Advisor Article

An Overview of 529 Savings Account Plans

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Introduction

A 529 savings plan is one of the most effective tools available to families who want to save for future education expenses while taking advantage of favorable tax treatment. These plans are designed to encourage long-term savings for education by allowing contributions to grow tax-deferred and withdrawals to be made tax-free when used for qualified education expenses.

Although 529 plans are commonly associated with college savings, their usefulness extends beyond traditional four-year universities. Depending on applicable rules, funds may be used for vocational schools, certain apprenticeship programs, K–12 education expenses, graduate school, and other qualifying educational purposes.

Understanding contribution limits, tax advantages, funding strategies, beneficiary rules, and distribution guidelines can help families determine how to incorporate a 529 plan into their broader financial and estate planning strategies.

Contribution Limits and Funding Rules

One of the most attractive features of a 529 plan is its flexibility regarding contributions. Unlike retirement accounts, 529 plans do not have a federally established annual contribution limit. Instead, each state establishes an aggregate account balance limit, which generally ranges from approximately $235,000 to more than $600,000 per beneficiary, depending on the plan. Once the account reaches the state's maximum balance, additional contributions may be restricted until the balance falls below the limit.

There are no federal income restrictions on who can contribute to a 529 plan or who can be named as a beneficiary. Parents, grandparents, relatives, friends, and even the beneficiary can contribute.

Gift tax considerations. Although there is no federal annual contribution limit, contributions are generally considered completed gifts to the beneficiary for federal gift tax purposes. For 2026, the annual gift tax exclusion is $19,000 per recipient, per donor. This means:

- An individual can contribute up to $19,000 per beneficiary in 2026 without using any of their lifetime gift and estate tax exemption.
- A married couple can collectively contribute $38,000 per beneficiary, assuming both spouses qualify for the exclusion.
- Contributions exceeding the annual exclusion may require the donor to file a federal gift tax return (Form 709), although filing does not necessarily mean gift tax is owed.

The five-year gift tax election. A particularly useful provision allows individuals to contribute up to five years of annual gift tax exclusions to a 529 plan in a single year. For 2026, this permits an individual to contribute up to $95,000 per beneficiary ($190,000 for a married couple) and elect to spread the gift equally over five years for gift tax purposes.

This strategy, commonly referred to as front-loading, can be especially beneficial for grandparents or parents who want to transfer assets into a child's education account early to allow more time for the contributions to grow on a tax-advantaged basis. Donors making this election must be mindful of other gifts made to the same beneficiary during the five-year period. Additional gifts may use some of the available annual exclusions. The election is also subject to special estate tax rules if the donor dies before the five-year period ends.

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Tax Treatment of 529 Plans

The primary advantage of a 529 plan is its favorable federal income tax treatment.

Tax-deferred growth. Contributions are made with after-tax dollars and are not deductible on the federal income tax return. However, investment earnings grow tax-deferred. This allows interest, dividends, and capital appreciation to accumulate without annual federal income taxation.

Tax-free qualified distributions. Withdrawals from 529 accounts are completely free of federal income tax when used for qualified education expenses.

State income tax benefits. Many states offer additional tax incentives for contributing to their sponsored 529 plans. Depending on the state, residents may qualify for a state income tax deduction or credit. Some states require residents to use their home-state plan to receive the benefit, while others allow deductions for contributions to any state's plan.

Tax consequences of nonqualified withdrawals. If money is withdrawn for expenses that do not qualify under 529 rules, the earnings portion of the withdrawal is generally subject to ordinary income tax and a 10% federal additional tax. The original contributions are not taxed again because they were made with after-tax dollars.

There are exceptions to the 10% additional tax, including certain distributions associated with scholarships, a beneficiary's death or disability, and attendance at a U.S. military academy. However, the earnings portion may still be taxable.

Funding Strategies for 529 Plans

A sound funding strategy should balance education savings with other financial priorities, including retirement savings, emergency reserves, and outstanding debt. Parents should avoid sacrificing their own retirement security to fund a child's education.

The earlier a family begins saving, the more opportunity the account has to benefit from compounding investment returns. Several strategies can help families maximize the value of their 529 plans.

Start early and contribute consistently. Establishing an account when a child is young provides a longer investment horizon. Even relatively modest monthly contributions can accumulate into meaningful savings over 15 to 18 years. Automatic monthly contributions can make saving easier and help establish a disciplined approach.

Make lump-sum contributions. Families with available cash or investment assets may choose to make larger contributions rather than funding the account gradually. The five-year gift tax election can make this particularly attractive for individuals who want to contribute substantial amounts while managing their annual gift tax exclusions.

Involve grandparents and other family members. Grandparents can establish their own 529 plans or contribute to an existing account. This provides an opportunity to help fund education while transferring assets outside their taxable estates under the applicable rules. Family members can also contribute as part of birthday, holiday, or graduation gifts.

Consider multiple beneficiaries. Parents with several children may establish separate accounts for each child or use one account and change the beneficiary when appropriate. Separate accounts are recommended when the children are likely to need the funds during

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the same year, as only one beneficiary may use 529 funds within a calendar year for qualified expenses.

Review investment selections over time. Most 529 plans offer age-based investment portfolios that automatically become more conservative as the beneficiary approaches college age. Families may also choose individual investment portfolios based on their risk tolerance and time horizon. Generally, the longer the investment period, the greater the opportunity to accept market risk, although investment losses are possible.

Beneficiary Rules and Account Ownership

A 529 plan has two important parties: the account owner and the designated beneficiary.

The account owner generally maintains control over the account, selects investments, determines when distributions are made, and can change the beneficiary subject to applicable rules. The account owner also retains control over unused funds and is not required to distribute the assets to the beneficiary.

