1099-Q
What Do I Do?

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1099 Q—What Do I Do?

- Objectives
  - Recognize qualified higher educational expenses for §529 plans
  - Properly calculate the tax-free and taxable portions of distributions from a §529 plan
  - Properly report the distributions from a §529 plan
  - Identify ways for a client to utilize §529 funds

1099 Q—What Do I Do?

- Section 529 state plans to save funds for education
  - Originally “college” expanded to elementary and secondary education by TCJA as well as other changes we will discuss
- Contributions to 529 plans—federal
  - Not deductible
  - Grows tax deferred
    - Will be tax exempt if used “correctly”
- Many states offer credits or deductions for 529 contributions

1099 Q—What Do I Do?

3131 ☐ VOID ☐ CORRECTED

PAYER'S/TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Gross distribution $	OMB No. 1545-1760 Form **1099-Q** (Rev. November 2019)	**Payments From Qualified Education Programs (Under Sections 529 and 530)**
		2 Earnings $	For calendar year 20____	
PAYER'S/TRUSTEE'S TIN	RECIPIENT'S TIN	3 Basis $	4 Trustee-to-trustee transfer ☐	**Copy A** **For Internal Revenue Service Center**
RECIPIENT'S name		5 Distribution is from: • Qualified tuition program— Private ☐ **or** State ☐ • Coverdell ESA ☐	6 Check if the recipient is not the designated beneficiary ☐	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **current General Instructions for Certain Information Returns.**
Street address (including apt. no.)				
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				

Form **1099-Q** (Rev. 11-2019) Cat. No. 32223J www.irs.gov/Form1099Q Department of the Treasury - Internal Revenue Service

1099 Q—What Do I Do?

- When money comes out of Section 529?
  - Form 1099 Q is issued
- To whom is the 1099-Q issued
  - If paid to the school—Form 1099-Q is issued to student
  - If payment made to an individual, Form 1099-Q is issued to individual
    - Typically, the student or account owner

1099 Q—What Do I Do?

- 1099-Q may be issued for a “rollover” from one plan to another
    - Follows same rules as IRA for direct transfers
        - If the “rollover” is a trustee-to-trustee transfer, a Form 1099-Q may not be issued
    - Only one “hands on” rollover allowed within 365-day time period
        - Where the individual takes the funds and then either establishes a new account elsewhere
        - 60-day period to complete
        - Only one per 365-day period
    - Be careful, some states consider a rollover to a plan outside their state to be taxable income. Always research the state impact.

1099 Q—What Do You Do?

- When money comes out of Section 529—what do we need to do?
  - Determine if any of the distribution is taxable?
- Gross distribution is at least the same amount or less than the total Adjusted qualified expenses (defined in a few)
  - Not taxable
  - Report on Form 5239 input
  - Will be part of data packet
- If gross distribution is more than the adjusted qualified expenses
  - Earnings may be taxable and possibly subject to 10% penalty

1099 Q—What Do You Do?

- Qualified expenses
  - Tuition, required fees
    - Post secondary (college, trade/vocational, graduate level)
    - Elementary and high school
      - Subject to an annual limit applied by student ($10,000)
  - Books, supplies, equipment required for enrollment
  - Qualified apprenticeship expenses
  - Student loan payment
    - Lifetime limit of $10,000
  - Room and board

1099 Q—What Do You Do?

- How do we compute “Room & Board”?
  - Actual method
  - Cost of attendance found on “college” website, typically under admissions
- Is there a worksheet to easily determine qualified expenses?
  - Yes, come visit the NATP booth

1099 Q—What Do You Do?

- "Qualified expenses" do not include
  - Required health insurance, even if collected by the educational institution

1099 Q—What Do I Do?

- Adjusted qualified expenses
  - Start with qualified expenses as listed earlier…
- Reduce the qualified expenses by:
  - Non-taxable scholarships
  - Veteran’s benefits
  - Non-taxable employer provider assistance
  - Amounts used to calculate:
    - AOTC
    - LLC

1099 Q—What Do I Do?

- What is the maximum portion of a distribution considered taxable for federal purposes?
  - Earnings
- Always consider the state
  - Generally, if the state allowed a deduction or credit and then the funds are taken for a non-qualified reason, there is some form of recapture or income recognition

1099 Q—What Do I Do?

- Qualified and nonqualified distributions
  - Sometimes qualified are taxable? But, what is the difference?
- Qualified distributions are used appropriately
  - Used to cover qualified expenses
- Nonqualified distributions are those not used appropriately
  - The amount which exceeds the adjusted qualified expenses

1099 Q—What Do I Do?

- Qualified distributions may be taxable if:
    - Non-taxable assistance is received
    - AOTC or LLC is claimed
- These may be taxable, but not subject to the 10% penalty!
- Taxable amount is reported on Schedule 1 on its own line

1099 Q—What Do I Do?

- Nonqualified distributions are taxable
  - Exceed the amount of qualified expenses

1099 Q—What Do I Do?

- Nonqualified distributions example:
  - Harry takes a distribution from his 529 to pay his credit card balance. The distribution is $24,000 of which $2,000 are the earnings.
    - For federal purposes, only $2,000 is taxable
    - Since the funds were not used appropriately, the $2,000 is also subject to penalty
    - Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts*, is the form used to calculate the penalty
    - Taxable amount is reported on Schedule 1 on its own line

NATP

1099 Q—What Do I Do?

- Henry’s Form 5329

Part II **Additional Tax on Certain Distributions From Education Accounts and ABLE Accounts.** Complete this part if you included an amount in income, on Schedule 1 (Form 1040), line 8z, from a Coverdell education savings account (ESA) or a qualified tuition program (QTP), or on Schedule 1 (Form 1040), line 8q, from an ABLE account.

