

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

TB-66 (Supersedes TB-33)  
ISSUED: September 5, 2012  
REVISED: October 16, 2019

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## Introduction

This bulletin explains the application of the nonrefundable Vermont income tax credit for contributions to a Vermont higher education investment plan (VHEIP) administered by the Vermont Student Assistance Corporation (VSAC) as an instrumentality of the State.<sup>1</sup> These plans are commonly called "529 plans." The credit is codified at 32 V.S.A. § 5825a(a) and 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 ten percent of the first \$2,500 per beneficiary, contributed by the taxpayer during the taxable year to a Vermont higher education investment plan account under 16 V.S.A. chapter 87, subchapter 7."

## 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 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.

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<sup>1</sup> Pursuant to 16 V.S.A. §2877(b)(6) VSAC has authority to "develop and use two or more types of participation agreements to provide a range of investment structures." It offers standard section 529 accounts and UGMA/UTMA accounts (Uniform Gift to Minors Act and Uniform Transfer to Minors Act respectively). The minor is the owner of an UGMA/UTMA account.

## **VHEIP and 529 Plans**

A VHEIP is a plan authorized by Section 529 of the Internal Revenue Code. After contributing to a VHEIP, earnings accumulate on a tax-deferred basis and distributions are not taxed federally or by the State of Vermont when used for qualified higher education expenses (as defined in the Internal Revenue Code), or, as a result of a 2017 Federal law change, qualified K-12 education expenses up to \$10,000 annually. The earnings will be subject to income tax and a ten percent federal penalty if they are distributed for a purpose that does not qualify.

### **Application of Credit**

(1) Contributions. Each account may have only one beneficiary. However, any Vermont taxpayer who contributes to a VHEIP may be eligible for the credit. For example:

Uncle Frank wants to assist in funding his nephew's education and contributes \$1,000 to a VHEIP UGMA/UTMA account set up by his brother. Uncle Frank may claim a \$100 credit. Uncle Frank also could set up his own account for his nephew and qualify for the credit.

Each spouse or civil union partner who files a joint income tax return is eligible to claim a maximum credit, regardless of who earned the income. For example:

John and Kathy open a VHEIP 529 account for each of their grandsons. 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 ( $\$5,000 \times 10$  percent). Kathy's credit is \$200 ( $\$2,000 \times 10$  percent). They may claim a \$700 VHEIP credit on their joint return.

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:

Mattie opens a VHEIP account for her daughter. 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 (because the credit is limited to 10 percent of the first \$2,500 per beneficiary) credit on her return. Ethan may claim a \$200 credit on his return.

(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 2019 Vermont income tax return. Sara opens a VHEIP for her niece, contributing \$2,500. Sara's Vermont tax liability for tax year 2019 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 to her \$75 tax liability.

Sara lives in New York, works in Vermont and files a 2019 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 the tax year 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. Because 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 for which the credit is claimed and must be made in cash. A rollover from an out-of-state 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.<sup>2</sup> 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 2018, Martin and Anna contributed \$2000 to a New York education plan and earned \$200 interest prior to rolling over the funds in 2019 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.<sup>3</sup>

Ronald rolled over funds from a New York education account to a VHEIP in 2018; then rolled over the same funds to a private education plan later in 2019. He is not entitled to the Vermont credit because he did not leave the funds in the VHEIP for the entire remainder of the year.

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 used exclusively for costs of attendance at an approved postsecondary education institution (as defined in Vermont law) triggers a repayment requirement of ten percent of the distribution up to the maximum of the total Vermont credits received by the taxpayer.

An approved postsecondary education institution is an accredited post-secondary institution providing educational credit, and any institution eligible to participate in a student aid program administered by the U.S. Department of Education. For more information, see [vheip.org](http://vheip.org). If the distribution is used for qualified K-12 education expenses, there will not be a federal penalty and the gains earned by the contributions will not be subject to tax. However, the Vermont repayment provision will apply. Repayments are subject to interest and penalty and collection in the same manner as income tax. 32 V.S.A § 5825a(b). For example:

In 2007, Kate and William contributed \$137,000 to a VHEIP and claimed credits totaling \$500 on their Vermont tax returns. The plan earns \$3000. Their son attends a four-year university from 2008 to 2012 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 \$500 to the

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<sup>2</sup> Thus, a taxpayer cannot claim a tax credit based on multiple rollovers of the same funds.

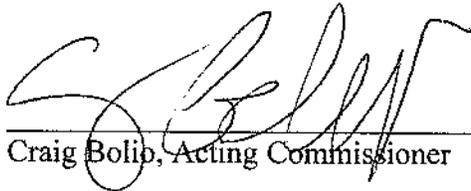
<sup>3</sup> This places them on equal footing with someone who originally contributed to a VHEIP. Such taxpayer may not claim the plan's earnings as a further contribution.

State of Vermont in 2011 (the lesser of ten percent of \$40,000 and the total credits they received). The earnings on the distribution are includible in their 2012 federal gross income under federal rules.

In 2018, Joe and Ellen contribute \$3000 to a VHEIP designating their daughter as beneficiary and taking a \$300 credit. In 2019, they withdraw the \$3000 contribution and the \$100 the plan has earned and use it to pay their daughter's private high school tuition – an expenditure allowed federally, but subject to the Vermont credit repayment provision. Joe and Ellen must repay the \$300 credit to Vermont in 2019. The \$100 capital gain is excluded from their 2019 federal gross income under federal rules and is likewise not taxed as income under Vermont law.

In 2008 through 2010, Richard and Pamela contribute \$50,000 to a UGMA/UTMA VHEIP claiming a \$500 credit. Their son is the owner of the account. The account earns \$1000. After enrolling in college in 2011 their son reached the age of majority, withdrew the \$50,000 and uses it to self-produce a musical CD. Richard and Pamela must repay the \$500 credit on their 2011 Vermont income tax return. The \$1000 is includible in their 2011 federal gross income under federal rules.

Approved:

  
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Craig Bolib, Acting Commissioner

10/15/19  
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Date