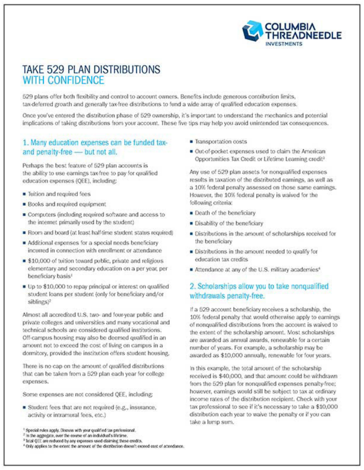
Build confidence taking 529 plan distributions

June 26, 2023

529 plan distributions can be confusing. And knowing how — and when — to take them can be critical for participants.

529 college savings plans are tax-advantaged accounts designed to pay for qualified education expenses, but the mechanics and implications of taking distributions from 529 plan accounts can be confusing. It's particularly important to know the difference between qualified education expenses — which can be funded tax- and penalty-free — and non-qualified education expenses. Any use of 529 plan assets for nonqualified expenses could result in taxation of the distributed earnings, as well as a 10% federal penalty.

Our paper on the subject can help clear up confusion for 529 investors and beneficiaries, including explaining qualified and non-qualified expenses, tax form 1099-Q and how to think about timing of distributions. There has been meaningful progress for individuals with disabilities and their families with the development of 529A accounts, also known as ABLE accounts, which can be used tax-free to pay for any disability-related expenses.



COLUMBIA THREADNEEDLE INVESTMENTS

TAKE 529 PLAN DISTRIBUTIONS WITH CONFIDENCE

529 plans offer both flexibility and control to account owners. Benefits include generous contribution limits, tax-deferred growth and generally tax-free distributions to fund a wide array of qualified education expenses.

Once you've entered the distribution phase of 529 ownership, it's important to understand the mechanics and potential implications of taking distributions from your account. These five tips may help you avoid unintended tax consequences.

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

Perhaps the best feature of 529 plan accounts is the ability to use earnings tax-free to pay for qualified education expenses (QEE), including:

- Tuition and required fees
- Books and required equipment
- Computers (including required software and access to the internet primarily used by the student)
- Room and board (at least half-time student status required)
- Additional expenses for a special needs beneficiary incurred in connection with enrollment or attendance
- $10,000 of tuition toward public, private and religious elementary and secondary education on a per year, per beneficiary basis[1]
- Up to $10,000 to repay principal or interest on qualified student loans per student (only for beneficiary and/or siblings)[2]

Almost all accredited U.S. two- and four-year public and private colleges and universities and many vocational and technical schools are considered qualified institutions. Off-campus housing may also be deemed qualified in an amount not to exceed the cost of living on campus in a dormitory, provided the institution offers student housing.

There is no cap on the amount of qualified distributions that can be taken from a 529 plan each year for college expenses.

Some expenses are not considered QEE, including:

- Student fees that are not required (e.g., insurance, activity or intramural fees, etc.)
- Transportation costs
- Out-of-pocket expenses used to claim the American Opportunities Tax Credit or Lifetime Learning credit[3]

Any use of 529 plan assets for nonqualified expenses results in taxation of the distributed earnings, as well as a 10% federal penalty assessed on those same earnings. However, the 10% federal penalty is waived for the following criteria:

- Death of the beneficiary
- Disability of the beneficiary
- Distributions in the amount of scholarships received for the beneficiary
- Distributions in the amount needed to qualify for education tax credits
- Attendance at any of the U.S. military academies[4]

2. Scholarships allow you to take nonqualified withdrawals penalty-free.

If a 529 account beneficiary receives a scholarship, the 10% federal penalty that would otherwise apply to earnings of nonqualified distributions from the account is waived to the extent of the scholarship amount. Most scholarships are awarded as annual awards, renewable for a certain number of years. For example, a scholarship may be awarded as $10,000 annually, renewable for four years.

In this example, the total amount of the scholarship received is $40,000, and that amount could be withdrawn from the 529 plan for nonqualified expenses penalty-free; however, earnings would still be subject to tax at ordinary income rates of the distribution recipient. Check with your tax professional to see if it's necessary to take a $10,000 distribution each year to waive the penalty or if you can take a lump sum.

[1] Special rules apply. Discuss with your qualified tax professional.
[2] In the aggregate, over the course of an individual's lifetime.
[3] Total QEE are reduced by any expenses used claiming these credits.
[4] Only applies to the extent the amount of the distribution doesn't exceed cost of attendance.

Get the white paper

Knowing how and when to take 529 plan distributions can be a critical consideration for participants. And understanding the mechanics and options can make for an easier experience with fewer tax consequences. Few financial vehicles provide account owners with as much flexibility and control as 529 plans, and fortunately those benefits extend to distributions.

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

Columbia Management Investment Advisers, LLC is an investment adviser registered with the U.S. Securities and Exchange Commission.

Columbia Threadneedle Investments (Columbia Threadneedle) is the global brand name of the Columbia and Threadneedle group of companies.

The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Management Investment Advisers, LLC (CMIA) associates or affiliates. Actual investments or investment decisions made by CMIA and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be appropriate for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Since economic and market conditions change frequently, there can be no assurance that the trends described here will continue or that any forecasts are accurate.

CTBP0K0 (06/23) 5714283