

IT 12-0004-GIL 03/13/2012 ADDITION MODIFICATIONS – OTHER RULINGS

General Information Letter: Taxpayer who claimed subtractions for contributions to Section 529 plans is required to add back distributions not used for qualifying expenses into income in the year of the distribution, rather than amending his returns for the years the contributions were made to disallow the subtractions.

March 13, 2012

Dear:

This is in response to your letter dated February 20, 2012 regarding Illinois income tax. The nature of your letter and the information provided require 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 86 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:

We are writing this letter to address an issue we came across with an Illinois resident taxpayer regarding the income recapture of deductions previously claimed for contributions to a 529 Plan.

During the tax years from 2007 to 2010, the taxpayer made contributions to IL Bright Start 529 plans which were treated as subtractions on his Illinois return, Schedule M, in the corresponding years at which time the IL tax rate was 3%. Due to unforeseen circumstances and the nature of the taxpayer's new business starting 2011, now a self-employed partner of a public accounting firm, he was forced to involuntarily liquidate his capitals from IL qualified education plans. Due the very strict independence rules that a partner in a public accounting firm has to endure, he could no longer keep his IL Bright Start plans.

Given the fact that the IL tax rate increased to 5% beginning in the 2011 tax year, the year in which he withdrew the funds, he would technically have to claim the recapture of the distributions as an addition on his 2011 Illinois return, Schedule M, and would be liable to pay a 5% tax rate on the entire amount albeit he received only a 3% tax break on each respective prior year returns. In order to mitigate paying the 2% tax difference, the taxpayer is willing to amend his 2008, 2009 and 2010 IL returns without claiming the deductions he originally claimed in prior years.

Before taking this route, we wanted to contact you to respectfully request the possibility of the abatement of any interest and penalties, resulting from amended prior year returns, from the IL Department of Revenue based on the facts and circumstances listed above? If not, are there or will there be provision in the 2011 IL tax laws which will allow the taxpayer to be taxed at a 3% rate in this circumstance, the same rate in which he received the related deductions in the prior years, as a result of his involuntary withdrawals during 2011?

RULING

Section 203(a)(2)(Y) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/203) provides a subtraction modification to adjusted gross income for moneys contributed to an Illinois Bright Start account. Section 203(a)(2)(D-22) provides:

For taxable years beginning on or after January 1, 2009, in the case of a nonqualified withdrawal or refund of moneys from a qualified tuition program under Section 529 of the Internal Revenue Code

administered by the State that is not used for qualified expenses at an eligible education institution, and 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, provided that the withdrawal or refund did not result from the beneficiary's death or disability.

Based on the information contained in your letter, there is no basis upon which to amend the taxpayer's 2008, 2009, or 2010 Illinois tax returns. During tax years 2008 to 2010, the taxpayer in fact contributed moneys to Illinois Bright Start accounts. Therefore, the subtraction modification under IITA Section 203(a)(2)(Y) applies to those contributions. Based on your letter, then, the taxpayer's returns for those taxable years are correct as filed. In 2011, the taxpayer made a nonqualified withdrawal of those contributions. Therefore, the addition modification under IITA Section 203(a)(2)(D-22) applies. The taxpayer's 2011 return must include that addition modification.

Unfortunately, the IITA does not contain a provision to remedy the fact that the tax rate was only 3% during the taxable years in which the subtraction applied, but 5% for the taxable year in which the addition applies. The opposite of this situation may occur in the future as the 5% tax rate begins to phase out in taxable year 2015, but likewise without remedy.

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. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)