Vermont Department of Taxes
TECHNICAL BULLETIN

CHAPTER: CHAPTER 151, INCOME TAXES
TAXATION OF INDIVIDUALS, TRUSTS, AND ESTATES

SUBJECT: CREDIT FOR VERMONT HIGHER EDUCATION INVESTMENT PLAN CONTRIBUTIONS PURSUANT TO 32 V.S.A § 5825a

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**Introduction**

This Bulletin explains the application of the nonrefundable Vermont income tax credit for contributions to a higher education investment plan (VHEIP) administered by the Vermont Student Assistance Corporation as an instrumentality of the State. The credit is codified at 32 V.S.A. § 5825a(a), which provides:

> "A taxpayer of this state, including each spouse filing a joint return, shall be eligible for a nonrefundable credit against the tax imposed under section 5822 of this title of five percent of the first $2,000 per beneficiary, contributed by the taxpayer during the taxable year to a Vermont higher education investment plan account under subchapter 7 of chapter 87 of Title 16."

The five percent and $2000 limitations apply to contributions made in calendar years 2004, 2005 and 2006. For contributions made in 2007 and after, the credit increases to ten percent of the first $2,500 per beneficiary.

**Definition of Terms**

The following terms are pertinent to this credit:

"Beneficiary" means any individual designated by a participation agreement to receive the proceeds of the higher education investment plan established pursuant to Subchapter 7 of Chapter 87 of Title 16.

"Contribution" means cash funds that are placed in a VHEIP account during the calendar year. *See* I.R.C. § 529(b)(2) ("A program shall not be treated as a qualified tuition program unless it provides that purchases or contributions may only be made in cash.")

"Credit" means, for tax years 2004, 2005 and 2006, five percent of the first $2000 per beneficiary contributed to a VHEIP; and for tax years 2007 and after, ten percent of the first $2,500 per beneficiary contributed to a VHEIP.

"Nonrefundable credit" means a credit that cannot exceed the claimant's tax liability for the tax year.

"Tax imposed under section 5822 of this title" means the Vermont income tax on individuals, estates and trusts.

**Application of Credit**

(1) Account Owner. In order to qualify for a VHEIP tax credit the claimant must be an owner of the VHEIP account. To allow credits to be efficiently tracked to contributions to qualifying accounts, each account may only have one account owner and one beneficiary, unless the other contributor is the spouse or civil union partner with whom the account owner is filing a joint income tax return. In such case, each spouse or civil union partner on a joint return is eligible to claim a maximum credit, regardless of who earned the income. For example:

In 2007, John and Kathy open separate VHEIP accounts for each of their grandsons, David and Oggie. John contributes $2,500 for each grandson. Kathy contributes $1,000 for each grandson. John and Kathy file a joint income tax return. John's credit is $500 ($5,000 x 10 percent). Kathy's credit is $200 ($2,000 x 10 percent). They may claim a $700 VHEIP credit on their joint return.

Uncle Frank wants to assist in funding David and Oggie's education and contributes $1,000 to each account John and Kathy set up. Because Frank is not the owner of the accounts, he is not eligible to claim the credit. (Note that Uncle Frank could set up his own accounts for his nephews and qualify for the credit.)

When married or civil union couples file their Vermont income tax returns separately, each spouse or partner may claim a credit for the contributions made to the VHEIP account that he or she owns. For example:

In 2007, Mattie opens a VHEIP account for her daughter, Zoe. Mattie's spouse, Ethan, contributes $2,000 to the account and Mattie contributes $3,000. Ethan and Mattie file separate income tax returns. Mattie may claim a $250 ($2,500 x 10 percent) credit. Because Ethan is not an owner of the account, he may not claim a credit.

