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Prop. Reg. 1.529-1

Qualified State tuition program, unrelated business income tax and definitions.

(a) In general. A qualified State tuition program (QSTP) described in section 529 is exempt from income tax, except for the tax imposed under section 511 on the QSTP's unrelated business taxable income. A QSTP is not required to file Form 990, Return of Organization Exempt From Income Tax, Form 1041, U.S. Income Tax Return for Estates and Trusts, or Form 1120, U.S. Corporation Income Tax Return. A QSTP may be required to file Form 990-T, Exempt Organization Business Income Tax Return. See §§1.6012-2(e) and 1.6012-3(a)(5) for requirements for filing Form 990-T.

(b) Unrelated business income tax rules. For purposes of section 529, this section and §§1.529-2 through 1.529-6:

(1) Application of section 514. An interest in a QSTP shall not be treated as debt for purposes of section 514. Consequently, a QSTP's investment income will not constitute debt-financed income subject to the unrelated business income tax merely because the program accepts contributions and is obligated to pay out or refund such contributions and certain earnings attributable thereto to designated beneficiaries or to account owners. However, investment income of a QSTP shall be subject to the unrelated business income tax as debt-financed income to the extent the program incurs indebtedness when acquiring or improving income-producing property.

(2) Penalties and forfeitures. Earnings forfeited on prepaid educational arrangements or contracts and educational savings accounts and retained by a QSTP, or amounts collected by a QSTP as penalties on refunds or excess contributions are not unrelated business income to the QSTP.

(3) Administrative and other fees. Amounts paid, in order to open or maintain prepaid educational arrangements or contracts and educational savings accounts, as administrative or maintenance fees, and other similar fees including late fees, service charges, and finance charges, are not unrelated business income to the QSTP.

(c) Definitions. For purposes of section 529, this section and §§1.529-2 through 1.529-6:

Account means the formal record of transactions relating to a particular designated beneficiary when it is used alone without further modification in these regulations. The term includes prepaid educational arrangements or contracts described in section 529(b)(1)(A)(i) and educational savings accounts described in section 529(b)(1)(A)(ii).

Account owner means the person who, under the terms of the QSTP or any contract setting forth the terms under which contributions may be made to an account for the benefit of a designated

beneficiary, is entitled to select or change the designated beneficiary of an account, to designate any person other than the designated beneficiary to whom funds may be paid from the account, or to receive distributions from the account if no such other person is designated.

Contribution means any payment directly allocated to an account for the benefit of a designated beneficiary or used to pay late fees or administrative fees associated with the account. In the case of a tax-free rollover, within the meaning of this paragraph (c), into a QSTP account, only the portion of the rollover amount that constituted investment in the account, within the meaning of this paragraph (c), is treated as a contribution to the account as required by §1.529-3(a)(2).

Designated beneficiary means-

- (1) The individual designated as the beneficiary of the account at the time an account is established with the QSTP;
- (2) The individual who is designated as the new beneficiary when beneficiaries are changed; and
- (3) The individual receiving the benefits accumulated in the account as a scholarship in the case of a QSTP account established by a State or local government or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as part of a scholarship program operated by such government or organization.

Distributee means the designated beneficiary or the account owner who receives or is treated as receiving a distribution from a QSTP. For example, if a QSTP makes a distribution directly to an eligible educational institution to pay tuition and fees for a designated beneficiary or a QSTP makes a distribution in the form of a check payable to both a designated beneficiary and an eligible educational institution, the distribution shall be treated as having been made in full to the designated beneficiary.

Distribution means any disbursement, whether in cash or in-kind, from a QSTP. Distributions include, but are not limited to, tuition credits or certificates, payment vouchers, tuition waivers or other similar items. Distributions also include, but are not limited to, a refund to the account owner, the designated beneficiary or the designated beneficiary's estate.

Earnings attributable to an account are the total account balance on a particular date minus the investment in the account as of that date.

