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Common Questions About 529 Plans

Executive Summary

University tuition costs and school-related fees such as housing, meals and books have been on an upward trajectory for the past two decades. If you have been thinking about saving for your child's or grandchild's college education, it may be time to consider a 529 plan, or qualified tuition plan. 529 plans were established by Congress to provide a tax-advantaged way to save for a child's college education. Income from assets in these plans is never taxed so long as the funds are eventually withdrawn and used for "qualified education expenses." In the past several years, the class of these expenses has been expanded to include not only college tuition but also apprenticeship fees, qualified student loan payments and $10,000 per student per year for K–12 tuition.

Here we answer some common questions about 529 plans.

Who can contribute to a 529 plan?

Anyone may contribute to a 529 plan account for one's self or another person. A contribution to a 529 account is a taxable gift for federal gift tax purposes; however, contributions up to the $15,000 annual exclusion amount per student per year may be made free of gift tax. A donor may contribute up to $75,000 free of gift tax in a single year as long as he or she files a gift tax return and elects to treat the gift as one current and four future $15,000 gifts, using the annual exclusion for the next five years. There is no federal income tax deduction for a 529 plan contribution.

Who owns the 529 account?

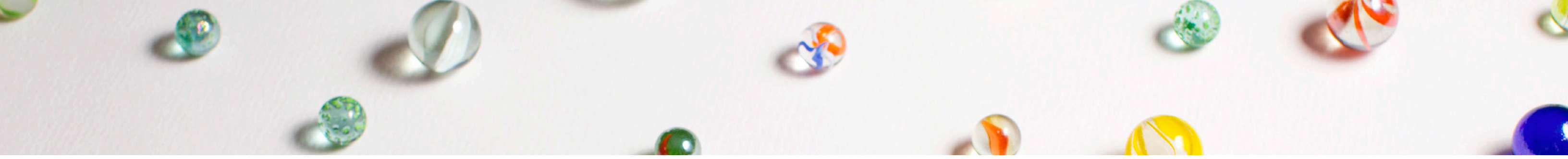
Usually the person who originally funded the account retains ownership, the power to direct the funds and the power to change the beneficiary. For both practical and tax reasons, grandparents sometimes change ownership to the student's parents or other relatives. Multiple persons may contribute to a single 529 account without changing the ownership.

What expenses can be paid from a 529 account?

Payments for qualified education expenses are not subject to federal income tax and include:

- Post-secondary tuition, fees, books, supplies and educational equipment
- The "reasonable" cost of room and board for a beneficiary enrolled at least half-time
- The cost of certain registered apprenticeship programs
- Tuition paid to a public, private or religious school for grades K–12, up to $10,000 per student per year
- Limited distributions to pay qualified student loan principal and interest

Plan distributions cannot be used to pay for travel expenses, health insurance, college applications, testing fees or room and board greater than the college's cost of attendance allowance. Distributions from 529 plans may also affect a parent's or student's ability to qualify for the American Opportunity Tax Credit or Lifetime Learning Tax Credit.



How much can be distributed to pay student loans?

Up to $10,000 can be distributed from a 529 plan to make payments to the plan beneficiary's qualified student loan. This is a lifetime limit. Additional distributions of $10,000 may be made from the 529 plan beneficiary's account to pay the qualified student loan debt of each of the beneficiary's siblings and, for these purposes, step-siblings. The $10,000 limitation applies separately to each plan beneficiary and each sibling. Student loan interest paid with tax-free 529 plan earnings is not deductible by the student or anyone else for income tax purposes.

Will the donor receive a federal or state income tax deduction for a gift into a 529 account?

There is no federal income tax deduction for the contribution, but the donor will avoid future federal income tax on income generated within the account. Withdrawals used for qualified education expenses are also tax free. Most states permit a limited state income tax deduction or tax credit if the contribution is made to a 529 plan based in-state (the amount varies widely state to state); a few states permit a deduction regardless of where the plan is based. If the 529 account owner ultimately uses a later distribution from the account for something other than a qualified education expense, the owner would likely be subject to state penalties to recapture the prior deduction, and be subject to state income tax on any portion of the payment that is untaxed income. Still, other states like California, Delaware, Kentucky, Maine and New Jersey respect the income-tax-free nature of 529 plan withdrawals but provide for no state income tax deduction for the funding. The best source for reviewing up-to-date information on your state rules is savingforcollege.com.

Are all distributions from a 529 plan free from income tax?

Withdrawals used for qualified education expenses are free from federal income tax, and most states provide the same benefit for state income tax. However, not all states have adopted the newer qualified expense categories of loan payments and K–12 tuition. As of this writing (May 2022), the states imposing income tax on withdrawals for K–12 tuition payments include California, Colorado, Hawaii, Illinois, Michigan, Minnesota, Montana, Nebraska, New Mexico, New York, Oregon and Vermont.

The states imposing income tax on withdrawals for qualified loan payments include not only all of the states identified above but also others, and the number of states remains fluid as states pass legislation to conform to the federal rules. The 529 plan owner and beneficiary should consult with local tax counsel.

What happens to 529 account funds not used for the intended beneficiary?

The owner can:

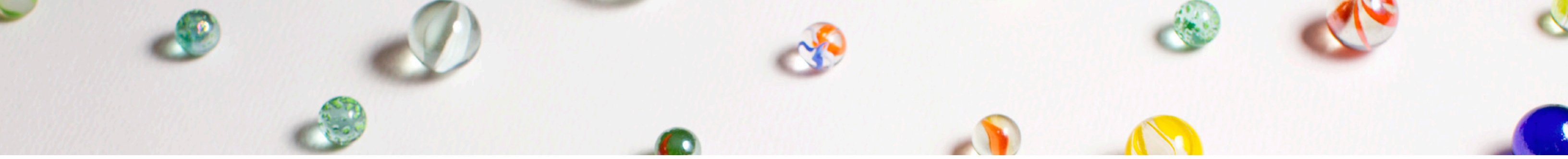
- Change the beneficiary to another qualifying family member, including him or herself
- Continue to hold the funds in the account until another beneficiary is identified
- Roll the funds over to a 529 ABLE account for a qualifying family member living with disabilities
- Withdraw the unused funds, paying income tax on the earnings portion and a 10% penalty

Where can I find more information?

In our experience, the most up-to-date information on a state-by-state basis is available on savingforcollege.com. You can also consult with your Relationship Manager, who is experienced in helping families save or pay for college in a myriad of ways, including 529 plans, family trusts and direct nontaxable, non-reportable gifts in the form of payment of tuition by a grandparent or other donor directly to a school.

Recommendation

529 plans are tax-effective vehicles that can help you avoid federal taxes if the funds are used for the purposes intended. Explore whether your state also permits a state tax credit or deduction for a gift into a 529 account and whether you can pay some or all of a beneficiary's K–12 tuition from the account.



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