

**MEMO# 31310**

August 1, 2018

# **IRS Announces Guidance on 529 Plan Recontributions, Rollovers from 529 Plans to ABLE Accounts, and Elementary and Secondary School Tuition as Qualified Expense for 529 Plans**

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August 1, 2018 TO: ICI Members

529 Plan Advisory Committee

ABLE Act Working Group

Tax Committee SUBJECTS: 529 Plans

Tax

Transfer Agency RE: IRS Announces Guidance on 529 Plan Recontributions, Rollovers from 529 Plans to ABLE Accounts, and Elementary and Secondary School Tuition as Qualified Expense for 529 Plans

On July 30, 2018, the Internal Revenue Service (IRS) released Notice 2018-58, announcing that it plans to issue regulations clarifying matters relating to (1) the administration of amounts recontributed to 529 plans, (2) the new rules permitting rollovers from 529 plans to ABLE accounts, and (3) the new rules treating elementary and secondary school tuition as qualified higher education expenses.[\[1\]](#) The Notice specifies that, until IRS issues proposed regulations, taxpayers, beneficiaries, and administrators of 529 plans and ABLE programs may rely on the rules described in the Notice.

## **Treatment of amounts recontributed to 529 plans**

The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act)[\[2\]](#) amended Internal Revenue Code (Code) section 529 to add a new enhancement to 529 plans, allowing certain distributed amounts to be recontributed to 529 plans. The provision allows a beneficiary who receives a refund of tuition (for example, after being forced to withdraw from school due to an illness) to recontribute an amount that had been withdrawn from a 529 plan, up to the refunded amount. The recontribution would allow the beneficiary to avoid incurring income inclusion or penalties, provided the amount is recontributed within 60 days of the date of the refund.

The statutory language left ambiguity regarding how the recontribution should be treated.

Most significantly, it was not clear whether the amount that represented earnings when distributed must continue to be treated as earnings upon the recontribution.[\[3\]](#) ICI and the College Savings Plan Network (CSPN) each submitted a letter to IRS last year requesting guidance on the treatment of recontributed amounts.[\[4\]](#)

In the Notice, IRS announces its intention to issue regulations that will provide that the entire recontributed amount will be treated as principal, rather than requiring a portion to be treated as earnings, based on the amount that represented earnings when distributed. IRS explains that it is implementing this rule of administrative convenience to eliminate the burdens associated with determining the earnings portion. IRS also confirms that the recontributed amount will not count against the contribution limit applicable to the beneficiary, because the amount will already have been taken into account when it was originally contributed to the 529 plan. Given that a beneficiary may have more than one 529 plan account, the Notice clarifies that the recontribution does not need to be made to the same account from which it was distributed. The recontribution must, however, be made to an account for the same beneficiary who received the distribution.

### **Rollovers from 529 plan accounts to ABLE accounts**

H.R. 1, the tax bill enacted in 2017 (the “2017 Tax Reform Legislation”)[\[5\]](#) amended Code section 529 to permit amounts from 529 plans to be rolled over to ABLE accounts without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 plan account, or a member of such designated beneficiary's family.[\[6\]](#) Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.[\[7\]](#) The provision applies to 529 plans amounts distributed after December 22, 2017 and before January 1, 2026.

When it issues regulations regarding these rollovers, IRS intends to impose a requirement that the funds distributed from a 529 plan must be contributed to an ABLE account within 60 days after the distribution. As provided in the statute, the amount of the rollover, when added to all other contributions made to that ABLE account, cannot exceed the annual limitation that applies to ABLE accounts. IRS expects the regulations to prohibit an ABLE program administrator from accepting a direct transfer that would cause the annual limitation to be exceeded. If an ABLE program administrator processing a direct transfer rejects an amount because it exceeds the limitation, the rejected amount may be returned to the 529 plan without being treated as a new contribution. The regulation will also clarify that, for purposes of determining which ABLE accounts may receive a rollover from a 529 plan, IRS will apply the broader definition of family member from Code section 529(e)(2), rather than the more limited definition in Code section 529A(e)(4).[\[8\]](#)

### **Expansion of 529 plans to cover elementary and secondary education expenses**

The 2017 Tax Reform Legislation also amended Code section 529 to permit limited distributions from 529 plan accounts to cover tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious elementary or secondary school.[\[9\]](#) Distributions are limited to not more than \$10,000 on a per-student basis, rather than a per-account basis. The provision applies to distributions made after December 31, 2017.

In the Notice, IRS announces its intention to issue regulations “defining the term ‘elementary or secondary’ to mean kindergarten through grade 12 as determined under State law, consistent with the definition applicable for Coverdell education savings accounts

in [Code section] 530(b)(3)(B).” IRS explains that using the same definition for both account types will facilitate the allocation of expenses between the two accounts in the event that a beneficiary receives distributions from both a 529 plan and a Coverdell account and the total distributions exceed the beneficiary’s qualified expenses.

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#### **endnotes**

[1] IRS Notice 2018-58 is available at <https://www.irs.gov/pub/irs-drop/n-18-58.pdf>.

[2] See ICI Memorandum No. 29576, dated December 18, 2015, available here: [https://www.ici.org/my\\_ici/memorandum/memo29576](https://www.ici.org/my_ici/memorandum/memo29576).

[3] If a distributed amount is not used for qualified higher education expenses, then the portion of the distribution that constitutes earnings is taxable.

[4] See ICI Memorandum No. 30540, dated January 25, 2017, available here: [https://www.ici.org/my\\_ici/memorandum/memo30540](https://www.ici.org/my_ici/memorandum/memo30540). CSPN’s letter requested that any recontribution, in its entirety, be treated as a new contribution. ICI’s letter did not take a position regarding which interpretation IRS should adopt but raised additional questions that must be addressed if IRS required the distribution to be “unwound” and an earnings portion to be calculated.

[5] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

[6] See ICI Memorandum No. 30991, dated December 21, 2017, available here: [https://www.ici.org/my\\_ici/memorandum/memo30991](https://www.ici.org/my_ici/memorandum/memo30991).

[7] ABLE accounts are subject to the limitation of Code section 529A(b)(2)(B)(i), the annual gift tax exclusion under Code section 2503(b) (\$15,000 for 2018). In addition to this limit, a designated beneficiary who works may also contribute his or her compensation up to the poverty line amount for a one-person household, provided that no contributions are made on behalf of that individual to a 401(a) defined contribution plan, a 403(a) annuity contract, a 403(b) annuity contract, or a 457(b) eligible deferred compensation plan.

[8] Code section 529(e)(2) defines “member of the family” as (1) the spouse of such beneficiary, (2) a first cousin of the beneficiary, (3) a child or a descendant of a child, (4) a brother, sister, stepbrother, or stepsister, (5) the father or mother, or an ancestor of either, (6) a stepfather or stepmother, (7) a son or daughter of a brother or sister of the beneficiary, (8) a brother or sister of the father or mother of the beneficiary, (9) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law, and (10) the spouse of anyone described in (3) through (9). Code section 529A(e)(4) limits “member of the family” to a brother, sister, stepbrother or stepsister.

[9] See ICI Memorandum No. 30991, dated December 21, 2017, available here: [https://www.ici.org/my\\_ici/memorandum/memo30991](https://www.ici.org/my_ici/memorandum/memo30991).

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