Earnings ratio means the amount of earnings allocable to the account on the last day of the calendar year divided by the total account balance on the last day of that calendar year. The earnings ratio is applied to any distribution made during the calendar year. For purposes of computing the earnings ratio, the earnings allocable to the account on the last day of the calendar year and the total account balance on the last day of the calendar year include all distributions made during the calendar year and any amounts that have been forfeited from the account during the calendar year.

Eligible educational institution means an institution which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C 1088) as in effect on August 5, 1997, and which is eligible to participate in a program under title IV of such Act. Such institutions generally are

accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Final distribution means the distribution from a QSTP account that reduces the total account balance to zero.

Forfeit means that earnings and contributions allocable to a QSTP account are withdrawn by the QSTP from the account or deducted by the QSTP from a distribution to pay a penalty as required by §1.529-2(e).

Investment in the account means the sum of all contributions made to the account on or before a particular date less the aggregate amount of contributions included in distributions, if any, made from the account on or before that date.

Member of the family means an individual who is related to the designated beneficiary as described in paragraphs (1) through (9) of this definition. For purposes of determining who is a member of the family, a legally adopted child of an individual shall be treated as the child of such individual by blood. The terms brother and sister include a brother or sister by the halfblood. Member of the family means-

- (1) A son or daughter, or a descendant of either;
- (2) A stepson or stepdaughter;
- (3) A brother, sister, stepbrother, or stepsister;
- (4) The father or mother, or an ancestor of either;
- (5) A stepfather or stepmother;
- (6) A son or daughter of a brother or sister;
- (7) A brother or sister of the father or mother;
- (8) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or
- (9) The spouse of the designated beneficiary or the spouse of any individual described in paragraphs (1) through (8) of this definition.

Person has the same meaning as under section 7701(a)(1).

Qualified higher education expenses means-

- (1) Tuition, fees, and the costs of books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution; and
- (2) The costs of room and board (as limited by paragraph (2)(i) of this definition) of a designated beneficiary (who meets requirements of paragraph (2)(ii) of this definition) incurred while attending an eligible educational institution:
 - (i) The amount of room and board treated as qualified higher education expenses shall not exceed the minimum room and board allowance determined in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher Education Act of 1965 (20 U.S.C. 108711) as in effect on August 5, 1997. For purposes of these regulations, room and board costs shall not exceed \$1,500 per academic year for a designated beneficiary residing at home

with parents or guardians. For a designated beneficiary residing in institutionally owned or operated housing, room and board costs shall not exceed the amount normally assessed most residents for room and board at the institution. For all other designated beneficiaries the amount shall not exceed \$2,500 per academic year. For this purpose the term academic year has the same meaning as that term is given in 20 U.S.C. 1088(d) as in effect on August 5, 1997.

(ii) Room and board shall be treated as qualified higher education expenses for a designated beneficiary if they are incurred during any academic period during which the designated beneficiary is enrolled or accepted for enrollment in a degree, certificate, or other program (including a program of study abroad approved for credit by the eligible educational institution) that leads to a recognized educational credential awarded by an eligible educational institution. In addition, the designated beneficiary must be enrolled at least half-time. A student will be considered to be enrolled at least half-time if the student is enrolled for at least half the full-time academic workload for the course of study the student is pursuing as determined under the standards of the institution where the student is enrolled. The institution's standard for a full-time workload must equal or exceed the standard established by the Department of Education under the Higher Education Act and set forth in 34 CFR 674.2(b).

Rollover distribution means a distribution or transfer from an account of a designated beneficiary that is transferred to or deposited within 60 days of the distribution into an account of another individual who is a member of the family of the designated beneficiary. A distribution is not a rollover distribution unless there is a change in beneficiary. The new designated beneficiary's account may be in a QSTP in either the same State or a QSTP in another State.

Total account balance means the total amount or the total fair market value of tuition credits or certificates or similar benefits allocable to the account on a particular date. For purposes of computing the earnings ratio, the total account balance is adjusted as described in this paragraph (c).