Texas Catholic Conference of Bishops
EDUCATION DEPARTMENT

January 2018
txcatholic.org | (512) 339-9882

529 Savings Accounts: Summary & 2018 Update

by Michael Barba, Associate Director of Public Policy

Introduction. In 2017, Congress passed a tax reform bill and the President signed it into law. At the heart of the *Tax Cuts and Jobs Act* are revisions to the income tax, but the law also expands the benefits of 529 Savings Plans. This policy brief explains 529s and the effect of reform; parents should consult a tax advisor with their questions.

Federal Tax Incentives for Education. 529 Savings Plans are one of 10 ways the federal government incentivizes saving for education.[1] Plans are administered at the state level, and offered by 48 states and Washington D.C.

Through savings programs, families pay into an investment portfolio, which often consists of mutual funds. Families generally choose an investment strategy that is either age-based or static. If age-based, portfolios gradually shift from more risky to less risky investments as the child nears college age. If static, portfolios have a constant blend of investments. Parents may withdraw funds at any time for qualified education expenses.

Qualified Education Expenses. In the past, 529 Savings Accounts could *only* be used for college expenses. Due to 2017 tax reform, 529s can now be used for Kindergarten through High School (K-12). Qualified expenses are defined as follows:

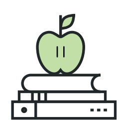
- For college, qualified expenses include tuition, fees, books, supplies, equipment required for attendance, computers, and related services.[2] There is no limit to the amount that can be spent in a year.
- For K-12, tuition is the only qualified expense, and the new tax law allows a maximum distribution of $10,000 per year from the 529.

Tax Advantages of 529 Savings. The biggest federal tax benefit of 529 Savings Programs is that all money contributed to the plan grows *tax-deferred* and can be withdrawn *tax-free* for qualified education costs.[3] Contributions to a 529 are not *deductible* on federal income tax returns. There is no federal tax *credit* for

Tax Implications of 529 Accounts

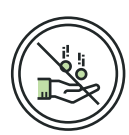
Earnings grow tax deferred.

529 earnings are not subject to income taxes. Earnings in other savings vehicles, such as mutual funds, are subject to federal income taxes.



Distributions are tax free.

There is no federal tax if savings are used for *qualified* education expenses. If savings are distributed for unqualified spending, the income tax applies and there is a 10% penalty.



After tax saving; no deduction or credit.

Savings can only be made *after* income taxes are taken out of a paycheck. There is no deduction, so saving does not reduce taxable income. There is no 529 tax credit.

No state tax incentive.

Just over 30 states offer their residents a deduction or credit on their state income tax for 529 savings. Texas has no income tax and no similar incentive.

contributions to a 529 savings account. Because Texas has no state income tax, there is no state-level incentive to contribute to a 529 savings plan.

529 Savings Advantages. There are several benefits unique to 529 Savings Programs:

- Most states hire investment or mutual fund companies to design and manage the program.
- The beneficiary of the savings can be changed to another family member at any time.[4]
- Savings with one state plan can be rolled over to another state's plan.
- There's no maximum federal contribution limit, and many plans set the maximum lifetime contribution limit at $300,000.
- Parents have full ownership over the account and make all decisions, including when or if to withdraw the savings and what to use it for.

529 Savings Disadvantages. There are several disadvantages unique to 529 Savings Programs:

- The investment or mutual fund companies that manage 529 programs charge fees.
- If distributions from the account are not qualified expenses, the federal government taxes the distribution as ordinary income and subjects the distribution to a 10 percent penalty.
- Fund rules, fees, and investment options can change at any point.[5]
- Investment options may be changed twice per year, or when the beneficiary is changed.

The Texas Catholic Conference of Bishops (TCCB) is a federation of all Roman Catholic dioceses and ordinariates located in the State of Texas. Through the TCCB, all dioceses and ordinariates share in the expenses of joint activities that extend the ministry of the Texas bishops.

Endnotes.

1. Savingforcollege.com, *Family Guide to College Savings*, p. 9-10. For example, there are three different kinds of 529s: qualified tuition programs, Coverdells, and ABLEs. This brief is limited in its discussion to the first type. For more detailed analysis, see *Family Guide*, p. 13-21.

2. This includes software and internet access fees. Another type of savings program, the 529 ABLE Account, is for children with disabilities, and permits expenditures for basic living expenses, job training, and healthcare. For more information, see the *Family Guide*, p. 21.

3. If savings are not disbursed for qualified education costs, then the federal government taxes the disbursement as ordinary income and subjects the disbursement to a 10 percent penalty.

4. When a 529 Savings Plan is established, the adult saver (usually parents) names the child for whom the fund is established.

5. If parents do not approve of the changes, but want to keep saving in a 529, they can roll over their account to another 529 plan without any federal tax penalty.