

Section 529 Plans

A Family Guide to Education Savings, Qualified Expenses & Smart Withdrawals

The big idea: A 529 plan can do much more than pay college tuition. Used correctly, it can cover a broad range of education costs while earnings grow tax-deferred and qualified withdrawals are federal income-tax free.

Compliments of Lenny G. Letcher, EA, RFC

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This guide is for general education. Tax rules change, and the best use of a 529 plan depends on the facts. Keep your records and coordinate 529 withdrawals with scholarships, education credits and other education benefits.

1. What Is a Section 529 Plan?

A Section 529 qualified tuition program is designed to help families save and pay for education in a tax-advantaged way. There are generally two types: college savings plans and prepaid tuition plans. Contributions are made with after-tax dollars. Earnings grow tax-deferred, and withdrawals are federal income-tax free to the extent they are used for qualified education expenses.

There is no federal income-tax deduction for making a contribution. State tax treatment can vary by state and by plan.

2. What Can the Money Pay For?

Expense	General 529 Treatment
College tuition & required fees	Generally qualified at an eligible higher-education institution.
Books, supplies & equipment	Qualified when they meet the applicable education rules.
Computers & internet access	Can qualify when used primarily by the beneficiary while enrolled.
Special-needs services	Certain education-related services for a student with disabilities can qualify.
Room & board	Can qualify for a student enrolled at least half-time, subject to applicable limits.
Registered apprenticeships	Required fees, books, supplies and equipment can qualify.
Student loans	Up to \$10,000 lifetime may be used for qualified student-loan principal and interest, subject to the rules.
Postsecondary credentials	Certain recognized postsecondary credentialing expenses are qualified under the 2025 law changes.

Room-and-board rule: For higher education, the student generally must be enrolled at least half-time. The qualified amount is limited by the school's applicable cost-of-attendance allowance or, for school-owned or operated housing, the actual amount charged.

3. K-12 Education: The Rules Expanded

For years after 2017, 529 plans could be used for limited K-12 tuition. The 2025 law expanded the rules. Effective after July 4, 2025, the course material states that the annual amount increased to \$20,000 and eligible K-12 expenses expanded beyond tuition.

- Curriculum and curricular materials
- Books and other instructional materials
- Online educational materials
- Tutoring or educational classes outside the home
- Testing fees
- Dual-enrollment fees at an institution of higher education
- Educational therapies for students with disabilities

Not included: Room and board for an elementary or secondary school student is not a qualified 529 expense.

4. The 1099-Q: Why the Paperwork Matters

When a 529 distribution is made, the plan administrator generally issues Form 1099-Q. If payment is made directly to the beneficiary or an educational institution, the beneficiary is generally listed as the recipient. Otherwise, the account owner may be listed.

A 529 withdrawal is treated as containing a pro-rata share of contributions and earnings. Your original contributions are a return of after-tax money; the earnings portion is where taxable income and penalties can arise if the withdrawal exceeds adjusted qualified education expenses.

Keep more than the tax form: A Form 1098-T or 1099-Q may be an important starting point, but families should also retain tuition statements, receipts, proof of payment, scholarship records, books and supplies receipts, computer costs, and room-and-board documentation.

5. Avoid the Double Dip

The same education expense cannot be used twice. A family may be able to use a 529 plan and also claim an American Opportunity Credit or Lifetime Learning Credit for the same student in the same year, but not for the same dollars of expense. Tax-free scholarships and similar assistance also reduce the expenses available to support a tax-free 529 distribution.

Planning opportunity: Before taking the final 529 withdrawal for the year, coordinate tuition, scholarships, grants and education credits. A little year-end arithmetic can prevent part of the 529 earnings from becoming taxable.

6. What Happens If Too Much Is Withdrawn?

If a distribution exceeds adjusted qualified education expenses, only the appropriate portion of the earnings becomes taxable. The taxable earnings may also be subject to a 10% additional tax unless an exception applies.

