A Parent's Guide to 529 Plan Distributions

Wealth Planning

Are your children in grades K-12 attending a private school? Is your child heading to college or pursuing vocational training? If you've been funding a 529 Plan, it may be time to start utilizing those savings. However, before taking distributions, consider the following questions to help maximize your 529 Plan's benefits and avoid common pitfalls.

What is the benefit of a 529 Plan?

Contributions to a 529 Plan grow tax free so long as the funds are ultimately distributed to pay for the beneficiary's qualified education expenses. Originally limited to postsecondary education, the Tax Cuts and Jobs Act of 2017 explanded 529 Plans to cover up to $10,000 annually of K-12 tuition. The One Big Beautiful Bill Act (OBBBA) of 2025 increased this limit to $20,000 per year starting in 2026 and also broadened the scope of "qualified expenses" for both K-12 and post-secondary education.

It is important to note that some states have not updated their definitions of qualified expenses to match the federal definition, including the OBBBA expansions. To avoid adverse tax consequences, be sure to consult with your qualified tax professional about your state's laws prior to using your 529 Plan.

What education expenses can be covered by a 529 Plan?

For K-12, qualified expenses were initially limited to tuition, but, under the OBBBA (effective after July 4, 2025), now include, but are not limited to:

- Tuition (up to $10,000 annually through 2025; $20,000 starting in 2026)
- Curriculum and curriculum materials
- Books or other instructional materials
- Online educational materials
- Tuition for tutoring or educational classes outside of the home
- Standardized test fees
- Educational support services (therapy, tutoring, etc.)

For postsecondary education, qualified expenses are broader and further expanded by the OBBBA, including:

- Tuition and fees
- Books
- Supplies (including computers, software, and internet access)
- Room and board, limited to the greater of:
  1) The allowance for room and board included in the school's cost of attendance for federal financial aid calculations; or
  2) The actual amount charged if the student is living in housing operated by the educational institution.
- Expenses related to registered apprenticeship programs including fees, books, supplies, and equipment
- Expenses for credentialing, licensing, and continuing education programs required to maintain a recognized postsecondary credential
- Principal and interest on qualified student loans for the designated beneficiary and siblings up to $10,000 (lifetime limit)

Save your receipts! It may be helpful to separate these qualified purchases from other non-qualified purchases by running separate transactions at the checkout register.

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How might a scholarship or other tax-free tuition assistance affect the use of 529 Plan funds?

Tax-free educational assistance, such as a Pell Grant, tax-free scholarship, tuition discount, or tax-free employer educational assistance program, reduces qualified expenses eligible for tax-free 529 distributions. For example, if a semester's tuition is $10,000, and the plan beneficiary receives a tax-free scholarship for $8,000, only the remaining $2,000 will be considered qualified expenses for 529 Plan distribution purposes.

How do 529 Plans relate to the American Opportunity Tax Credit and Lifetime Learning Credit?

These tax credits can be extremely valuable. The American Opportunity Tax Credit (AOTC), for example, provides a tax credit of 100% of the first $2,000 of eligible expenses and 25% of the next $2,000 of eligible expenses for a total credit of $2,500. The Lifetime Learning Credit (LLC) provides a tax credit of 20% of the first $10,000 of eligible expenses for a total credit of $2,000. Any expenses used to claim an education tax credit may not also be used to determine the tax-free portion of a 529 Plan distribution. For example, if the beneficiary of a 529 Plan is eligible for the AOTC, it may be a good idea to leave $4,000 of qualified education expenses unpaid by the 529 Plan. This will allow the taxpayer to claim the full $2,500 AOTC.

Be aware that the AOTC begins to phase out once your modified adjusted gross income (MAGI) reaches a certain level. If your MAGI will prevent you from claiming the AOTC, you may choose to pay the qualified education expenses fully from your 529 Plan.

What if there is a 529 Plan balance remaining after all education expenses are paid?

Up to $35,000 may be transferred tax free to a Roth IRA for the 529 Plan beneficiary. Several limitations apply to utilize this option, so it will be important to discuss this with your Stifel Financial Advisor and tax advisor before transferring any funds. You may also consider changing the beneficiary to another family member who may be able to use the remanining funds for qualifed education expenses.

If the remaining funds are distributed for something other than a qualified expense or Roth IRA transfer, income tax and a 10% penalty may apply to the earnings portion of the distribution. Additional taxes may also apply depending on state law.

There are many important factors to consider before using a 529 Plan to pay for education expenses. The information listed above is not intended to be an exhaustive review of these factors. Before dipping into your 529 Plan, consult with your Stifel Financial Advisor and qualified tax professional to be sure you are well positioned to achieve the best results.

Investors should consider carefully the investment objectives, risks, and charges and expenses associated with a 529 Plan before investing or sending money. The official program offering statement, which includes information on municipal fund securities, is available from your Financial Advisor and should be read carefully before investing. The value of a 529 account may fluctuate, and there is no guarantee that any investment portfolio will achieve the stated goal. Your investment may be worth more or less than its original value.

Non-qualified withdrawals are taxable as ordinary income to the extent of earnings and may also be subject to a 10% federal income tax penalty.
State tax treatment may differ. Investors should discuss their particular tax situation with a tax professional.

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