(2) Limitation of credit. Neither the contributor nor the beneficiary is required to be a Vermont resident. However, because VHEIP credits are nonrefundable, they may only be applied against the Vermont income tax liability of an individual, estate or trust. The credit amount cannot exceed the total tax liability and unused credits may not be carried forward or back to another year. For example:

Sara lives in New York, works occasionally in Vermont and files a 2007 Vermont income tax return. Sara opens a VHEIP for her niece, contributing $2,500. Sara's Vermont tax liability for tax year 2007 is $75. The VHEIP credit of 10 percent of the first $2,500 contribution is $250. Because this is a nonrefundable credit, the credit is limited by her $75 tax liability.

Sara lives in New York, works in Vermont and files a 2007 Vermont income tax return. Sara opens a VHEIP for her niece, contributing $2,500. Sara made $750 in estimated payments and her Vermont tax liability for tax year 2007 is $700. The VHEIP credit is 10 percent of the $2,500 contribution - or $250. The $250 credit is applied to Sara's $700 tax liability, leaving a $450 liability. Since she already paid $750 in estimated tax, she receives a refund of $300.

(3) Source of contributions. Contributions must be made to a VHEIP plan during the calendar year and must be made in cash. A rollover from another education account may qualify as a contribution to the extent that the funds were *contributed* to the other plan and provided that the funds remain in the VHEIP for the remainder of the taxable year in which the funds were rolled into the VHEIP. A taxpayer may not claim credit in a subsequent year with respect to the same contribution.[1] Note that certain rollovers avoid the general rule that distributions are includible in the gross income of the distributee. *See* I.R.C. 529(c)(3)(C). For example:

> In 2005, Martin and Anna contributed $2000 to a New York education plan and earned $200 interest prior to rolling over the funds in 2006 to a VHEIP benefiting their granddaughter. This is not a distribution and so does not have to be included in the income of the granddaughter. They can claim a Vermont credit for the $2000 that was originally contributed to an education plan; they may not claim the $200 earned on their contribution[2].
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> Ronald rolled over funds from a New York education account to a VHEIP in 2006; then rolled the same funds to a private education plan later in 2006. He is not entitled to the Vermont credit.
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> Carol and Steve transfer funds from a VHEIP benefiting their daughter to another VHEIP designating their son as beneficiary. This is not a distribution and so does not have to be included in the income of the son. However, Carol and Steve cannot claim a Vermont credit for this transfer of funds since this is a rollover from another account and is not a cash contribution.

**Repayment Provision**

A distribution from a VHEIP that is not excludable from federal gross income in the taxable year triggers a repayment requirement of five percent of the distribution up to the maximum of the total Vermont credits received by the taxpayer. Ten percent of the distribution must be repaid if the contributions were made in 2007 or after. Repayments are subject to interest and penalty and collection in the same manner as income tax. 32 V.S.A. § 5825a(b). For example:

> From 2004 to 2006, Kate and William contributed $137,000 to a VHEIP and claimed credits totaling $600 on their Vermont tax returns. The plan earns $3000. Their son attends a four-year university from 2007 to 2011 at an annual cost of $25,000. After he graduates, the remaining $40,000 is distributed to Kate and William and they use it to buy a sailboat. They must repay $600 to the State of Vermont in 2011 (the lesser of five percent of $40,000 and the total credits they received). The earnings on the distribution are includible in their 2011 federal gross income under federal rules.
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> In 2007, Joe and Ellen contribute $3000 to a VHEIP designating their daughter as beneficiary, taking a $300 credit. In 2008, they withdraw the $3000 contribution and the $100 the plan has earned and use it to pay their daughter's private high school tuition. Joe and Ellen must repay

[1] Thus, a taxpayer cannot claim a tax credit based on multiple rollovers of the same funds.

[2] This places them on equal footing with someone who originally contributed to a VHEIP. Such taxpayer may not claim the plan's earnings as a further contribution.

the $300 credit to Vermont in 2008. The $100 is includible in their 2008 federal gross income under federal rules.

Signed: ____________________________________
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Approved: __________________________________
Commissioner of Taxes