529 Plans: FAQs

# Frequently Asked Questions About 529 Plans

## What are 529 plans?

Section 529 plans, named for the section of the tax code that provides for their favorable tax treatment, are formally called "qualified tuition programs." These investment programs are designed to help pay for future qualified education expenses.

There are two types of 529 plans:

1. Prepaid tuition programs allow a contributor to establish an account in the name of a student to cover the cost of a specified number of academic periods or course units in the future at current prices.
2. Savings plans allow individuals to contribute to an investment account to pay for a student's qualified education expenses.

States currently offer both of these types of plans. In addition, a group of nearly 300 private US colleges and universities offers a prepaid tuition program called the Private College 529 Plan, which allows investors to purchase discounted tuition at any of the colleges and universities that participate in the program.

## At which institutions may 529 college savings plan withdrawals be used?

Before 2017, withdrawals from 529 savings plans could be used to pay for qualified higher education expenses at any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. This included virtually all accredited public, nonprofit, and privately owned profit-making postsecondary institutions.

The new tax bill passed in 2017 expanded qualified education expenses to include tuition at a public, private, or religious elementary or secondary school.

State-sponsored prepaid plans may only cover specified costs (tuition and/or room and board) at specified state institutions; the Independent 529 program covers tuition at colleges and universities that are members of that program.

## What expenses are covered by 529 plan withdrawals?

To avoid adverse tax consequences, withdrawals from 529 plans can only be used to pay for qualified education expenses. The prepaid programs typically cover tuition and room and board.

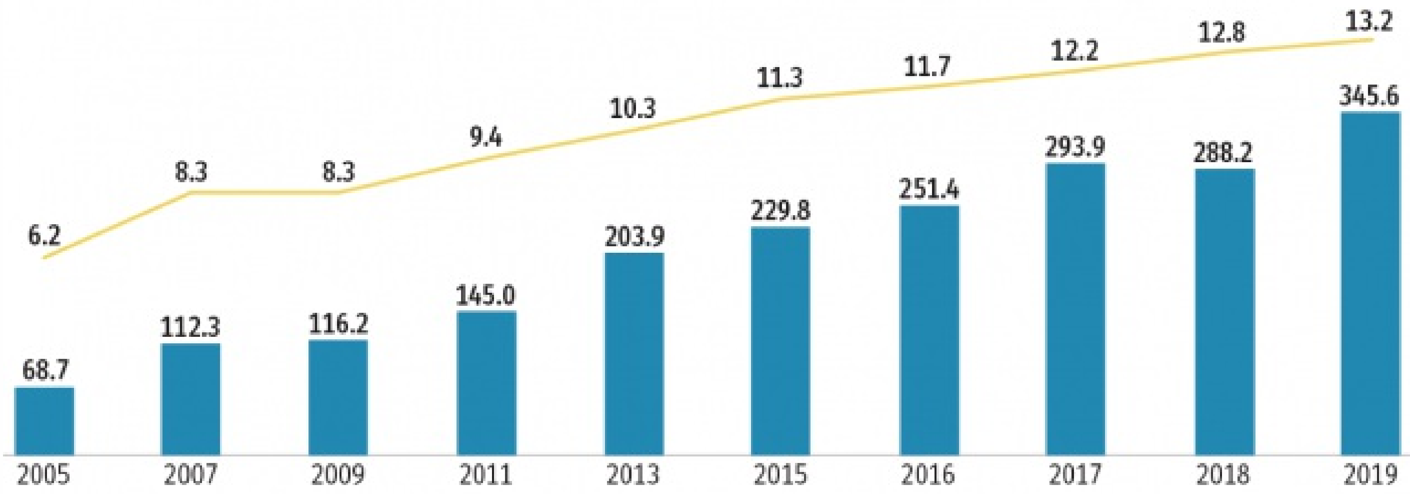
For the savings plans, qualified expenses include tuition and fees, the cost of books, supplies, and other equipment, and the cost of room and board if the designated beneficiary is at least a half-time student at an eligible educational institution. Qualified expenses also include computers, software, and internet access that will be used primarily by the student. For students in elementary or secondary school, withdrawals can be used to pay for tuition expenses, up to $10,000 per student, per year.

