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New tax law brings big changes to 529 plans

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Just in time for the holidays, President Trump kept his promise to the American people by signing the Republican tax reform bill. The Tax Cuts and Jobs Act brings major changes to corporate and personal tax rates and deductions. The plan also includes a smaller provision that will expand the benefits of 529 savings plans:

Allowing 529 plans to be used for K-12 education expenses

529 plans are tax-advantaged investment accounts originally designed to help families pay for college. The earlier you start saving, the greater you will benefit from tax-free compounding. Currently, 529 withdrawals are tax-free as long as the funds are spent

toward qualified higher education expenses, which include tuition, room and board, and computer software and equipment at any eligible post-secondary institution.

With the new tax bill, parents who send their children to private elementary and high school will have more options when it comes to saving for tuition. Up until now, the only vehicles that offered tax-free savings for K-12 were Coverdell Education Savings Accounts (ESAs). With tax-free earnings growth and tax-free withdrawals for qualified purchases, Coverdell ESAs operate very similar to a 529 savings plan. There are, however, a few key differences:

	Coverdell ESA
Income Limits	Individuals must earn less than $110,000 ($220,000 if married filing jointly) to be eligible
Contribution Limits	$2,000 per year, per beneficiary
Contribution Deadline	Contributions must be made before the beneficiary turns 18
Account Time Limit	Funds in the account must be used by the time the beneficiary turns 30, unless the beneficiary special needs

The GOP Tax bill would allow 529 plans to be used for up to $10,000 per year in K-12 expenses, giving more families an opportunity to save tax-free for private and religious schools. Families who are currently saving with a Coverdell ESA and want to switch to a 529 plan can do a rollover with no tax consequences.

With a shorter time horizon, you might not see much of a federal tax benefit from using a 529 to pay for elementary school, but you could be eligible for a state tax break. Currently, over 30 states offer a deduction or credit for contributions to a 529 plan. The amount of the potential benefit varies by state, but deduction limits range from $500 per year (for an individual) to the total amount of the contribution. Some states also allow residents to carry forward any excess contributions above the limit to future tax years. Generally, you have to use your home state's plan to qualify for the deduction or credit, but residents of Arizona, Kansas, Minnesota, Missouri, Montana and Pennsylvania may be eligible for a tax deduction for contributions to any state's 529 plan.

If you're already using a 529 plan to save for college, consider opening an additional account to save for K-12. This will help you keep better track of each goal, and select the appropriate investments based on your withdrawal schedule.

ABLE account rollovers

The Republican tax plan also allows existing 529 savings plans to be rolled into 529 ABLE accounts. ABLE accounts were first introduced in 2014, to help Americans living with disabilities save for education and other living expenses. Prior to the ABLE Act, if a person with a disability earned more than $700 per month, or had $2,000 or more in savings, they risked having to forfeit eligibility for public benefits like Medicaid. Like traditional 529 plans, ABLE accounts offer tax-free investment growth and tax-free withdrawals when the funds are used to pay for qualified expenses. For ABLE accounts, this includes things like college, job training, and healthcare and financial management.

In some cases, parents start saving for their child's college education in a traditional 529 plan, and later learn that the child has a disability. Before now, these parents had limited options, since taking a distribution from the 529 plan to fund an ABLE account would have been considered a non-qualified withdrawal – triggering income tax and a 10% penalty on the earnings portion. 27 states currently offer ABLE plans, each with their own fee structure and investment options. Some plans also offer a debit or purchasing card for everyday expenses.

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