

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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Income Tax
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1978 Legislation

Parent's and Student's Savings Plan

and Tuition Expenses

Chapter 70 of Laws of 1978 amends various sections of the New York State Tax Law to provide for the establishment of the Parent's and Student's Savings Plan called "PASS". The amendments also provide for deductions from federal adjusted gross income for contributions to this type of plan, for college tuition expenses paid on behalf of a dependent, and for the recovery for tax purposes of the income which has been deducted from the federal adjusted gross income of the creator of this type of plan.

For tax years beginning after December 31, 1977, New York State resident taxpayers are allowed to take educational deductions by two distinct methods. These deductions are taken as a modification reducing federal adjusted gross income in computing total New York income.

The first method allows a deduction for a portion of college tuition expenses paid for a taxpayer's dependents. The basic rules which apply to this method are:

- 1- The dependent on whose behalf the expenses are paid must be in full-time attendance at an institution of higher education.
- 2- The institution of higher education must be located in New York State.
- 3- The amount allowable as a deduction is the lesser of ½ of the tuition paid (less Tuition Assistance Program awards) or \$1,000.
- 4- This deduction is not allowed if the tuition is paid on behalf of any person who received a distribution from a qualified higher education fund during the taxable year.
- 5- A nonresident may not claim this deduction even though the dependent may be attending an institution of higher education in New York State.

The second method allows a deduction for contributions to a qualified higher education fund and for the income realized by the fund, to the extent that it was included in federal adjusted gross income. The fund itself is tax exempt for New York State and City of New York purposes. The basic rules which apply to this method are:

- 1- The contributions must be made to a qualified higher education fund established by the taxpayer.
- 2- The contributions are limited to \$750 per each eligible beneficiary.
- 3- The number of eligible beneficiaries will be determined as of the first or last day of the taxable year, whichever is greater.
- 4- The number of eligible beneficiaries cannot include any individual who was a student at an institution of higher education during the previous taxable year.

The term "student" shall be the same as the federal definition in Section 151(e)(4) of the Internal Revenue Code except that the reference to "5 calendar months" shall be considered "3 calendar months" for the purpose of the proceeding sentence.

For the purposes of this legislation, the following definitions are used:

- 1- Institution of higher education is an educational organization which maintains a regular faculty and curriculum and has a body of students in attendance and which awards an associate, baccalaureate or higher degree or has a program which is acceptable for full credit toward a degree.
- 2- Eligible beneficiary is a person who:
 - a) is a son or daughter or the descendent of either, stepson or stepdaughter, brother, sister, stepbrother or stepsister, or a son or daughter of your brother or sister.
 - b) may be claimed as your dependent for Federal income tax purposes, or is a member of the Armed Forces of the United States on active duty, a volunteer in the Peace Corps, or a full-time volunteer under the Domestic Volunteer Service Act of 1973.
 - c) has not reached the age of 21 by the close of the taxable year or is a full-time student at a regular educational organization during some part of each of 5 calendar months of the calendar year, or
 - d) qualifies as a student if he is pursuing a full-time, accredited, on-farm training course.
- 3- Qualified higher education fund is a fund established under a written plan solely for defraying costs of attendance at an institution of higher education for one or more eligible beneficiaries.
 - a) "Costs" will include applicable tuition and fees (except laboratory breakage, dormitory damage, etc.), room and board, and books and supplies.
 - b) Distributions will not be made for purposes other than those stated.
 - c) Contributions will not be accepted in excess of \$750 per eligible beneficiary.
 - d) Provision is made for distributions of assets to the creator of the fund, his estate or a trust if fund is terminated.
 - e) The fund constitutes a trust or a custodial account, the assets of which are held by a bank, insurance company, or other person satisfactory to the Tax Commission.

A person who met the requirements of an eligible beneficiary will cease to be such if payments to or for him are not begun within 5 years after graduation or separation from secondary school or 10 years elapse after graduation or separation from secondary school, excluding any period up to 4 years during which he was a member of the Armed Forces on active duty, a volunteer in the Peace Corps or a full-time volunteer under the Domestic Volunteer Service Act of 1973. He may also cease to qualify if he does not file a Notice of Consent, as required, within 6 months after his 18th birthday.

