

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(7)I
Income Tax
December 28, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I050307A

On March 7, 2005, a Petition for Advisory Opinion was received from Upromise Investments, Inc., c/o Jennifer Coates, Esq., Sidley, Austin, Brown & Wood, LLP, 787 7th Ave., New York, New York 10019.

The issues raised by Petitioner, Upromise Investments, Inc., are:

1. Whether amounts transferred from an account in a college savings plan established by another state under section 529 of the Internal Revenue Code (IRC) (529 Plan) to the New York State College Choice Tuition Savings Program (New York 529 Plan) can be deducted pursuant to section 612(c)(32) of the Tax Law in determining New York adjusted gross income.
2. Whether amounts accumulated under the Upromise Rewards Service program described below and contributed to the New York 529 Plan can be deducted pursuant to section 612(c)(32) of the Tax Law in determining New York adjusted gross income.

Petitioner submits the following facts as the basis for this Advisory Opinion.

The New York 529 Plan was established under Article 14-A of the Education Law authorizing the establishment of family tuition accounts. According to Petitioner, an account owner may make contributions to the New York 529 Plan by any of the following methods: check, automatic investment plan, electronic bank transfer, transfer from a Upromise Rewards Service Account, rollover from another state's 529 plan, transfer from another account within the New York 529 Plan, transfer from a Coverdell Education Savings Account, redemption of a qualified United States Savings Bond, payroll deduction, and transfer from a custodial account under the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act. Only an account owner may make contributions to an account in the New York 529 Plan after it is opened.

The Upromise Rewards Service program (Upromise Service) is a consumer loyalty program sponsored by Upromise Inc. (together with its subsidiary Upromise Investments, Inc., "Upromise") that is designed to encourage and facilitate college savings. Upromise enters into agreements with participating vendors of goods and services (Merchant Participants) and customers participating in the Upromise Service (Members) allowing Members to purchase goods or services at the same price as other consumers and to receive rebates from Merchant Participants. The amount of the rebate is negotiated between Upromise and each Merchant Participant. Certain Merchant Participants, instead of paying a rebate to Members, pay referral fees to Upromise for Member purchases of goods and services on the Internet through a link from the Upromise Web site. Upromise passes all or a portion of such fees on to its Members as

rebates. The Merchant Participants represent a broad spectrum of the consumer economy, including groceries, consumer goods, utilities, automobiles, computers, travel, and entertainment.

During the enrollment process, a Member provides Upromise with his or her credit or debit card numbers and registers for certain Merchant Participants from which the Member expects to make purchases of goods or services. Thereafter, Members generally will not be required to provide any additional purchase or transaction information in order to receive rebates from the designated entities. Members can also make online purchases of products and services through Upromise's Web site. Information about a Member's purchases is gathered by Upromise either by a direct information feed from the Merchant Participant or by an information feed from a third party experienced in processing such data. Upromise matches the information provided by the Merchant Participant or third party with the Member's identification to calculate the rebate amount. Based on this transaction data, Merchant Participants forward a payment representing the amount of the Member's rebate to an account maintained for the benefit of the Member by Upromise for the purpose of accumulating rebates earned through the Upromise Service (a Member Account). In the case of Merchant Participants that are on-line merchants and that pay Upromise a referral fee, Upromise forwards to Member Accounts a portion of such fees as rebates upon notice of receipt of payment from the merchant.

Pursuant to its agreements with Merchant Participants and Members, Upromise is contractually obligated to allocate the rebate portion of payments received from Merchant Participants to Member Accounts. The agreements between the Members and Upromise state that a Member has no rights to rebate amounts until deposited into the Member Account for the benefit of the Member. Funds in Member Accounts are held for the benefit of the Members, and neither Upromise nor any affiliate of Upromise has any right to apply amounts credited to Members for any purpose other than at the direction of the respective Member. However, any interest earned on amounts held in the Member Accounts is paid to and retained by Upromise. Under the Member agreement, Upromise may terminate a Member Account if there has been no activity within 12 months. In such case, Upromise will distribute the balance pursuant to instructions from the Member, or if no instructions have been received, as a cash withdrawal to the Member.

Members are encouraged to direct rebates accumulated in their Member Accounts into the New York 529 Plan or an account opened in a college savings plan established by another state under section 529 of the IRC. Upromise has entered into contractual arrangements with program managers of 529 Plans or broker-dealers selling interests in 529 Plans to facilitate the opening of 529 Plan accounts and transfers of Member Account balances to the accounts. Thus, a Member can link his or her Member Account with a 529 Plan account after properly enrolling in and opening a 529 Plan and otherwise meeting the eligibility requirements of the 529 Plan. Once a Member establishes a linked 529 Plan, the Member can instruct Upromise to transfer amounts credited to the Member's Account to the 529 Plan. Provided the applicable 529 Plan's minimum investment requirements are met, amounts in the Member's Account can be transferred automatically on a periodic basis to the 529 Plan. Upromise does not have any discretion in determining the manner in which balances are transferred to a Member's chosen

529 Plan, and balances are transferred strictly in accordance with the Member's 529 Plan designations. An election by a Member to invest amounts in his or her Member Account in a 529 Plan can be withdrawn by the Member at any time with respect to amounts not yet invested in a 529 Plan.

