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529 College Savings FAQ

UBS Wealth Way

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- College is expensive, but costs vary significantly by institution and program. Moreover, out-of-pocket costs can depend on whether students receive financial aid or merit-based scholarships. Therefore, families will need a plan to save and invest *enough* for college **and** a strategy to deal with the potential risk of having saved *too much* for college.
- In this report, we answer common questions using 529 college savings accounts—which offer tax-advantaged growth for funding qualified education expenses—to save and invest for education costs.

Saving for college is important, but knowing where to start can be challenging. This report answers frequently asked questions about 529 College Savings Plans—one of the most effective ways to prepare for this significant investment in future generations.

1. Why use a 529 plan to save for college?

529 plans, which are available in all 50 states, help families save for education expenses by encouraging early savings and offering two key tax benefits:

1. Contributions are tax-deductible, or come with tax credits, in over 30 states (though not at the federal level).
2. Investment earnings grow tax-free, and distributions are tax-free if used for qualified education expenses.

529 plan tax benefits are an important feature, because they compound over time. For example, let's consider a $10,000 contribution, invested for 15 years at a 7% annualized total return (5% price appreciation plus a 2% dividend yield). In a 529 account, this approach would yield **$27,590** for qualified education costs, which is **24%** more than the **$22,250** of after-tax distributions from a taxable account subject to a 23.8% tax on dividends and long-term capital gains. This tax advantage could be even larger if you are eligible for state deductions or credits for your 529 plan contributions, or if capital gains tax rates go higher.

In addition to tax benefits, some employers even offer to match a portion of employees' 529 College Savings contributions, though this is still a rare benefit.

2. Which 529 distributions are "qualified"?

Surprisingly, according to IRS guidance, 529 college savings plans aren't just for college. The general guidelines are tuition, fees, books, and room and board (if the student is enrolled at least half-time) at eligible institutions. Computer technology, equipment, and internet access may also qualify if used by the beneficiary while enrolled. Additionally, families can use up to $10,000 per year for K-12 tuition at public, private, or religious schools (federal law, but rules vary by state).[1]

Principal and interest payments toward qualified higher education loans are now also considered qualified 529 plan expenses, up to the lifetime limit of $10,000 per beneficiary and $10,000 for each beneficiary's siblings. However, the portion of student loan interest paid with 529 assets is not eligible for the student loan interest deduction.

If you make nonqualified distributions from your 529 account, any gains in the account will be taxed as income, with an additional 10% penalty. Some states may also impose taxes or restrictions on certain distributions, so do consider your state's policies.

3. How much do I need to save?

When it comes to estimating college costs and evaluating the amount you should save and invest, there are many variables to consider:

1. How many children will you send to college? Which type of school will each child attend?
2. How much are we willing to cover for each child? What about graduate school?
3. Will you be eligible for financial aid? Are the children likely to receive a scholarship?
4. How much will college cost in the future?

Your financial advisor can help you to answer these questions and work with you to design a savings strategy that won't derail your retirement savings strategy.

4. How much can I contribute?

There's no federal contribution limit for 529 plans. However, each state sets as a maximum aggregate account balance (generally $235,000 to $550,000). Once this limit is reached, no further contributions are allowed.

Federal gift tax rules are another potential limit on 529 contributions. For federal gift tax purposes, contributions to 529 plans are considered completed gifts to the beneficiary. The annual gift tax exclusion for 2025 is $19,000 ($38,000 for married couples filing jointly); contributions above this amount may require filing a gift tax return, reducing their lifetime gift and estate tax exemption.

529s have a special feature known as "accelerated gifting" or "front-loading," where you can contribute up to five times the annual exclusion in one year and treat it as if it were made over five years ($19,000 × 5 = $95,000 for individuals, $38,000 x 5 = $190,000 for married couples) without incurring federal gift taxes or using your lifetime gift and estate tax exemption.[2] In addition to giving a healthy start to funding future educational expenses, front-loading can also help with estate planning, removing gifted dollars —along with their future growth—from the donors' taxable estate.[3]

5. What if I save too much?

Saving and investing early can help you get the most value from the tax-free growth in a 529 account. On the other hand, whenever you contribute to a 529 account, there is a risk that you will not need the funds for college education expenses. Your children may get a full-ride scholarship, or decide not to attend college.

