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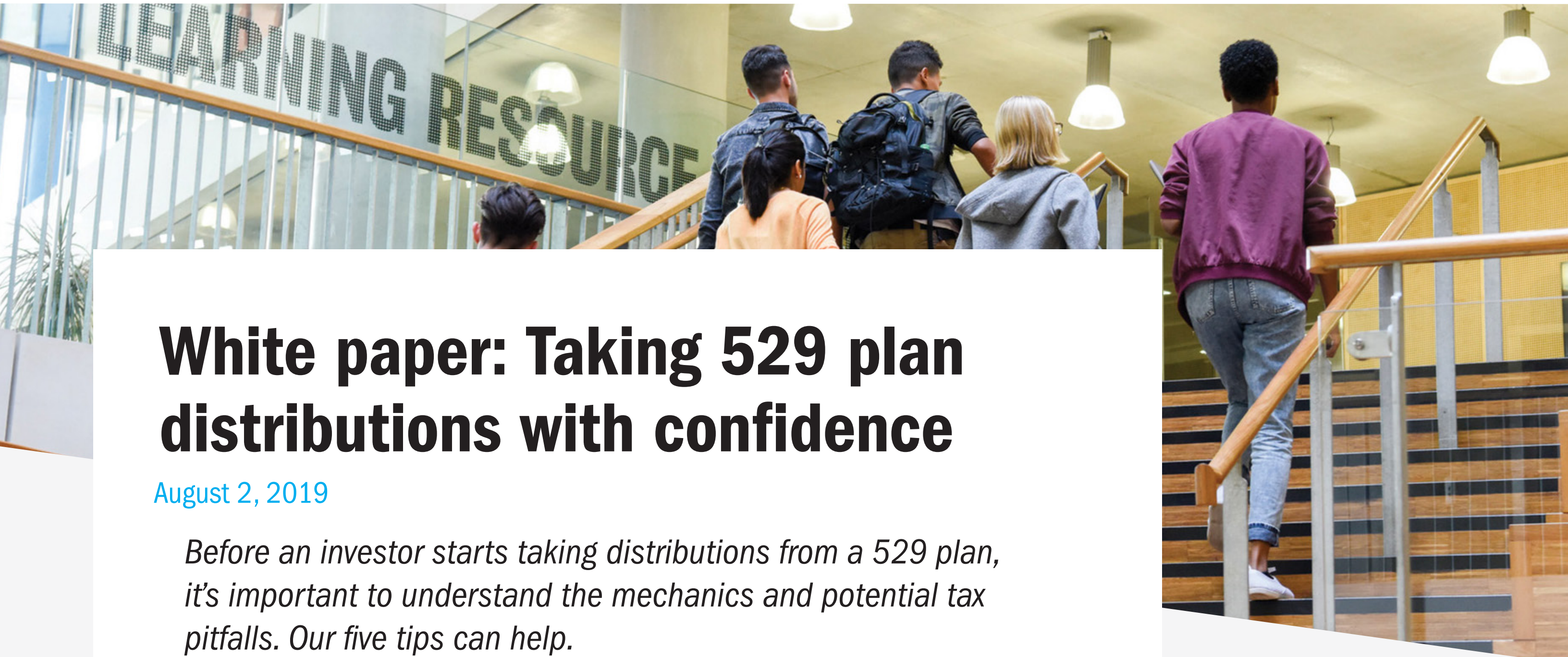


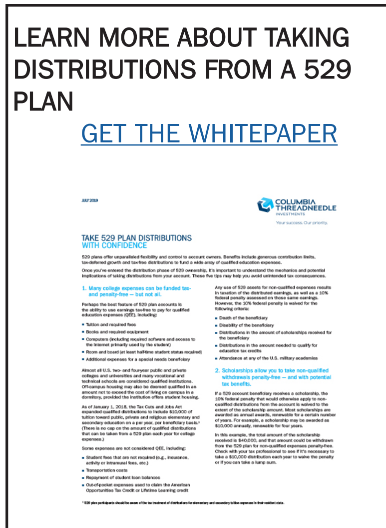
White paper: Taking 529 plan distributions with confidence

August 2, 2019

Before an investor starts taking distributions from a 529 plan, it's important to understand the mechanics and potential tax pitfalls. Our five tips can help.

529 plans offer many well-known benefits, including generous contribution limits, tax-deferred growth and tax-free distributions to fund qualified education expenses.

But the mechanics of 529 plan distributions can be confusing for account owners. These five tips may help investors avoid unintended tax consequences, and in some cases, even help account owners and beneficiaries take advantage of little-known tax benefits.


LEARN MORE ABOUT TAKING DISTRIBUTIONS FROM A 529 PLAN

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TAKE 529 PLAN DISTRIBUTIONS WITH CONFIDENCE

1. Many college expenses can be funded tax- and penalty-free — but not all.

Account owners can use earnings tax-free to pay for qualified education expenses at qualified institutions, including tuition, fees, books, computers and room and board. But using earnings for non-qualified expenses may result in taxation plus a 10% federal penalty. Knowing what isn't considered qualified is critical.

2. Scholarships allow account owners to take non-qualified withdrawals penalty-free.

If an account beneficiary receives a scholarship, the 10% federal penalty that would otherwise apply to non-qualified distributions from the account is waived. And there's also some flexibility around how much can be withdrawn each year.

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3. The IRS will send a 1099-Q, but that doesn't always mean you owe taxes.

All distributions from a 529 plan result in the generation of a 1099-Q, sent to the recipient of the distribution (either the education institution, the designated beneficiary or the account owner). A tax professional can help the recipient determine whether the withdrawal is considered a qualified distribution and what the tax consequences may be.

4. Be careful how much you withdraw in anticipation of future expenses.

Qualified distributions from 529 plans should be taken in the same taxable year the expense was incurred. But distributions don't need to be taken prior to, or in direct relation to, specific expenses. Account owners can easily reimburse themselves for expenses paid throughout the year with one distribution. But they should be mindful not to withdraw too much money in case expenses do not materialize — excess withdrawals usually can't be put back in the same beneficiary's 529 account.

5. 529A accounts offer special opportunities for people with disabilities and their families.

The Achieving a Better Life Experience (ABLE) Act and 529A accounts now allow individuals with disabilities to take advantage of 529 and 529A account saving strategies. ABLE accounts can be used tax-free to pay for any disability-related expenses. And certain investing strategies can help account owners take full advantage of ABLE accounts, beyond the $15,000 annual funding limit.

Bottom line

There's a lot of education on how to fund 529 plan accounts — how much to invest, gifting limits, etc. But knowing how and when to take 529 plan distributions can be just as important to participants. And understanding the mechanics and options can make for an easier experience, with fewer tax consequences.

To find out more, call 800.426.3750
or visit columbiathreadneedle.com

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