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How Do Changes to 529 Rules Affect Children's Savings Account Programs?

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Background and Changes to 529 Rules

In December 2017, Congress made sweeping changes to the tax code with the Tax Cuts and Jobs Acts. Of particular relevance to the Children's Savings Account (CSA)¹ field, the federal legislation expanded the allowable uses of 529 college savings plans to include withdrawals of up to \$10,000 annually for K-12 tuition. This expansion alters the original intent of 529s from subsidizing savings *exclusively for postsecondary education* to also including private elementary and secondary school tuition. The additional incentives exacerbate already inequitable tax benefits, since wealthier families disproportionately have savings in 529s.²

State Responses

Because money in 529 plans grows tax-free, any withdrawals for purposes other than qualified expenses are subject to federal—and sometimes state—taxes and a 10% penalty on the earnings portion of savings. Yet, the impact of the federal legislation varies at the state level, where 529 plans are implemented and managed. The website savingforcollege.com is [tracking the states](#) that comply with the new federal 529 plan rules to consider K-12 tuition as an allowable use for 529 savings. Some states have not yet decided how to act, while other states will continue to define their allowable uses as only for postsecondary expenses and restrict any state-subsidized incentives—such as tax deductions or savings matches—to postsecondary education.³

¹ Children's Savings Accounts are also known as Child Development Accounts (CDAs).

² Government Accountability Office [GAO]. (2012). *A Small Percentage of Families Save in 529 Plans*. (GAO-13-64). Washington, D.C.: GAO.

³ Since 30 states offer tax deductions or credits based on 529 contributions, budgetary consequences are a significant concern for some states. See [King and Clancy](#), 2018 for more information.

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Implications for CSA Programs

About 54% of CSA programs—representing 86% of total children with a CSA—use 529s as their investment vehicle.⁴ All of these CSA programs explicitly intend for program funds to be used for postsecondary education. What are the implications of the 529 rule changes for these programs and those in development? The answer differs, in part, depending on the account structure(s) that programs use:

- **Omnibus or master program–owned 529 CSAs** — Most large CSA programs, such as the Harold Alfond College Challenge in Maine and Nevada College Kick Start, hold program-provided incentive funds in a single omnibus or master 529 account on behalf of all participating children.⁵ These funds are owned by the programs, so they have full control over how the funds can be used, typically to be sent directly to the postsecondary education institution. ***Funds in these CSAs can still be restricted by CSA programs solely for postsecondary education use.***
- **Individual, program-owned 529 CSAs** — Some CSA programs hold program-provided incentive funds in individual, entity-owned (i.e. owned by the program) 529 accounts for each participating child. For example, El Monte Promise Foundation owns individual 529 accounts, referred to as “scholarship accounts,” for each child in the Scholars Savings program. The scholarship accounts hold all program-provided funds. Similar to omnibus accounts, the funds in these accounts are owned by programs, so they have full control over how the funds can be used. ***Funds in these CSAs can still be restricted by CSA programs solely for postsecondary education use.***
- **Parent-/guardian-owned 529 CSAs** — CSA programs that use omnibus or individual, entity-owned 529s to hold program-provided incentives generally encourage families to open separate parent-owned 529s into which they can contribute. ***As was the case prior to 2018, families can still withdraw money in their own accounts for any reason, with penalties dictated by federal and state rules. However, penalty-free withdrawals may now include K-12 tuition, depending on state regulations.***
- **Hybrid CSAs** — A smaller number of CSA programs, such as Connecticut’s CHET Baby Scholars, deposit program incentives directly into parent-owned accounts. Since these accounts are owned by parents or guardians, the programs could never restrict how these funds (including any incentives put directly into the account) were used. ***As was the case prior to 2018, families can still withdraw money in their own accounts for any reason, with penalties dictated by federal and state rules. Similar to parent-guardian-owned CSAs, penalty-free withdrawals may now include K-12 tuition, depending on state regulations.***

⁴ Prosperity Now’s 2017 CSA Program Survey.

⁵ Clancy & Beverly, 2017. [Statewide Child Development account policies: Key design elements](#). (CSD Policy Report 17-30). St. Louis, MO: Washington University, Center for Social Development.

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Regardless of their account structure, all CSA programs that use a 529 plan may face a communications challenge. The federal rule changes may create inaccurate public perceptions that CSA program funds can be used for K-12 tuition. Many programs are addressing this proactively. For example, the Harold Alfond College Challenge has implemented a pop-up notification for any visitor to their website clearly announcing:

“Congress has passed legislation that makes important changes that affect 529 plans, including Maine’s 529 plan NextGen. However, no changes have been made to the Alfond Grant – it is still intended only for use at institutions of higher education.”

Conclusion

The new federal 529 rule changes do not affect the ability of CSA programs to retain previous or define new restrictions on funds for postsecondary education use. Yet, as this discussion illustrates, existing CSA programs and those in development should be familiar with their current or planned account structure and the response of their state government to the federal changes. CSA programs may also want to reinforce their rules and messaging regarding the use of CSA funds. We will continue to follow new developments and update the field.

Additional Resources

- [How Can States Seize the Moment and Reform College Savings?](#) — New America
- [529 Savings Plans and Private School Tuition](#) — Savingsforcollege.com

About the Authors

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