

General Information Letter: Exempt interest of a minor child reported by the parent on federal Form 8814 must be added to the adjusted gross income of the parent.

January 15, 2008

Dear:

This is in response to your letter dated January 1, 2008, in which you request information regarding the Illinois tax treatment of certain interest and dividend income and Coverdell Education Savings. The nature of your request and the information provided with respect to Illinois income tax requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com.

Your letter states as follows:

I have two questions relating to taxable personal income in the state of Illinois. Both of the questions relate to additions to income found on Schedule M IL-1040.

1. Line 1 of the 2007 Schedule M deals with children's federally tax-exempt interest and dividend income. The instructions read as follows:

Write the amount of any federally tax-exempt interest and dividends earned by your child if you elected to report your child's interest and dividend income on U.S. Form 8814, Parent's Election to Report Child's Interest and Dividends.

a. Is the intention of this provision to tax any interest or dividend income earned by children that is tax exempt at the federal level or just such income if it was reported on U.S. Form 8814?

All four of my minor children have savings accounts (in a bank) that were established using their personal social security numbers when they were infants. None of the savings accounts earns enough money in the way of interest to be taxed by either the IRS or the Illinois Department of Revenue. As a result, their interest income is not reported to the IRS on separate individual returns or on my Federal 1040 return using U.S. Form 8814.

b. If the intention of this provision is to tax any interest or dividend income earned by children, does the interest income they earn that is not taxable at the Federal level need to be reported to the Illinois Department of Revenue on Line 1 of Schedule M (or somewhere else)?

2. The Line 5 of the 2007 Schedule M deals with IRC Section 529 college savings plans earnings. The instructions read as follows:

Include earnings distributed from IRC Section 529 college savings and tuition programs if these earnings are not included in your adjusted gross income of Form IL-1040, Line 1.

Do not include these earnings if they were rolled over tax-free into another program.

Also, do not include earnings received from the following, which are exempt from tax.

“Bright Start” College Savings Pool
“Bright Directions” College Savings Pool
“College Illinois” Prepaid Tuition Program

Qualified IRC Section 529 tuition programs that

- comply with the College Savings Plans Network’s disclosure principles, and
- annually inform Illinois residents and those distributing the program that in-state programs exist.

In addition to the savings accounts discussed in question 1 above, my wife and I have opened Coverdell Education Savings Accounts for each of our four children. To date, none of the earnings generated by these accounts – income dividends, long-term capital gains, or short-term capital gains – have been withdrawn from the accounts. The earnings have been reinvested in the accounts.

a. Does the Illinois Department of Revenue view any of these reinvested earnings to be taxable under Line 5 of Schedule M or anywhere else on the IL-1040?

b. When the earnings are withdrawn at some point in the future (e.g. to pay for college), will the Illinois Department of Revenue view the distributed earnings from these Coverdell Education Savings Accounts to be taxable income?

RULING

The Illinois Income Tax Act (“IITA”; 35 ILCS 5/101 *et seq.*) imposes tax on a taxpayer’s Illinois “base income.” The computation of base income starts with federal adjusted gross income, which is then modified by statutorily prescribed addition and subtraction modifications. Accordingly, unless there is an applicable addition or subtraction modification, an item of income or deduction is treated the same for Illinois purposes as it is for purposes of computing federal adjusted gross income.

Under Internal Revenue Code (IRC) Section 1(g)(7)(B)(i), the interest and dividend income of a child that a parent elects to report on the parent’s return is included in the gross income of the parent. The instruction referred to in your letter requires a parent to report on Illinois Schedule M only a child’s exempt interest income as reported on Line 1b of U.S. Form 8814. In your case, since you did not elect to report your child’s interest or dividend income on Form 8814, do not report any amount on Line 1 of the Illinois Schedule M.

With respect to Coverdell education savings accounts, the IITA does not contain a modification provision that would cause the taxation of such accounts to deviate from the federal taxation. Thus, to the extent that earnings within a Coverdell account are exempt from federal income tax, they are likewise exempt from Illinois income tax, and to the extent that distributions from a Coverdell education savings account are excluded from adjusted gross income for federal income tax purposes, they are excluded from Illinois base income.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

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Sincerely,

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