in the amount included in the federal taxable income that was derived from money contributed to a Higher Education Savings

Incentive Program, subject to the limitations set out in Title 53B of the Utah Code. Utah tax law, in Utah Code Ann. §59-10-114 (2) (i) authorizes a deduction as follows:

the amount included in federal taxable income that was derived from money paid by an account owner to the program fund under Title 53B, Chapter 8a, Higher Education Savings Incentive Program, not to exceed amounts determined under Subsection 53B-8a-106(1)(d), and investment income earned on account agreements entered into under Section 53B-8a-106 that is included in federal taxable income, but only when the funds are used for qualified higher education costs of the beneficiary;

With regard to SAVINGS PLAN contributions and savings, you have asked for tax advice based on the following scenarios:

ROLLOVERS FROM ANOTHER STATE'S 529 PLAN

1.A Utah taxpayer contributed to a 529 plan in another state, but did not claim a tax deduction for that contribution. Now that taxpayer wants to roll over the investment to a SAVINGS PLAN account. You ask if the rollover is considered a contribution to SAVINGS PLAN for purposes of the income tax deduction.

Utah Code Ann. §59-10-114 (2) (i) can be read to allow a deduction only for contributions from taxable income earned in the same tax year that the deduction is taken. This strict reading of the statute disallows a deduction for contributions from other sources, such as personal savings accounts or proceeds from the sale of property. It is possible that the Legislature, in fact, intended to encourage SAVINGS PLAN accounts as a means to create new savings rather than transferred savings. However, due to the fungibility of money, the Tax Commission cannot monitor the source of the money contributed and, therefore, cannot enforce such a provision. Therefore, we look for another reasonable reading of the statute.

Utah does not recognize plans established in other states. Therefore, when a taxpayer contributes to a SAVINGS PLAN account, it is treated as a contribution to a SAVINGS PLAN account in the tax year in which it occurs regardless of the source of the money so long as the taxpayer has taxable income in that year. Under this reading of the law, the taxpayer may take a deduction in Utah for amounts rolled over from another account. The amount of the deduction is limited by the statutory cap and by the taxpayer's Utah taxable income. That is, for 2006, a deduction of up to \$1560 is allowed so long as the taxpayer has at least \$1560 in taxable income. Any amount in excess of the statutory cap or the taxable income is not deductible.

One other, more specific, concern we raise is that if funds are transferred under a qualified rollover, a taxpayer would be allowed to maintain the exclusion from federal income taxes for interest earned on the original contribution. Thus, in contrast with withdrawing funds

from a normal savings account, where interest would be subject to tax, the qualified rollover would have no federal or state tax consequences. At the same time, we recognize that taxpayers may withdraw funds from investments and money accounts that are also subject to various exemptions or deductions for federal and state tax purposes. Taking these points into account, the Commission believes that it would be contrary to the stated public policy for educational savings plans, to force a taxpayer to lose a federal tax benefit in order to establish state tax benefit. Consequently, we find that a taxpayer would still qualify for the deduction from state income tax as indicated in the preceding paragraph.

2. A non-resident contributed to a savings plan in another state. Upon moving to Utah in the current tax year, the account owner wants to roll that out-of-state account into a SAVINGS PLAN account, subjecting the taxpayer to recapture of any deductions previously claimed in the other state. You ask whether all or some of the rollover (principal and interest) is eligible for the Utah state tax deduction. You also ask about the impact of any tax deduction claimed in the other state.

As stated in response to number 1 above, any amount contributed to establish the SAVINGS PLAN is eligible for a deduction in Utah, subject to the statutory cap and limited by the amount of the taxpayer's Utah income for that tax year. Whether the other state allows a tax deduction or provides for recapture of the deduction is not a matter that impacts Utah's revenues or the application of Utah income tax law. As stated above, the taxpayer is allowed a deduction in Utah for the contribution made to establish the SAVINGS PLAN account without regard to tax implications in other states.

ROLLOVERS INTO SAVINGS PLAN FROM COVERDELL ESA's OR QUALIFIED US SAVINGS BONDS

Federal law recognizes a tax-free rollover of Coverdell ESA fund and US Savings Bonds. You have asked if rollovers from these accounts to a SAVINGS PLAN account qualify for deduction.

Contributions to accounts from any source qualify for the deduction.

RECAPTURE OF UTAH DEDUCTIONS AFTER ROLLOVER FROM A SAVINGS PLAN ACCOUNT TO A NON-SAVINGS PLAN ACCOUNT.

SAVINGS PLAN account holders may withdraw funds from the SAVINGS PLAN account and roll those funds over to another state's plan. You asked if this disbursement out of the SAVINGS PLAN is considered a non-qualified disbursement, subjecting it to recapture in Utah.

Utah law imposes tax on unqualified disbursements to the extent that they were deducted on a Utah return in previous tax years if the funds are not used for qualified higher education costs of the beneficiary. Qualified higher education costs are defined in Utah Code Ann. §53B-8a-102 (8) as “certified costs of tuition, fees, room and board, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an institution of higher education.” A disbursement for any other purpose subjects the disbursement to recapture to the extent of the amount that was deducted on previous Utah tax returns. (See Utah Code Ann. §§59-10-114 and 59-7-105) An investment in another account, even for an educational savings plan in another state, is not a qualified contribution, and is thus subject to recapture.

PROSPECTIVE APPLICATION

Regarding the issue of prospective application, it appears that our response is consistent with your preferred response. The statutory language sets out a system of recapture for funds rolled out of SAVINGS PLAN accounts and allows a deduction for rolling into a Utah account. An account holder who failed to comply with the recapture provisions may be subject to audit, and could be liable for any unpaid taxes attributable to funds that were rolled out of the SAVINGS PLAN. An account holder who failed to claim a deduction for rolling funds into a new Utah account may file an amended return to claim the deductions within the statutory period allowed.

For the Commission,

Marc B. Johnson
Commissioner

06-016
MBJ/IR