Northwestern Mutual®

529 Distributions After the SECURE Act

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act) creates more opportunities for tax-free distributions from 529 education accounts. Beneficiaries of 529 accounts can now receive tax-free distributions for expenses related to apprenticeship programs as well as to pay down up to $10,000 of their student loans.

Background

Section 529 of the Code allows a taxpayer to make cash contributions to tax-advantaged accounts established by state plans for education purposes. These contributions are invested and managed by a state-selected money manager for the benefit of the account's designated beneficiary. The account grows tax-deferred and distributions used for qualified higher education expenses are income tax-free.

Prior to the SECURE Act, qualified higher education expenses were limited to:

- Tuition, fees, books, supplies, and equipment required for the beneficiary's enrollment or attendance at an eligible educational institution.[1]
- Room and board for students who are enrolled at least half-time at an eligible education institution. This can be for on or off-campus housing but is limited to the amount used in the school's Cost of Attendance (COA) calculation for financial aid purposes. The COA amount for room and board can be found on the financial aid page of a school's website or by contacting the school's financial aid office directly.
- Certain expenses for the purchase of computer or peripheral equipment, computer software, internet access, or related services. The equipment, software, and services must be used primarily by the beneficiary while enrolled at an eligible educational institution and any software must be predominantly educational in nature (for example, no software designed for sports, games, or hobbies).
- Expenses for special needs services that are incurred in connection with enrollment or attendance of a special needs beneficiary at an eligible education institution.
- Up to $10,000 for tuition expenses in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. The $10,000 limit applies per designated beneficiary, per tax year. Note that the tax-free distribution for elementary and secondary education is limited to tuition.

Eligible expenses added by the SECURE Act

- **Apprenticeship expenses.** Expenses for fees, books, supplies, and equipment required for participation in an apprenticeship program are now eligible for tax-free distributions. The apprenticeship program must

[1] An eligible educational institution is any college, university, trade school, or post-secondary educational institution that is eligible for Title IV federal student aid programs. In addition to United States schools, this includes some international schools used in study abroad programs. The Office of Federal Student Aid publishes a sortable list of institutions with Federal School Codes that participate in Title IV Federal student aid programs at https://ifap.ed.gov/ilibrary/document-types/federal-school-code-list. An international school's eligibility for tax-free 529 distributions should be verified with study abroad programs.

be registered and certified with the Secretary of Labor under §1 of the National Apprenticeship Act. See http://www.apprenticeship.gov for information about how to find registered apprenticeships.

- **Student loan repayments.** 529 beneficiaries (and their siblings) can take tax-free distributions to pay principal or interest on any qualified education loan of the beneficiary (or their siblings).

Tax-free distributions to pay student loans are limited to $10,000 per individual for that individual's lifetime.[2] For example, if an individual applies $10,000 of distributions toward his or her student loans in one year, no other tax-free distributions for payment of that person's student loans may be taken from any 529 account for the rest of that person's life. If that person is the beneficiary of a 529 account, distributions can still be taken from that 529 account to pay for the beneficiary's siblings' student loans, as long as the siblings have not exceeded their respective $10,000 lifetime limits. A 529 account owner can use that 529 account to pay for the beneficiary's siblings' student loans without changing the beneficiary designation.

A qualified education loan is any loan the beneficiary (or sibling) took out solely to pay qualified higher education expenses. Additionally, the loan must have been used for the education expenses of the borrower, the borrower's spouse, or the borrower's dependent; the expenses must have been for education provided during an academic period when that student was enrolled at least half-time in a post-secondary degree program; and the expenses must have been paid or incurred within a reasonable period of time before or after the borrower took out the loan. The lender could be the federal government or a private entity. This definition of a qualified education loan is the same definition used when determining if a taxpayer can deduct student loan interest payments. The beneficiary of a 529 plan is not able to deduct any student loan interest paid that year through a tax-free 529 distribution.[3]

Tax treatment of distributions for non-eligible expenses

If distributions from a 529 plan are not used for qualified higher education expenses, then the earnings portion of the distribution is subject to ordinary income tax. Nonqualified distributions represent pro-rata portions of earnings and contributions in relation to the underlying account. Unless the nonqualified distribution is due to the beneficiary receiving a scholarship, attending a United States Military Academy, dying, or becoming disabled, a 10% penalty applies to the earnings portion of the distribution. The tax and penalty are paid by the account owner or beneficiary, depending on who receives the funds.

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[2] The $10,000 maximum is not adjusted for inflation under current law.
[3] I.R.C. § 221(e)(1).