## How much is invested in 529 savings plans?

Since their introduction in 1996, assets in 529 plans have grown rapidly, particularly in 529 savings plans. Surveys indicate that assets held in 529 plans grew from about $133.5 billion in 2009 to $371.5 billion in 2019. Assets in 529 savings plans, which represent the majority of 529 plan assets, grew from $116.2 billion in 2009 to $345.6 billion in 2019. The number of 529 savings plan accounts also has grown, rising from 8.3 million in 2009 to 14.3 million in 2019.

**Section 529 Savings Plans**

***Year-end, selected years***




Sources: Investment Company Institute and College Savings Plans Network. See Investment Company Institute, "529 Plan Program Statistics."

## What role do mutual funds play in 529 savings plans?

When an investor invests in a 529 savings plan, she or he must select an investment vehicle from among those offered by the plan. Upon making a selection, the investor's 529 account proceeds are invested the vehicle selected. Mutual funds are the most commonly used investment vehicles in 529 savings plans.

## What is the tax treatment for 529 plan contributions and earnings?

While there is no federal income tax deduction for contributions to Section 529 plans, a number of states allow residents who participate in their own state's plan to claim a partial or full state income tax deduction on contributions. Because prepaid plans have no earnings, the tax treatment of earnings is only relevant for 529 savings programs. Earnings on 529 savings plans grow tax-free. Earnings withdrawn from 529 savings plans to pay for qualified education expenses are free from federal tax. In addition to this favorable treatment under federal law, some states provide residents with a tax break on those earnings distributions.

## Do all states offer 529 savings plans?

Currently, almost all states and Washington, DC, offer 529 savings plans. Each state with an existing plan offers various investment options specifically designed to save for education expenses. Participants may transfer 529 assets from one state's plan to another or among various plans within the same state, tax-free, once every 12 months (additional transfers may be subject to federal taxation). Determining which plan to invest in will depend on individual circumstances, taking into account several factors associated with the programs, such as fees, expenses, investment options, and performance. In addition, investors should consider their state tax consequence inasmuch as investing in the plan offered by an individual's own state might lower that individual's state income tax burden, depending on the laws of the state. Also, some states may provide additional benefits (e.g., account fee reductions or waivers) to their state's residents.

## Who can contribute to 529 plans?

Generally, an account holder can open an account on behalf of any student or potential student. For example, parents can save on behalf of a child and grandparents can save on behalf of grandchildren.

## How much can be contributed to a 529 plan?

For the state-sponsored plans, each state sets its own contribution limit, and the majority of states have set limits in excess of $200,000 per student. (These limits are typically related to the tuition charged by the state's institutions of higher education.) For the Private College 529 Plan, the limit would be based on the cost of tuition at the participating institutions. With respect to any limits under federal law, the only limits go to the amount an account holder can "gift" to the designated beneficiary without being liable for gift tax. Currently, an individual can contribute up to $15,000 in one year for each beneficiary without incurring gift taxes, or a lump sum up to $75,000 as long as no further gifts to or for that individual are made during the next five years.

## What if my child does not pursue a postsecondary education?

A 529 plan account can be held until a later date when the student may decide to attend college or transferred to any person who is a relative of the original beneficiary. Because 529 plan accounts do not expire, an investor may even decide to become the account's beneficiary in order to pursue postsecondary education at some point during his or her career or during retirement! This is permitted so long as the investor is a relative of the original beneficiary.

Alternatively, you may request a refund, and the account will be refunded according to the policy of your specific 529 plan. For savings plans, the refund would include any earnings in the account. For prepaid plans, the refund would likely be limited to any principal in the account. Under federal law, there may be income tax consequences and a refund penalty may be assessed, except for refunds resulting from the student's death, disability, or receipt of a scholarship.

## Will 529 savings plans affect a student's chance to qualify for financial aid?

Any investment may impact a student's eligibility for need-based financial aid. Financial aid treatment of investments changes through the years so it is impossible to know how assets will be treated in the future. In addition, it is uncertain as to how much or what types of financial aid will be available to families in the future.

## Where can I find more information on 529 plans?

ICI compiles statistical data on 529 plan accounts and assets, and ICI's *Investment Company Fact Book* offers information about US households' education savings. Many mutual fund company websites offer information on education savings programs they offer. Individuals seeking additional information may want to visit the US Securities and Exchange Commission, Internal Revenue Service, or College Savings Plans Network websites.

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