Example: Assume a \$5,300 distribution includes \$950 of earnings, but only \$1,200 of adjusted qualified education expenses remain. The excess distribution is \$4,100. The taxable earnings are computed as $\$950 \times (\$4,100 / \$5,300)$, or approximately \$735.

Refund from the school? If qualified higher-education expenses are refunded - for example, after a class is dropped - the course explains that the refunded amount can generally be recontributed to a 529 plan for that beneficiary within 60 days, subject to the applicable rules.

7. What If the Child Doesn't Need All the Money?

Unused money does not automatically mean the family is trapped. Depending on the facts, the account owner may be able to change the beneficiary, roll funds to another 529 plan, make an eligible ABLE rollover, or use the SECURE 2.0 Roth IRA rollover provision.

529 to Roth IRA - A Major Planning Tool

- Lifetime rollover limit: up to \$35,000 for the beneficiary.
- The 529 account must have been open for more than 15 years.
- The rollover is subject to the annual Roth IRA contribution limit.
- Amounts contributed to the 529 during the previous five years cannot be rolled over.
- The provision applies to qualifying distributions after December 31, 2023.

Why families care: This provision can reduce the fear of 'overfunding' a child's 529 account. It does not eliminate the rules, but it creates another potential destination for qualifying leftover funds.

8. 529 to ABLE Account Rollovers

A qualifying 529 distribution can be rolled to an ABLE account of the designated beneficiary or an eligible family member. Under the course material, the funds must be contributed to the ABLE account within 60 days, and the rollover plus other contributions subject to the annual limit cannot exceed the applicable ABLE contribution maximum. The 2025 law made this rollover provision permanent.

9. Grandparents & Large Contributions

529 plans can also be useful in gift and estate planning. A contribution is generally treated as a completed gift to the designated beneficiary, even though the account owner retains important control over the account.

The Five-Year Election

A donor who contributes more than the annual gift-tax exclusion may elect to spread an eligible 529 contribution - up to five times the annual exclusion - ratably over five years for gift-tax purposes. Form 709 is used to make the election and requires an explanation.

Important: The five-year election is a gift-tax reporting strategy, not permission to ignore Form 709. Large contributions should be coordinated with your tax professional.

10. Direct Tuition Payments: A Different Gift-Tax Rule

A donor can generally pay tuition directly to a qualifying educational institution without a specific dollar limit under the separate gift-tax tuition exclusion. This direct-payment exclusion applies to tuition - not books, room and board or reimbursements paid to the student.

That creates a potential planning combination for grandparents: use 529 funds for other qualified costs and, when appropriate, pay tuition directly to the institution.

11. Changing the Beneficiary

The account owner generally retains control and can change the designated beneficiary. The course explains that changing or rolling the account to a new beneficiary generally avoids a taxable gift when the new beneficiary is a family member of the old beneficiary and is in the same generation. Moving to a lower generation can create additional gift- or generation-skipping-transfer considerations.

12. Family Year-End Checklist

- ☐ Gather the year's Forms 1098-T and 1099-Q.
- ☐ Total tuition, required fees, books, supplies, equipment and other qualifying costs.
- ☐ Document room and board and verify half-time enrollment when applicable.
- ☐ Subtract tax-free scholarships, grants and other nontaxable education assistance.
- ☐ Reserve expenses being used for the American Opportunity or Lifetime Learning Credit.
- ☐ Match 529 distributions to the remaining qualified expenses.
- ☐ Keep receipts and proof of payment with the tax records.
- ☐ Before taking a nonqualified withdrawal, consider beneficiary changes, rollovers, ABLE options or a qualifying Roth IRA rollover.

Lenny's Take: The 529 plan is no longer just a 'college tuition account.' It can be a flexible family education and planning tool - but the tax-free result depends on matching the withdrawal to the right expense, in the right amount, with the right records.

A Final Word

Education planning often involves several tax rules at the same time. Before making a large contribution, changing beneficiaries, taking a year-end distribution, or coordinating a 529 plan with an education credit, talk with your tax professional about the complete picture.

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