

Guidance is provided on allocating certain types of compensation for past services under various scenarios and the related withholding required.

March 25, 2024

NAME

Via email to EMAIL

Re: Whether certain expenses from Bright Start college savings program are required to be added back on Schedule M

Dear NAME:

This letter is in response to your email dated March 21, 2024, in which you requested information regarding Illinois income tax. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.tax.illinois.gov.

Your letter states as follows:

I am a Tax Pro with COMPANY trying to clarify Illinois tax law around this situation:

My client contributed to a Bright Start 529 Plan and deducted contributions from Illinois taxable income in prior years. He has been using most of the funds toward his oldest daughter's college education. In 2023, he took a distribution for his other daughter (not the designated beneficiary) to pay for private secondary school.

The 1099-Q has these amounts:

1. Gross Distribution \$XXXX
2. Earnings \$XXXX
3. Basis \$XXXX

5. Distribution is from Qualified Tuition program....X State
6. Box checked for the recipient is not the designated beneficiary.

Recipient is the father who invested in the 529 Plan for his oldest daughter.

MY TAX QUESTION IS:

1. Does Illinois consider use of this Bright Start 529 for the younger daughter's secondary education considered "Qualified Education Expense"? Does Illinois defer to the rules in Pub 970 pg 51?
2. If not, then I have to enter a recapture amount on Schedule M line 9. Would that amount just be the Basis since that is the "amount contributed" and claimed on prior year Illinois tax returns as a deduction?
3. Does it matter that she is the sister of the primary beneficiary?

RULING

Section 203(a)(2)(Y) of the Illinois Income Tax Act (IITA) allows a subtraction modification for amounts contributed to a college savings pool and not deducted from adjusted gross income:

For taxable years beginning on or after January 1, 2005, a maximum of \$10,000 contributed in the taxable year to (i) a College Savings Pool account under Section 16.5 of the State Treasurer Act or (ii) the Illinois Prepaid Tuition Trust Fund, except that amounts excluded from gross income under Section 529(c)(3)(C)(i) of the Internal Revenue Code shall not be considered moneys contributed under this subparagraph (Y). For purposes of this subparagraph, contributions made by an employer on behalf of an employee, or matching contributions made by an employee, shall be treated as made by the employee.

IITA section 203(a)(2)(D-22) requires that amounts deducted under section 203(a)(2)(Y) that were not used for qualified expenses be added back in the computation of Illinois taxable income:

For taxable years beginning on or after January 1, 2018: (1) in the case of a nonqualified withdrawal or refund, as defined under Section 16.5 of the State Treasurer Act, of moneys from a qualified tuition program under Section 529 of the Internal Revenue Code administered by the State, an amount equal to the contribution component of the nonqualified withdrawal or refund that was previously deducted from base income under subsection (a)(2)(Y) of this Section,

Section 16.5 of the State Treasurer Act defines qualified expenses:

"Qualified expenses" means: (i) tuition, fees, and the costs of books, supplies, and equipment required for enrollment or attendance at an eligible educational institution; (ii) expenses for special needs services, in the case of a special needs beneficiary, which are incurred in connection with such enrollment or attendance; (iii) certain expenses, to the extent they qualify as

qualified higher education expenses under Section 529 of the Internal Revenue Code, for the purchase of computer or peripheral equipment or Internet access and related services, if such equipment, software, or services are to be used primarily by the beneficiary during any of the years the beneficiary is enrolled at an eligible educational institution, except that, such expenses shall not include expenses for computer software designed for sports, games, or hobbies, unless the software is predominantly educational in nature; (iv) room and board expenses incurred while attending an eligible educational institution at least half-time; (v) expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program registered and certified with the Secretary of Labor under the National Apprenticeship Act (29 U.S.C. 50); and (vi) amounts paid as principal or interest on any qualified education loan of the designated beneficiary or a sibling of the designated beneficiary, as allowed under Section 529 of the Internal Revenue Code. A student shall be considered to be enrolled at least half-time if the student is enrolled for at least half the full-time academic workload for the course of study the student is pursuing as determined under the standards of the institution at which the student is enrolled.

Section 16.5 further defines eligible educational institution:

"Eligible educational institution" means public and private colleges, junior colleges, graduate schools, and certain vocational institutions that are described in Section 1001 of the Higher Education Resource and Student Assistance Chapter of Title 20 of the United States Code (20 U.S.C. 1001) and that are eligible to participate in Department of Education student aid programs.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Expenses for secondary education would not be considered qualified and must be added back on Schedule M to the extent they were previously deducted from Illinois taxable income.

Sincerely,

Brian Fliflet
Deputy General Counsel, Income Tax Policy

cc: Daily File
Correspondence file