Although Upromise Service encourages the use of rebates for college expenses, Members are not required to apply their Member Account balances to the New York 529 Plan or any other 529 Plan. A Member may withdraw some or all of the amounts in a Member Account, make a gift of accumulated rebates to another Member by transferring all or a portion of the account balance to the account of another Member through the Upromise "Family and Friends" network, or donate all or a portion of the account balance to the Upromise Education Foundation. At any time, a Member may designate another individual as a beneficiary of the assets in the Member Account.

Applicable law and regulations

Section 612(a) of the Tax Law provides:

General. The New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section.

Section 612(c) of the Tax Law provides, in part:

Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:

* * *

(32) Contributions made during the taxable year by an account owner to one or more family tuition accounts established under the New York state college choice tuition savings program provided for under article fourteen-A of the education law, to the extent not deductible or eligible for credit for federal income tax purposes, provided, however, the exclusion provided for in this paragraph shall not exceed five thousand dollars for an individual or head of household, and for married couples who file joint tax returns, shall not exceed ten thousand dollars.

Section 529(c)(3) of the IRC, for purposes of the tax treatment of beneficiaries and contributors under qualified tuition programs, provides, in part:

(A) In general. Any distribution under a qualified tuition program shall be includible in the gross income of the distributee in the manner as provided under section 72 to the extent not excluded from gross income under any other provision of this chapter.

* * *

(C) Change in beneficiaries or programs.

(i) Rollovers. Subparagraph (A) shall not apply to that portion of any distribution which, within 60 days of such distribution, is transferred -

(I) to another qualified tuition program for the benefit of the designated beneficiary, or

(II) to the credit of another designated beneficiary under a qualified tuition program who is a member of the family of the designated beneficiary with respect to which the distribution was made.

Opinion

Section 612(c)(32) of the Tax Law provides that contributions made during the taxable year by an account owner to one or more New York 529 plans, not in excess of \$5,000 for an individual and \$10,000 for married couples who file a joint New York personal income tax return, may be subtracted from federal adjusted gross income when computing New York adjusted gross income.

With respect to issue 1, as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), section 529 of the IRC respecting qualified tuition programs was amended to grant the account owner the ability to roll over a 529 Plan without changing the beneficiary. EGTRRA amended section 529(c)(3)(C)(i) of the IRC to allow the account owner, after December 31, 2001, to roll over a 529 Plan to another state's 529 Plan for the same beneficiary. Section 529(c)(3)(C)(i) of the IRC does not subject distributions from a state college savings plan to taxation if within sixty days the funds are rolled over to another state college savings plan for the benefit of the designated beneficiary or member of the family of the designated beneficiary.

For purposes of the subtraction modification under section 612(c)(32) of the Tax Law, the term *contribution* includes amounts transferred from another state's 529 Plan and rolled over to a New York 529 Plan. This includes the earnings portion of the distribution from the other state's 529 Plan not included in federal gross income pursuant to IRC section 529(c)(3)(C)(i) and the portion of the distribution considered an investment in the other state's 529 Plan.

With respect to issue 2, in order for the amounts accumulated in a Member's Account under the Upromise Service and transferred to a New York 529 Plan to be deductible, the transfer must represent a contribution to the New York 529 Plan by the account owner.

In a related issue, Internal Revenue Service Letter Ruling 200228001, April 10, 2002, addressed whether a taxpayer, as a company cardholder, makes a charitable contribution when a rebate is transferred to a qualified charitable organization. In the ruling, the Service held that if the taxpayer makes an affirmative election to donate merchant rebates to charity rather than to receive them personally, rebates transferred to charity pursuant to that election are charitable contributions deductible by the taxpayer. The participant must have the opportunity to decide whether rebates on his or her purchases will be made to a charity or received personally. The taxpayer is entitled to a charitable contribution deduction in the year that the company transfers the rebate to charity.

In this case, the Member has exclusive rights to the rebates received from Merchant Participants when the rebates are deposited in the Member's Account. Members are encouraged to direct rebates accumulated in their Member Accounts into a New York 529 Plan or into an account opened in a college savings plan established by another state under section 529 of the IRC. However, members are not required to apply their Member Account balances to the New York 529 Plan or any other 529 Plan. A Member may withdraw some or all of the amount in a Member Account, direct rebates accumulated in their Member Account into the New York 529 Plan or another state's college savings plan, make a gift of accumulated rebates to another Member by transferring all or a portion of the account balance to the account of the other Member through the Upromise "Family and Friends" network, or donate all or a portion of the account balance to the Upromise Education Foundation. At any time, the Member may designate another individual as a beneficiary of the assets in the Member Account.

It appears, therefore, that Members decide whether rebates on their purchases under the Upromise Service will be transferred into the New York 529 Plan or received personally or directed to another individual or entity. Accordingly, amounts accumulated in a Member Account under the Upromise Service and contributed to the New York 529 Plan are considered a contribution by the Member for purposes of the subtraction modification under section 612(c)(32) of the Tax Law in determining New York adjusted gross income.

DATED: December 28, 2005

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.