If a qualified higher education fund is terminated, the assets must be distributed to the creator of the fund or his estate or trust. If the fund is terminated because

- a) the plan ceases to have an eligible beneficiary
- b) the creator of the fund dies without a testamentary disposition or the creation of a living trust,

a separate tax is imposed on the creator of the fund or his estate or trust. This tax is computed by taking 1/5 of the value of the assets immediately prior to termination, computing an initial tax at the regular rates on the 1/5 value and multiplying the initial tax by 5. The Investment Credit, Resident Credit, and the Accumulated Distribution Credit for Residents and Nonresidents are not allowed against this tax.

If the fund is terminated because

- a) excessive contributions were made to the fund
- b) distributions were made by the fund to or on behalf of someone other than an eligible beneficiary, or
- c) contributions were made to the fund by the creator in a year in which he was a nonresident individual or a nonresident estate or trust

the creator of the fund must increase his federal adjusted gross income by 110% of the value of assets at the time of termination.

If the assets are distributed as payments to the beneficiary for the purposes specified, the eligible beneficiary must increase his federal adjusted gross income each year for five years by 1/5 of all payments made on his behalf. This addition to income is made beginning in the first year that no payments are made and such year follows a year in which payments were made. The beneficiary is not required to make the addition to income for up to 4 years while he was a member of the Armed Forces on active duty, a volunteer in the Peace Corps, or a full-time volunteer under the Domestic Volunteer Service Act of 1973.

The comparable sections of Article 30 and the Administrative Code of the City of New York have been similarly amended to allow residents of the City of New York the same deductions provided by the "PASS" legislation and to provide for the recovery of this income for tax purposes. Any reference to "resident" or "nonresident" in this Article or Administrative Code is considered to be a reference to a resident or nonresident of the City of New York.

The deductions provided in this legislation are not allowed to a nonresident of the City of New York on a Nonresident Earnings Tax Return. If a taxpayer changes his residence to or out of New York City but remains in New York State, he would use the CR-60.1 to properly compute his City of New York resident income. The amendments to this Article and Administrative Code provide for proration of the allowable deductions and the required additions to income when a change of resident status for City of New York purposes takes place.

Sections of the New York State Tax Law
affected by the PASS legislation

Section 612(c) is amended adding paragraph (15) which provides for a deduction for contributions to a qualified higher education fund and (16) which provides for the deduction of tuition expenses. A new subsection (k) provides the requirements for establishing a higher education fund, the definitions of the terms used, and the conditions which will terminate the

fund. A new subsection (1) provides for the tax effects when a fund is terminated under certain conditions and the tax treatment of payments from the fund to a beneficiary.

Section 601(d) is amended to exempt a qualified higher education fund from taxation under Article 22.

Section 601-D is added and imposes a separate tax on the distribution of the assets of a fund when it is terminated under certain conditions.

Section 612(b) is amended adding paragraph (14) requiring an individual to increase his federal adjusted gross income for amounts required to be reported under subsection (1).

Section 618(5) is repealed and a new subsection (5) is added to provide the modifications described in Sections 612(c)(15) and 612(b)(14) for a resident trust or estate.

Section 632(a) is amended by adding a new paragraph (3) which provides for the increase to federal adjusted gross income of a nonresident for amounts distributed to the creator of a qualified higher education fund which terminated and for the payments made to an individual from a qualified higher education fund for his college education.

Section 638(a)(3) is amended to provide the required modification described in the preceding paragraph for nonresident estates and trusts.

Section 651(a)(1),(2),(3) and (4) is amended to add the requirement to file tax returns if a resident individual, estate or trust or a nonresident individual, estate or trust is subject to the separate tax on the termination of a qualified higher education fund as provided in the new Section 601-D.

Section 683(d) is amended adding the distribution of assets from a qualified higher education fund as an item which can be assessed at any time within six years after the return was filed if the omission of this income is more than 25%.

Sections 1301(a) and 1301-C of Article 30 are amended to empower cities to impose similar legislation. Sections T46-101.0(d), T46-101.1, T46-101.3, T46-112.0, T46-112.0(15)(16), T46-112.0(k), T46-112.0(1), T46-118.0(5), T46-151.0(a), and T46-183.0(d) of the Administrative Code of the City of New York are amended to provide legislation corresponding to Article 22 with respect to PASS and tuition expenses.

This legislation was signed April 14, 1978, is effective immediately, and applies to taxable years commencing after December 31, 1977.