5	Distributions included in income from a Coverdell ESA, a QTP, or an ABLE account.	5	2,000
6	Distributions included on line 5 that are not subject to the additional tax (see instructions)	6	
7	Amount subject to additional tax. Subtract line 6 from line 5	7	2,000
8	**Additional tax.** Enter 10% (0.10) of line 7. Include this amount on Schedule 2 (Form 1040), line.8.	8	200

1099 Q—What Do I Do?

- Henry's Schedule 1

u	Wages earned while incarcerated	8u			
z	Other income. List type and amount: QTP Distribution	8z	2,000		
9	Total other income. Add lines 8a through 8z			9	2,000
10	Combine lines 1 through 7 and 9. Enter here and on Form 1040,1040-SR, or 1040-NR, line 8			10	2,000

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule 1 (Form 1040) 2022**

1099 Q—What Do I Do?

- **Example:** Bob received $11,000 from his 529 plan with $2,000 in earnings
  - Bob's qualified higher education costs were $5,000
  - He did not claim any education credits

1099 Q—What Do I Do?

- **Example:** Bob received $11,000 from his 529 plan with $2,000 in earnings
- The first step is to computed the ratio of qualified educational expenses over the gross distribution
  - ($5,000/$11,000 = .4545)
- The qualified (or non-taxable) amount is $909
  - ($2,000 x .4545 = $909)

1099 Q—What Do I Do?

- **Example:** Bob received $11,000 from his 529 plan with $2,000 in earnings. Qualified expenses were $5,000.
- The taxable amount is:
  - $2,000 - $909 = $1,091
  - $1,091 is reported on Schedule 1, Line 8 (z)
- Is the $1,091 subject to the penalty?
  - Yes, in addition to federal income tax, the $1,091 is subject to the 10% penalty calculated on Form 5329
- Do not forget the state impact

1099 Q—What Do I Do?

- Example: John’s Form 1099-Q gross distribution of $ 4,000, earnings of $1,500
  - Expenses:
    - $4,000 for tuition
    - $1,000 for books
    - $500 for supplies
    - $2,500 for room and board
  - Scholarship of $1,000

1099 Q—What Do I Do?

Expense	Amount
Tuition	4,000
Books	1,000
Supplies	500
Room and Board	2,500
Total qualified higher education expense	**$8,000**

1099 Q—What Do I Do?

Total Qualified Expenses	**$8,000**
Less scholarship	($1,000)
Less amt used for AOTC	($4,000)
Adjusted qual expenses	$3,000

1099 Q—What Do I Do?

Adjusted Qual Expenses	**$3,000**
Excludable earnings **(Earnings x AQHEE/gross dist)** **$1,500 x $3,000/$4,000**	$1,125
Taxable earnings	$375

1099 Q—What Do I Do?

- Where do we report the $375?
  - Schedule 1, Line 8 (z)
- Is it subject to penalty?
  - No, the distribution was used appropriately
- But why is it taxable?
  - Double dipping. We used a tax favored account to pay an expense that we also claimed a tax credit.

1099 Q—What Do I Do?

- Are there any exceptions to penalty besides the tax credit?
  - Death or disability of the beneficiary
  - Qualified expenses covered by scholarship

1099 Q—What Do I Do?

- Refund of educational expenses
  - Sometimes expenses may be refunded
    - Classes canceled, students drop out
  - Refund of expense can be deposited back into the 529 within 60 days of receipt
    - Not taxable
  - Student can open a new 529 account with the deposit

1099 Q—What Do You Do?

- Changing the beneficiary
  - Beneficiary, not account owner
  - Some states generate a Form 1099-Q
    - If so, federal does not “tax” this
    - Considered a rollover

1099 Q—What Do I Do?

- Changing the beneficiary
  - Beneficiary’s spouse
  - Son, daughter, stepchild, foster child, adopted child or a descendant of any of them
  - Brother, sister, stepbrother or stepsister
  - Father or mother or ancestor of either
  - Stepfather or stepmother
  - Son or daughter of a brother or sister
  - Brother or sister of father or mother
  - Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law
  - The spouse of any individual listed above
  - First cousin

1099 Q—What Do I Do?

- Visit the NATP booth in the Exhibit Hall to receive full copies of the John example and 529 reference material to help you with your clients!

THANK YOU!

Just for IRS Tax Forum attendees

SAVE $50 on NATP Professional level membership

Visit the NATP booth in the expo hall