

Montana Department of Revenue Memorandum

Montana FESP Letter Ruling  
Montana Department of Revenue  
Income & Miscellaneous Tax Division

DATE: April 27, 1998

FROM: Robert Turner, Bureau Chief, Income & Misc. Tax Division

**RE: Montana Family Education Savings Program**

Below are the answers to the questions you requested that the Department either confirm or provide an alternate answer. They are as follows:

1. Montana code 15-30-111 (2) (1), MCA, excludes from Montana adjusted gross income "money, not exceeding \$3,000 for each taxpayer, contributed to a family education savings program account established in accordance with 15-62-201." In the case of a married couple filing jointly or separately, is a \$3,000 reduction allowed for each spouse?

Yes. A \$3,000 reduction is allowed for each spouse. 15-30-111, (2) (1), specifically states "not exceeding \$3,000 for each taxpayer."

2. The instructions for the 1997 Montana Form 2 state that a taxpayer may contribute up to \$3,000 to a family education savings account. The Family Education Savings Act permits the Board of Regents to establish contribution limits, but the Act does not set a \$3,000 limit on contributions. May a taxpayer reduce his or her adjusted gross income by \$3,000 in a year if the contributor contributes more than \$3,000 to a family education savings account during the year?

Yes. A taxpayer may contribute more than \$3,000 to a family education account but under 15-30-211 (2) (1) may only take a deduction up to a maximum of \$3,000.

3. The instructions for the 1997 Montana Form 2 require a taxpayer to submit a copy of the application to the Board of Regents to claim a deduction in adjusted gross income for a contribution to a family education savings account. Under the Family Education Savings Act, a taxpayer need only submit an application to the Board of Regents in the initial year of contribution. May a taxpayer submit a copy of a verifiable indicium of contribution such as a confirmation notice or canceled check a reduction in income?

A taxpayer is required by law to be able to verify all deductions taken on their Montana income tax return. As set forth in Administrative Rule 42.15.804, a taxpayer must attach to their income tax return information to verify the

taxpayer's contributions and interest to the account. A year end statement from the financial institution is sufficient to verify the activity in the account. However, if requested, a taxpayer may be required to furnish the original Family Education Savings Account application and the checks or deposit slips showing deposits made to the account.

4. If an individual contributes to a family education savings account and claims a deduction for the contribution and amounts are subsequently withdrawn for the account other than to pay tuition or fees of the designated beneficiary at higher education institution, will the withdrawal be taxable?

Yes. A nonqualified withdrawal will be constitute income for Montana income tax purposes according to 15-62-201 (4), MCA. The section states "A nonqualified withdrawal constitutes income for Montana purposes to the extent it was previously deducted from income in calculating Montana individual income taxes."

5. If contributions have been made to a family education savings account in any year by an individual who was not able to exclude from Montana adjusted gross income all of his contributions for the year, what portion of the principal withdrawn is treated as attributable to deductible contributions?

If a taxpayer makes contributions to an account which are not excludable, all withdrawals made for "eligible higher education expenses" are not taxable. However, for those withdrawals that are ineligible, the ratio that the ineligible contributions bear to the total contributions times the withdrawal amount represents the portion that is not includable in income.

6. Qualified higher education expenses are defined more narrowly by 15-62-103, MCA, than defined by section 529 of the Internal Revenue Code. It is anticipated the Board of Regents will adopt the broader federal definition for purposes of determining whether withdrawals are subject to a penalty. If an amount is withdrawn from a family education savings account to pay higher education expenses that qualify under section 529 of the Internal Revenue Code but do not qualify under 15-62-103, MCA (room or board or withdrawals because the designated beneficiary earned a scholarship), will deductions for contributions have to be recaptured even though the withdrawal is not subject to penalty?

Presently, if an amount is withdrawn for a family education savings account and is determined to be a "nonqualified withdrawal" as defined in 15-62-103 (9), MCA, it constitutes income for Montana purposes to the extent it was previously deducted under 15-62-201 (4), MCA. To be a "qualified withdrawal," the expense has to be for tuition and fees required for enrollment or attendance at a higher education institution as set forth in 15-62-103 (11), MCA. However, if the interest portion of the nonqualified withdrawal is excludable for federal purposes, it will also be excludable for Montana purposes.