The designated beneficiary is the individual for whose benefit the account was established. This is typically a child or grandchild, although an adult can establish an account for themselves.

One of the most valuable features of 529 plans is the ability to change the beneficiary. If the original beneficiary does not need all of the funds, the account owner can generally transfer the balance to another eligible family member without federal income tax or gift tax consequences. Eligible family members include siblings, parents, children, grandchildren, spouses, nieces, nephews, aunts, uncles, first cousins, and certain other relatives defined under the tax code.

For example, if one child receives a scholarship or decides not to attend college, the remaining account balance could be transferred to a sibling who plans to pursue higher education. However, beneficiary changes involving individuals in a lower generation may create gift or generation-skipping transfer tax considerations. Families should consult a tax professional before making beneficiary changes involving grandchildren or other younger generations.

Roth IRA rollover opportunity. Another important option for unused 529 funds is the ability to transfer eligible funds directly into a Roth IRA for the designated beneficiary. Under current federal rules, the account must generally have been open for at least 15 years, and the rollover is subject to a $35,000 lifetime limit, annual Roth IRA contribution limits and other requirements, including restrictions on recent contributions and earnings. The beneficiary must also have sufficient eligible compensation.

This provision offers families an additional way to preserve the value of education savings if the beneficiary does not need all of the funds for school.

Distribution Guidelines and Qualified Education Expenses

The tax advantages of a 529 plan depend on how the money is ultimately distributed and used. Families should understand which expenses qualify before making withdrawals.

Qualified higher education expenses. For eligible colleges, universities, vocational schools, and other qualifying postsecondary institutions, tax-free distributions may generally be used for:

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- Tuition and required enrollment fees.
- Books, supplies, and required equipment.
- Computers, computer software, and internet access used primarily by the beneficiary during enrollment.
- Room and board, provided the student is enrolled at least half-time and the expenses do not exceed the applicable cost-of-attendance allowance established by the institution.
- Certain expenses associated with students who have special needs.

These provisions make 529 plans useful for a broad range of higher education-related costs, not simply tuition.

K–12 education expenses. Recent legislation has expanded the use of 529 funds for elementary and secondary education. Beginning in 2026, eligible K–12 expenses include:

- Tuition at public, private, and religious schools.
- Curriculum and instructional materials.
- Required books and online educational materials.
- Certain tutoring and educational classes.
- Fees for standardized achievement tests, Advanced Placement examinations, and college admission examinations.
- Certain dual-enrollment fees.
- Qualifying educational therapies for students with disabilities.

The annual aggregate distribution limit for these K–12 expenses is $20,000 per beneficiary across all 529 accounts for the 2026 tax year. This is an important expansion of the flexibility previously available to families using 529 plans.

Apprenticeship programs. Funds may also be used for certain expenses associated with apprenticeship programs registered and certified with the U.S. Department of Labor. Qualifying expenses include required fees, books, supplies, and equipment.

Student loan repayment. A 529 plan may be used to repay qualified student loans belonging to the beneficiary or an eligible sibling. However, the lifetime amount of qualified 529 distributions for student loan repayment is limited to $10,000 per individual.

Nonqualified distributions. If funds are withdrawn for purposes that do not meet the applicable requirements, the earnings portion of the withdrawal is generally taxable to the recipient and subject to the additional 10% federal tax. For example, using 529 funds to pay for a car, ordinary living expenses unrelated to qualifying room and board, or other personal expenses would generally be considered nonqualified.

Important distribution considerations

Families should follow several guidelines when taking withdrawals:

1. Match distributions to qualified expenses incurred during the same tax year.
2. Maintain receipts, tuition statements, housing records, and other documentation supporting the expenses.
3. Coordinate 529 withdrawals with scholarships, grants, and education tax benefits.

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4. Avoid using the same education expense to justify both a tax-free 529 distribution and an education tax credit.
5. Ensure distributions are made to the account owner, beneficiary, or eligible educational institution in accordance with the plan's procedures.

For example, families may be able to pay some college expenses out of pocket to qualify for an education tax credit while using 529 funds for other eligible expenses. Proper coordination can help maximize the overall tax benefits available.

Summary

529 savings plans provide families with an effective and flexible way to prepare for future education expenses. Their tax-free growth potential, favorable gift tax provisions, flexible beneficiary rules, and expanded qualified distribution guidelines make them an important component of many families' financial and estate planning strategies.

The ability to contribute substantial amounts, take advantage of the five-year gift tax election, involve grandparents and other family members, and potentially transfer unused funds to a Roth IRA provides flexibility that extends well beyond traditional college savings.

However, a 529 plan should be evaluated within the context of a family's overall financial situation. Investment costs, state tax incentives, anticipated education expenses, financial aid considerations, and other savings priorities should all be considered before determining how much money to contribute.

With proper planning and ongoing review, 529 plans can help families reduce the financial burden of education while providing meaningful tax advantages and opportunities to transfer wealth to future generations.

Important: Tax laws and individual state 529 plan provisions can change. Families should review their plan documents and consult with their financial advisor and tax professional before making significant contributions, beneficiary changes, or distributions.

Resources

The following resources provide additional information on 529 plan rules and tax treatment:

1. IRS Publication 970 – Tax Benefits for Education.
2. Internal Revenue Code Section 529 – Qualified Tuition Programs. Includes the 2026 K–12 expense provisions and other statutory rules.
3. IRS – Frequently Asked Questions on Gift Taxes. Includes the 2026 annual gift tax exclusion and five-year gifting considerations.
4. IRS Tax Topic 313 – Qualified Tuition Programs. Includes distribution, student loan repayment, and Roth IRA rollover guidelines.

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