The Tax Law Provision Benefiting Private School Families

By: Christopher Smith *December 2018*

As the holiday season approaches and our children fill out their "wish lists," is funding their 529 plan on the list? A provision within the "2018 Tax Cuts and Jobs Act" tax law now permits families to use 529 assets for up to $10,000 of K-12 tuition expenses per student, per year. If navigated correctly, you potentially could reduce your state income tax bill while also saving for your children's future college expenses.

What's a 529 plan you may ask?

A 529 plan is a tax-advantaged savings plan used for future education expenses. Contributions grow tax-free, and qualified distributions from the plan are also not taxed. Pennsylvania is one of thirty states to deduct 529 contributions from state taxable income, which could mean significant savings on your annual PA tax bill.

The annual contribution limit is set at the annual gift-tax exclusion amount ($15,000 for 2018) per grantor. Both spouses can contribute to their children's 529 if the parent's income is more than their contribution. In fact, anyone can help contribute to your child's 529 plan—even grandparents.

How can 529 plan assets be used?

K-12 qualified distributions may only be used for up to $10,000 in tuition expenses per student, per year. Qualified 529 distributions for college expenses must meet specific rules to maintain their favorable tax treatment. Some of the acceptable expenses for college are tuition and fees, books, and computers. If you use 529 assets for non-qualified expenditures such as buying a car for your child's 16th birthday, you will be required to report the distributed earnings as income and pay a 10% penalty.

How does the new tax law's 529 provision benefit you?

Let's look at an example. Assume you are married with one child, and each parent contributes $15,000 each to the 529 plan (total $30,000), and the child's future K-12 tuition expense is equal to the max $10,000 distribution. You may save up to $921 in PA income taxes while also saving $20,000 towards your child's future college expenses, plus any potential investment returns.

To maximize your child's education savings and avoid costly tax mistakes, contact your financial advisor to discuss your options.