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S.F. No. 1708 – Repeal of 529 plan contribution addback (as proposed to be amended by the A-1 amendment)

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Section 529 college savings plans allow taxpayers to contribute to qualified tuition programs for designated beneficiaries. Earnings on and distributions from a 529 plan account are excluded from gross income. Distributions from the account must only be used for qualified higher education expenses, which traditionally have included tuition, fees, books, supplies, and equipment, including computer equipment, required for the enrollment or attendance of a designated beneficiary at an eligible educational institution,

The 2017 Tax Cuts and Jobs Act (TCJA) modified the definition of “qualified higher education expenses” to include up to \$10,000 for K-12 tuition expenses. Minnesota did not adopt this change for purposes of its tax code and applies the pre-TCJA definition of “qualified higher education expenses. Therefore, taxpayers who use 529 plan distributions for K-12 tuition must add back the lesser of the following for purposes of calculating Minnesota taxable income:

- Total distributions from the taxpayer’s plan for the taxable year that are expended for K-12 tuition; or
- The total amount of earnings required to be reported to the taxpayer by a trustee of a 529 plan.

In addition, a recapture tax applies for taxpayers who claimed either the subtraction or credit for 529 plan contributions (under different sections of law) and used 529 plan distributions for purposes other than qualified higher education expenses. The recapture tax is based on a calculation of the amount of the distribution for non-qualified higher education expenses and the amount of the subtraction or credit claimed in the current tax year.

As proposed to be amended, this bill: 1) strikes language from the recapture tax that applies to distributions used for K-12 expenses; and 2) repeals the add back provision.

Effective beginning in tax year 2021.