

General Information Letter: Addition for recapture of subtraction claimed for contributions to College Illinois! savings plans must be included in income in the year of a disqualified distribution from the plan.

August 28, 2012

Dear:

This is in response to your letter dated February 26, 2012 in which you state the following:

My name is Mr. Z and I am submitting this letter and attached documentation as a request for a Private Letter Ruling. This request is made on behalf of Mr. Z and Mrs. Z (my wife) who together filed a 2011 Form IL-1040 with the “married filing jointly” filing status.

This request for a Private Letter Ruling concerns the recapture of deductions for contributions to college savings plans withdrawn for nonqualified expenses or refunded (Schedule M, Line 9).

The format of Schedule M results in the disbursement being classified as an addition to income and thus subject to the current year tax rate. The format of Schedule M for 2010 and earlier years was appropriate and resulted in a recapture equal to the prior tax benefit when the tax rate that gets applied to the refunded contributions (the tax rate of the current year) was equal to the applicable tax rate in the prior years when contributions were made.

However, the format of Schedule M is no longer appropriate when the tax rate of the current year is not equal to that of prior years (such as the 5% rate in 2011 versus the 3% rate in prior years). In effect, the format of the 2011 Schedule M is not appropriate because it results in the tax rate for the current year being applied to income from prior years under certain circumstances such as those detailed in the statement of facts included with this letter.

With regards to the 2011 IL-1040 filed by Mr. Z and Mrs. Z, the incorrect format of Schedule M resulted in a \$594 overstatement of recapture of deductions for contributions to college a savings plan that translates into a 2011 tax obligation that is \$594 too high.

The purpose of this request for a Private Letter Ruling is for Mr. Z and Mrs. Z to obtain the ruling and necessary direction/supporting documentation to file an amended 2011 IL-1040 that correctly reflects the recapture of deductions for contributions to college savings plans at a lever equal to the benefit obtained in prior years and avoid a \$594 overpayment of Illinois taxes.

Per the requirements listed in Title 02 (Revenue) Part 1200 (Public Information, Rulemaking and Organization) Section 1200.110 (Private Letter Rulings) of the Illinois Department of Revenue Administrative Code, the following information is included in this request for a Private Letter Ruling:

- 1) A complete statement of the facts and other information pertinent to the request. The request must contain a complete statement of all material facts. The material facts include the identification of all interested parties, a statement of the business reasons for the transaction, and a detailed description of the transaction. The request must contain an analysis of the relation of the material facts to the issues.**

My wife and I made contributions over several years to a College Illinois! account for our daughter Ms. Y as follows:

<u>Year</u>	<u>Amount</u>	<u>Tax Rate</u>	<u>Tax Benefit</u>	<u>2011 Recapture (5% Tax Rate)</u>	
2008	\$9,929	3%	\$298	(\$496)	
2009	\$9,929	3%	\$298	(\$496)	
2010	<u>\$9,929</u>	3%	<u>\$298</u>	<u>(\$496)</u>	
2008-2010	\$29,787	5%	\$894	(\$1,488)	(\$594) Difference
2011	<u>\$9,929</u> (3/11)	5%	\$496	(\$496)	
Total	\$39,716		\$1,390	(\$1,984)	

Late last year, with all of the publicity surrounding the under-funded nature of the College Illinois! program, my wife and I elected to terminate our College Illinois! agreement and obtain a refund of our contributions. The disbursement was received from College Illinois! on December 6, 2011 and I rolled over the pretax earnings into a separate 529 account on December 28, 2011 (see Document #5).

Regarding the principle contributions, I was aware that the state of Illinois would recapture the prior tax benefit (for 2008-2010 in our case – 2011 is a wash since the March contribution is offset by the December disbursement). However, the format of Schedule M results in the disbursement being considered as an addition to income and thus subject to the current year tax rate of 5%. In effect, the tax rate for the current year is being applied to income from prior years. As a result, the “recapture” for 2008-1020 is overstated since it is \$594 higher than the prior tax benefit (\$1,488 instead of \$894).

I am submitting this request for a Private Letter Ruling with regards to what I believe to be an incorrect recapture of deductions for contributions to college savings plans withdrawn for nonqualified expenses or refunded with the 2011 Schedule M form. Given the circumstances detailed above, income for the 2008-2010 periods has the 2011 tax rate (5%) incorrectly applied instead of the appropriate rate for the respective periods (3%). The 2011 recapture is \$594 higher than the tax benefit received in 2008-2010.

2) All contracts, licenses, agreements, instruments or other documents relevant to the request.

