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Federal Tax Reform and 529 Plans

What is a 529 plan?

A 529 plan, technically called "qualified tuition plan," is a tax-advantaged savings plan designed to encourage savings for college, post-secondary training and other educational expenses. 529 plans are operated by states or educational institutions.

The Vermont Higher Education Investment Plan (VHEIP) is Vermont's 529 plan. The owner of the 529 plan can withdraw the funds for use of qualified education expenses. These expenses include tuition, books, computers, and room and board.

What are the main tax advantages to using a 529 plan?

The main tax advantage of 529 plans is that the earnings are not subject to federal or State taxation. When the account holder withdraws the funds from the account for qualified education expenses, the earnings on their investments is not subject to any capital gains taxes at either the Federal or State level.

Vermont also offers a tax credit to individuals who contribute to their 529 plans. This credit is equal to 10% of the first $2500 (single) or $5000 (married, filing joint) contributed to the account. This means that a married couple that contributes $5000 or more to their 529 plan qualifies for a $500 credit on their Vermont taxes. Additionally, there may be other tax advantages relating to estates and gift taxes.

However, the contributions to a 529 plan are not tax deductible at either the State or Federal level.

What is the current law regarding 529 plans?

Under current law, money withdrawn from 529 plans can only be used for qualified education expenses. Qualified education expenses currently include tuition, room and board, and other educational expense (computers, school supplies, internet etc.). Qualified education expenses only are only those expenses relating to *higher-education,* not private secondary or elementary schools.

How do the rules for 529 plans change in the Tax Cut and Jobs Act?

Under the new law, *private elementary and secondary* education expenses are qualified education expenses. This means that owners of a 529 plan can use their account savings on private elementary and high schools. The amount of eligible private elementary and secondary school expenses is capped at $10,000 per-student, per-year.

The new law affects other types of education savings plans, namely Coverdell Education Savings Accounts (ESAs) and ABLE accounts. Savings from Coverdell ESAs (which are similar to 529 plans but have lower contribution limits and can be used for elementary and secondary education) can now be rolled into a 529 plans without tax consequences. ABLE (Achieving a Better Life) accounts (which are also similar to 529 plans but allow the account holder to withdraw savings for disability expenses) can now be rolled into a 529 plan without tax consequences and vice-versa.

How will this affect Vermont?

The potential effects on Vermont are likely to be felt in the long term.

On the revenue side, the changes could have a negative impact on Vermont revenues. If individuals who were not previously saving for private elementary or secondary education expenses open 529 accounts because of the new changes, it could have additional further negative revenue impacts. Moreover, if there are individuals who begin transferring their Coverdell ESA or ABLE assets to 529 plans and take advantage of the tax credit, it could have a negative effect on revenues.

According to the 2017 Tax Expenditure report, in FY2015, a total of 4,362 tax returns had accounts in the Vermont Higher Education Investment Plan. The total cost of the corresponding tax credit was estimated to be $2,325,000 in FY2015, with the cost rising to $2,500,000 in FY2018. The tax credit accounts for 4.1% of total FY2015 tax expenditures ($56.6 million).

Indirectly, these changes could have impacts on elementary and secondary education in Vermont. The tax advantages of 529 plans may incent individuals to save for private elementary or secondary school, rather than Vermont public schools. Although Coverdell ESAs already allowed parents to use the savings for private elementary and secondary education expenses, 529 plans have some advantages over Coverdell ESAs. Unlike Coverdell ESAs, 529 plans are eligible for the State tax credit and do not have contribution limits. This may lead to existing Coverdell individuals to transfer their assets to a 529 plan and save more for private elementary and high school. Moreover, the changes may provide an incentive for individuals currently not saving for private elementary or secondary school to begin doing so.