

Transition Relief for Certain Section 529 Qualified Tuition Programs Required to File Form 1099-Q, Payments From Qualified Education Programs (Under Sections 529 and 530)

Notice 2016-13

SECTION 1. PURPOSE

This notice provides transition relief for section 529 qualified tuition programs that timely file a 2015 Form 1099-Q, *Payments From Qualified Education Programs (Under Sections 529 and 530)*, that does not reflect the repeal of the aggregation requirement under section 529(c)(3)(D) of the Internal Revenue Code (Code) applicable to distributions from qualified tuition programs. Section 302(b) of the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), enacted on December 18, 2015, as part of the Consolidated Appropriations Act, 2016 (Pub. L. 114-113), repealed section 529(c)(3)(D) effective for distributions made after December 31, 2014.

In response to concerns expressed by section 529 qualified tuition programs about their inability to adjust their systems to retroactively accommodate the new method of calculating the earnings portion of a distribution before the due date of the 2015 Form 1099-Q, the Internal Revenue Service (IRS) will not impose penalties under section 6693 solely because of a reported earnings computation that does not reflect the repeal of section 529(c)(3)(D). This notice is limited to 2015 Forms 1099-Q required to be filed by February 29, 2016 (or March 31, 2016, if filed electronically). This notice does not provide penalty relief for any other failure that would cause a program to be subject to penalties under section 6693 or any other penalty under any provision of the Code.

This notice also provides information regarding the other changes made to section 529 by the PATH Act.

SECTION 2. BACKGROUND AND STATUTORY CHANGES

Under section 529, a State or its agency or instrumentality may establish or maintain a program that permits a person to prepay or contribute to an account for a designated beneficiary's qualified higher education expenses. In addition, an eligible educational institution may establish or maintain a program that permits a person to prepay a designated beneficiary's qualified higher education expenses. These programs are collectively referred to as "section 529 qualified tuition programs." If a distribution is used solely for qualified higher education expenses, the distribution (including any attributable earnings) is not subject to income tax. The PATH Act made three changes with regard to section 529 qualified tuition programs.

Expansion of definition of qualified higher education expenses. Under section 529(e)(3)(A), "qualified higher education expenses" include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and, in the case of a special needs beneficiary, expenses for special needs services that are incurred in connection with such enrollment or attendance. Qualified higher education expenses also include reasonable costs for room and board for students who are enrolled at least half-time. Effective beginning in 2015, the PATH Act amended section 529(e)(3)(A)(iii) to provide that qualified higher education expenses also include expenses for the purchase of computer or peripheral equipment (as defined in section 168(i)(2)(B)), computer software (as defined in section 197(e)(3)(B)), and 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. Computer software designed for sports, games, or hobbies is qualified only when the software is predominantly educational in nature.

Computation of earnings. Under section 529(c)(3), to the extent distributions from a section 529 qualified tuition program exceed a designated beneficiary's qualified higher education expenses, the earnings portion of the excess is includible in the gross income of the distributee in the manner provided under section 72. Prior to the repeal of section 529(c)(3)(D) by the PATH Act, section 529(c)(3)(D)(i) provided that, for purposes of applying section 72, all section 529 qualified tuition programs of which an individual is a designated beneficiary are treated as one program. Proposed regulations issued under section 529 provided that all accounts maintained by a section 529 qualified tuition program for the benefit of a designated beneficiary would be treated as a single account for purposes of calculating the earnings portion of any distribution. See Prop. Reg. section 1.529-3(d). In response to comments received regarding the proposed regulations, however, Notice 2001-81, 2001-2 C.B. 617, provided an interim rule that only accounts maintained within the same section 529 qualified tuition program and having the same account owner and the same designated beneficiary are aggregated for purposes of calculating the earnings portion of any distribution. The PATH Act repealed section 529(c)(3)(D) for distributions after December 31, 2014, eliminating the aggregation requirement.