The following documents are attached to this request for a Private Letter Ruling:

Document #1 – Cover Letter included with 2011 IL-1040 for Mr. Z and Mrs. Z

Document #2 – 2011 IL-1040 for Mr. Z and Mrs. Z

Document #3 – Letter confirming cancellation of contract with College Illinois!

Document #4 – 2011 Form 1099-Q from College Illinois!

Document #5 – Upromise College Fund (529 Account) statement confirming

rollover of \$1,351.72 earnings from College Illinois! reported in Document #3 and Document #4

3) An identification of the tax period at issue, and disclosure of whether an audit or litigation is pending with the Department.

The tax period at issue is 2011. This is the period that my wife and I received a refund of contributions made in the 2008-2010 period to the College Illinois! savings program.

There is no audit or litigation pending with the Department.

4) A statement that to the best of the knowledge of both the taxpayer and the taxpayer's representative the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, or whether the taxpayer or any representatives previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued.

The Department has not previously ruled on the same or similar issue for Mr. Z or Mrs. Z. This issue has not been previously submitted to the Department (in fact, this is the first request for a Private Letter Ruling that has ever been submitted by Mr. Z and/or Mrs. Z).

5) A statement of authorities supporting the taxpayer's views, an explanation of the grounds for that conclusion and the relevant authorities to support that conclusion.

We are not aware of any authorities who support the taxpayer's views.

6) A statement of authorities contrary to the taxpayer's views. Each taxpayer is under an affirmative duty to identify any and all authorities contrary to the taxpayer's views. If the taxpayer determines that there are no authorities contrary to his or her views, or taxpayer is unable to locate such authority, the request must contain a statement to that effect.

We are not aware of any authorities who refute the taxpayer's views.

7) An identification of any specific trade secret information taxpayer requests be deleted from the publicly disseminated version of the private letter ruling.

There is not (*sic*) specific trade secret information that should be deleted from the publicly disseminated version of the Private Letter Ruling.

8) The signature of the taxpayer or the taxpayer's representative. A taxpayer's representative must also provide a properly executed power of attorney.

Please contact I with any questions. Thank you in advance for your consideration.

The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.tax.illinois.gov/LegalInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

The applicable statutory provisions are Sections 201(a), 201(b)(4), 201(b)(5), 203(a)(2)(D-22) and 203(a)(2)(Y) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.). IITA Sections 201(a), (b)(4) and (b)(5) provide the authority to tax Illinois residents and states the rate of taxation for individuals:

Sec. 201. Tax Imposed.

(a) In General.

A tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or *receiving income* in or as a resident of this State. Such tax shall be in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

(b) Rates.

The tax imposed by subsection (a) of this Section shall be determined as follows, except as adjusted by subsection (d-1):

...

(4) In the case of an individual, trust, or estate, for taxable years beginning prior to January 1, 2011, and ending after December 31, 2010, an amount equal to the sum of (i) 3% of the taxpayer's net income for the period prior to January 1, 2011, as calculated under Section 202.5, and (ii) 5% of the taxpayer's net income for the period after December 31, 2010, as calculated under Section 202.5.

(5) In the case of an individual, trust, or estate, *for taxable years beginning on or after January 1, 2011, and ending prior to January 1, 2015, an amount equal to **5% of the taxpayer's net income for the taxable year.***

Emphasis added.

Under Illinois law, an individual's base income for Illinois income tax liability is the taxpayer's federal adjusted gross income as modified by certain addition and subtraction modifications set forth in IITA Section 203. The following are the applicable statutory language for College Illinois! contributions:

203. Base income defined.

(a) Individuals.

- (1) In general. In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).
- (2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified by **adding thereto** the sum of the following amounts:

...

(D-22) 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, ***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***, provided that the withdrawal or refund did not result from the beneficiary's death or disability;

...

and by deducting from the total so obtained the sum of the following amounts:

...

(Y) 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) 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).

...

Emphasis added.

Your letter states that the "disbursement was received from College Illinois! on December 6, 2011." Documentation shows that \$40,957.47 was disbursed of which \$29,787 is at issue due to the 2008 through 2010 annual deductions in the amount of \$9,929 for contributions to College Illinois! pursuant to IITA Section 203(a)(2)(Y). IITA Section 203(a)(2)(D-22) specifically requires the \$29,787 that had been deducted in earlier years be added back to your adjusted gross income the year of distribution. The Illinois tax rate at the time of distribution, December 2011, was 5% which is the tax rate to be used in your situation.

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As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Associate Counsel -- Income Tax