

Exempt Organizations

Section 529 Programs

Notice 2001-55

This notice provides guidance to qualified tuition programs described in 529 of the Internal Revenue Code and participants in 529 programs regarding the restriction on investment direction described in 529(b)(5). This notice sets forth a special rule under which a program may permit investments in a 529 account to be changed annually and upon a change in the designated beneficiary of the account.

Section 529(b)(5) states that a program shall not be treated as a 529 program unless it provides that any contributor to, or designated beneficiary under, such program may not directly or indirectly direct the investment of any contributions to the program (or any earnings thereon). The proposed regulations under 529, which were published in the Federal Register on August 24, 1998 (63 F.R. 45019), provide that a program does not violate this requirement if it permits a person who establishes a 529 account to select among different investment strategies designed exclusively by the program, only at the time when the initial contribution is made establishing the account.

Prop. Treas. Reg. 1.529-2(g).

Several commenters on the proposed regulations suggested that permitting a participant in a 529 program to select among various broad-based investment strategies offered by a program, both at the time that contributions are made, and at certain other times, would be consistent with 529(b)(5). For example, these commenters suggested that it would be appropriate to allow a change in the investment

strategy selected for an account where there has been a significant change in market circumstances since the account was initially established, where there is a change in the designated beneficiary of an account (as permitted under 529(c)(3)(C)) and the new beneficiary has a different expected matriculation date, or where the program establishes new investment options.

The Internal Revenue Service and the Treasury Department recognize that there are a number of situations that might warrant a change in the investment strategy with respect to a 529 account. Accordingly, the Internal Revenue Service and the Treasury Department expect that the final regulations under 529 will provide that a program does not violate 529(b)(5) if it permits a change in the investment strategy selected for a 529 account once per calendar year and upon a change in the designated beneficiary of the account. It is expected that the final regulations will also provide that, to qualify under this special rule, a program must (1) allow participants to select only from among broad-based investment strategies designed exclusively by the program; and (2) establish procedures and maintain appropriate records to prevent a change in investment options from occurring more frequently than once per calendar year or upon a change in the designated beneficiary of the account. The Internal Revenue Service and the Treasury Department believe that permitting a change in investment options once per calendar year and upon a change in designated beneficiary should provide sufficient flexibility to address concerns raised by commenters.

Section 529 programs and their participants may rely on this notice pending the

issuance of final regulations under 529.

The Internal Revenue Service invites comments on the matter described in this notice and any other comments relating to 529, including the amendments made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107-16, 115 Stat. 38). Please send written comments by December 24, 2001, to: CC:ITA:RU (Notice 2001-55), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submission may be hand-delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (Notice 2001-55), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the Tax Regs option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/prod/tax_regs/regslst.html.

Comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Monice Rosenbaum of the office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Ms. Rosenbaum at (202) 622-6070 (not a toll-free number).