Prior to their repeal, section 529(c)(3)(D)(ii) and (iii) provided that, for purposes of applying § 72, except as otherwise provided by the Secretary, all distributions during a

taxable year are treated as one distribution and the value of the contract, earnings, and basis are computed as of the close of the calendar year in which the taxable year begins. Notice 2001-81 provided a modified rule that the earnings portion of each distribution is determined as of the date of distribution. This rule continues to apply.

Section 529(d) requires section 529 qualified tuition programs to make annual reports regarding contributions, distributions, and such other matters as the IRS may require. Notice 2001-81 instructs section 529 qualified tuition programs to use Form 1099-Q for reporting under section 529(d). These programs must report the amount of the gross distribution and the portion of the gross distribution attributable to earnings on Form 1099-Q. These programs also must furnish a Form 1099-Q to distributees on or before January 31st of the year following the calendar year in which the distribution is made (February 1, 2016, in the case of 2015 Forms 1099-Q) and file the Form 1099-Q with the IRS on or before February 28 (February 29, 2016, in the case of 2015 Forms 1099-Q), or March 31 if filed electronically, of that same year. If a section 529 qualified tuition program required to file a Form 1099-Q fails to timely file the form, such program is subject to a \$50 penalty under section 6693 for each failure unless the failure is due to reasonable cause.

Recontribution of funds. The PATH Act also added new section 529(c)(3)(D) to address situations in which section 529 qualified tuition program funds are distributed for a beneficiary's qualified higher education expenses, but some portion of those expenses subsequently are refunded to the beneficiary. This could occur, for example, if the beneficiary dropped a class mid-semester. Section 529(c)(3)(D) now provides that the portion of a distribution refunded to the beneficiary of a section 529 qualified tuition

program by an eligible educational institution is not subject to income tax to the extent that the refund is recontributed to a section 529 qualified tuition program of which the individual is a beneficiary not later than 60 days after the date of such refund. New section 529(c)(3)(D) applies to refunds received after December 31, 2014. The PATH Act included a transition rule, however, applicable to refunds received after 2014 but before the date of enactment. Specifically, those refunded distributions are exempt from income tax if they are recontributed to the beneficiary's section 529 qualified tuition program account not later than 60 days after the date of enactment of the PATH Act. Thus, amounts refunded in 2015 before December 18, 2015, must be recontributed no later than February 16, 2016.

SECTION 3. TRANSITION RELIEF

Due to concerns expressed by section 529 qualified tuition programs about their inability to adjust their systems to comply with the retroactive repeal of the aggregation requirement of section 529(c)(3)(D) and still timely satisfy their reporting requirement for the 2015 calendar year, the Treasury Department and the IRS are providing transition relief to enable these programs to timely file 2015 Forms 1099-Q and to furnish them to distributees without reflecting the repeal of section 529(c)(3)(D). Specifically, the IRS will not impose any penalty under section 6693 for Forms 1099-Q timely filed for the 2015 calendar year if, due solely to the aggregation rule change resulting from the repeal of section 529(c)(3)(D), the earnings are incorrectly reported in Box 2 or basis is incorrectly reported in Box 3 of a 2015 Form 1099-Q.

If a distributee with multiple accounts that were aggregated for purposes of calculating earnings for 2015 pursuant to this grant of transition relief for section 529

qualified tuition programs would prefer to have earnings computed for 2015 without aggregation, the distributee may request a corrected 2015 Form 1099-Q from the section 529 qualified tuition program that computes earnings for 2015 without aggregation. The program must furnish to the distributee, and file with the IRS, a corrected 2015 Form 1099-Q, if so requested, as soon as possible. See 2015 *General Instructions for Certain Information Returns (Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G)*. For this purpose, the beneficiary's funds invested in different investment options under the program do not constitute separate "accounts".

A request for a corrected 2015 Form 1099-Q does not extend the due date for filing individual income tax returns for 2015. Taxpayers generally must file their income tax returns or request an extension by April 18, 2016 (April 19, 2016, for taxpayers living in Maine or Massachusetts).

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Peter A. Holiat of the Office of the Associate Chief Counsel (TEGE). For further information regarding this notice contact Mr. Holiat at 202-317-4541 (not a toll-free call).