

Certain Maryland Prepaid College Trust Distributions Excluded from Gross Income

Notice 2024-23

SECTION I. PURPOSE

This notice provides guidance on certain distributions from or distributions transferred to the Maryland Prepaid College Trust (MPCT), a qualified tuition program within the meaning of section 529 of the Internal Revenue Code (section 529 program),¹ for taxpayers impacted by recent system issues described in the Maryland State Treasurer's Decision Memorandum dated July 10, 2023 (Memorandum).² Specifically, this notice provides that the 12-month limitation described in section 529(c)(3)(C)(iii) will not be treated as applying to certain distributions described in section III of this notice.

SECTION II. BACKGROUND

Generally, any distribution from a section 529 program is includable in the gross income of the distributee under section 529(c)(3)(A) to the extent not otherwise excluded from gross income under another provision of chapter 1 of the Code. Section 529(c)(6) imposes an additional tax on distributions includable in gross income equal to 10 percent of the amount that is so includable. Section 529(c)(3)(C)(i)(I), however,

¹ Unless otherwise specified, all "section" references are to sections of the Internal Revenue Code (Code).

² *Decision Memorandum with Respect to Maryland Prepaid College Trust*, MD. STATE TREASURER, <https://www.treasurer.state.md.us/media/178937/final%20decision%20document%2007072023.pdf>.

excludes from gross income any portion of a distribution from a section 529 program that, within 60 days of such distribution, is transferred to another section 529 program for the benefit of the designated beneficiary (qualified rollover). Section 529(c)(3)(C)(iii) allows only one tax-free qualified rollover in a 12-month period.

In recent years, MPCT has experienced accounting discrepancies, administrative issues, and inconsistencies concerning the interest rate to apply to certain distributions out of MPCT accounts, as described more fully in the Memorandum.³ To protect trust assets while system issues were resolved, the state agency administering MPCT froze access to MPCT interest earnings beginning in April 2022. System access has since been restored, and on July 10, 2023, the Maryland State Treasurer announced a final decision that provided retroactive interest earnings for affected MPCT account holders. However, due to the unique and unanticipated circumstances described in the Memorandum, many taxpayers had already executed a qualified rollover out of MPCT. After the Maryland State Treasurer announced the decision to credit retroactive interest to affected MPCT account holders, some taxpayers who had previously executed a qualified rollover from an MPCT account to another qualified state tuition program may wish to execute a second rollover back to the MPCT, to the extent permitted by Maryland law. In addition, Chapter 113 of the 2023 Laws of Maryland established a claims resolution process for account holders affected by the system issues. Settlement of a claim must “be conditioned on an agreement of the account holder to

³ Details described in this paragraph are taken from the Memorandum.

transfer all funds in the account to any other qualified state tuition program.”⁴ If any of these taxpayers execute a second rollover within 12 months of a qualified rollover out of or back into MPCT, however, the amount so transferred may be includable in the gross income of the designated beneficiary under section 529(c)(3)(A) and may be subject to additional tax under section 529(c)(6) due to the application of section 529(c)(3)(C)(iii).

SECTION III. GRANT OF RELIEF

Due to the nature of the above-described system issues, the Department of the Treasury and the Internal Revenue Service will grant the following relief as a matter of sound tax administration: If section 529(c)(3)(C)(iii) would apply to deny treatment as a qualified rollover to any portion of a distribution from or a distribution transferred to an MPCT account for a designated beneficiary before January 1, 2025, and if that distribution was preceded by a qualified rollover from an MPCT account for the benefit of the same designated beneficiary occurring after December 31, 2021, then that distribution will be treated as a qualified rollover to which section 529(c)(3)(C)(i)(I) applies notwithstanding section 529(c)(3)(C)(iii).

SECTION IV. DRAFTING INFORMATION

The principal author of this notice is Elliot DiGioia of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice contact Elliot DiGioia at (202) 317-6836 (not a toll-free call).

⁴ MD. CODE ANN., EDUC. § 18-1917(f)(l) (2023).