Section 529 Plans Expanded to Cover Registered Apprenticeships and Student Loan Payments

A 529 plan (also known as a qualified tuition program) is a tax-exempt program established and maintained by a state (or a state agency or instrumentality) or one or more eligible educational institutions (public or private) under which a taxpayer may:

. . . buy tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses-i.e., a prepaid educational services account, or

. . . make contributions to an account set up to meet the designated beneficiary's qualified higher education expenses-i.e., an educational savings account. This option is available only for state programs.

Any person can make nondeductible cash contributions to a 529 plan on behalf of a designated beneficiary. The earnings on the contributions accumulate tax-free. Distributions from a 529 plan are excludable up to the amount of the designated beneficiary's qualified higher education expenses, which include:

1. tuition, fees, and expenses for books, supplies, and equipment required for the designated beneficiary s enrollment or attendance at an eligible educational institution;
2. up to $10,000 per designated beneficiary per tax year for tuition for enrollment or attendance at an elementary or secondary public, private, or religious school
3. certain expenses for the purchase of computer or peripheral equipment, computer software, or internet access and related services;
4. expenses for special needs services; and
5. room and board costs (subject to a limit) for students who are at least half-time.

Before January 1, 2020, qualified higher education expenses didn't include the expenses of registered apprenticeships or student loan repayments.

Individuals may claim an above-the-line deduction under Code Sec. 221 for interest paid on qualified education loans, subject to a $2,500 annual limit. The deduction is phased out ratably. For 2019, the phaseout applies to taxpayers with modified AGI between $70,000 and $85,000 ($140,000 and $170,000 for married taxpayers filing a joint return).

A qualified education loan is any debt incurred by the taxpayer solely to pay qualified higher education expenses that are: (1) incurred on behalf of the taxpayer, spouse, or any dependents as of the time the debt was incurred; (2) paid or incurred within a reasonable period of time before or after the debt is incurred; and (3) attributable to education furnished while the recipient was an eligible student, i.e., at least a half-time student in a postsecondary degree, certificate, or other program at an eligible educational institution.

The SECURE Act allows tax-free distributions from 529 plans beginning January 1, 2020, to pay for fees, books, supplies, and equipment required for the designated beneficiary s participation in an apprenticeship program. The program must be registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act (29 USCS 50).

In addition, the Act allows tax-free distributions from 529 plans to pay principal or interest on a qualified education loan of the designated beneficiary or a sibling of the designated beneficiary. This allows a student loan distribution to be made from a 529 plan account to a sibling of the account's designated beneficiary without changing the designated beneficiary.

A "sibling" is defined as under the rules for dependents, i.e., the term includes a brother, sister, stepbrother, or stepsister.

An individual may not receive more than $10,000 of student loan distributions, in aggregate, over the individual s lifetime. If this limit is exceeded, the earnings portion of the excess distribution is included in the individual's income and is subject to a 10% penalty tax.

The $10,000 lifetime limit applies to student loan distributions to an individual from all 529 accounts. Thus, the limit can't be circumvented by receiving distributions from more than one account.

A student loan distribution to a sibling of a designated beneficiary is applied to the sibling's $10,000 lifetime limit, not to the lifetime limit of the designated beneficiary.

The deduction for interest paid by the taxpayer during the tax year on a qualified education loan is disallowed to the extent the interest was paid from a tax-free distribution from a 529 plan. The deduction under Code Sec. 221 is phased out at higher levels of modified AGI. The exclusion for student loan distributions from 529 plans has no phase-out. The deduction under Code Sec. 221 has a $2,500 annual limit but no lifetime limit. The exclusion for student loan distributions from 529 plans has a lifetime limit of $10,000 per individual recipient.

Questions?

If you have any questions, please contact **David DeJarnett**, leader of the Bowles Rice Tax Team, at **(304) 264-4232**.