Overfunding is an important risk that you should consider. After all, nonqualified distributions from a 529 plan can trigger income taxes and a 10% penalty on the earnings portion.[4]

Here are strategies to reduce the risk of overfunding a 529 plan:

1. **Diversify college savings across account types.** In addition to funding a 529 plan, consider setting aside funds for college in a Roth IRA and other account types with more flexibility. If you're older than age 59½ when your children go to college—and you wait at least five years between your first contribution and your first withdrawal—then growth in a Roth IRA will be tax-free if you use the funds for college expenses. Roth IRAs will also have more investment options than a 529 plan.
2. **Use 529 funds for K-12 tuition.** As mentioned above in the "qualified distributions" section, your family can use up to $10,000 per year for K-12 tuition (federal law, state rules may differ).[1] If your children are approaching college age and your 529 accounts appear to be over-funded, this strategy may allow your family to use 529 funds for tax-free educational expenses without incurring the penalty.
3. **Rollover 529 assets into a Roth IRA.** As of 2024, up to $35,000 (lifetime cap) can be rolled over from a 529 to a Roth IRA for the beneficiary. The 529 account must have been open for at least 15 years. Annual rollovers count towards each year's annual IRA contribution limit, along with any other IRA contributions that the IRA owner has made for those tax years. Unlike other contributions to Roth IRAs, 529-to-Roth IRA rollovers are not subject to an upper income constraint. At this time, not all states allow 529-to-Roth rollovers.[5]
4. **Change the beneficiary.** You can change the beneficiary to another qualifying family member without

tax penalty once per year. For smaller families, a single account can be "handed down" to the next sibling (or other qualifying family members, such as a first cousin or niece/nephew) once the first beneficiary's costs are covered. For larger families, especially those where two or more children will be in college at the same time, it may be better to set up multiple accounts to allow for more flexibility.

6. How do 529s impact financial aid?

529 plans have a limited impact on financial aid, but the impact depends on the owner of the 529 plan.

Students' and parents' assets and income are counted in the formula for financial aid, but parent-owned assets (including 529s) only reduce aid eligibility by a maximum of 5.64% of account value.

Grandparent-owned 529 plans are not included in the formula for financial aid and, as of the 2024-25 Free Application for Federal Student Aid (FAFSA), distributions from these plans no longer count as "untaxed income" for aid purposes and students are no longer required to manually report other types of cash support. Instead, students' "total income" (which includes untaxed income) will now be automatically derived from the IRS based on federal income tax returns.

However, grandparent-owned 529 plans may still institutional aid formulas, such as CSS Profile, which is used by 300 colleges, universities, and scholarship organizations.

7. How should I invest my 529?

529 plans typically offer these investment options:

1. **Age-based/target date portfolios** start with a high allocation to stocks when the child is young and automatically reduce risk as college (the "target date") approaches.
2. **Risk-based portfolios** invest in a balanced portfolio consistent with a risk level (e.g., conservative, moderate, aggressive) that does not change over time.
3. **Individual fund options** target individual asset classes, such as US stocks, international stocks, or government bonds.
4. **Principal protected funds**—such as stable value funds, money market funds, or FDIC-insured bank deposit accounts—offer cash-like risk and return characteristics.

We generally recommend following a target date approach, reducing risk as the student nears college age. Funds for a newborn's college expenses have ample time to enjoy significant growth, so an aggressive portfolio may be appropriate; as the child moves within three to five years of college, there will be limited time to recover from market losses.

Therefore, we generally recommend that investors move any funds that are needed in the next three to five years into a safe investment options, such as a bond fund or a principal protected fund option. Any funds not needed in the next three to five years can remain invested in an aggressive risk or all-equity portfolio.

Nevertheless, it's also important to coordinate your 529 plan with your overall financial plan and investment strategy. Investors who have saved very little for education outside the 529 plan will want to take on less risk in that part of their portfolio; for investors with ample room to make up for shortfalls with other assets, getting the most out of the tax-free growth is the primary goal, and the portfolio can take on more risk.

8. Do I need to invest in my state's 529 plan? What if I move?

While 529 plans are administered and offered at the state level, you are not required to participate in your state's plan. Nor does the beneficiary need to attend school in the same state in which the plan is administered.

If you live in a state without an income tax, or a state that doesn't offer contribution deductions or credits, you may want to choose an out-of-state option with other characteristics that you prefer, such as investment options.

Additionally, nine states (Arizona, Arkansas, Kansas, Maine, Minnesota, Missouri, Montana, Ohio, and Pennsylvania) offer tax parity for 529 contributions, meaning contributions to any plan (not just your home state) will qualify for a state income tax deduction or credit. If you live in one of these states, you have the flexibility to use any state's plan while still receiving a tax benefit for your contribution.

Given the portability of 529 plan funds, families generally do not need to worry about moving states while saving for college. There are many options to roll funds from one state's plan to another, or simply open a second 529 account for the beneficiary in your new home state. However, all this flexibility comes with tax considerations, so we recommend consulting your tax advisor before making any decisions.

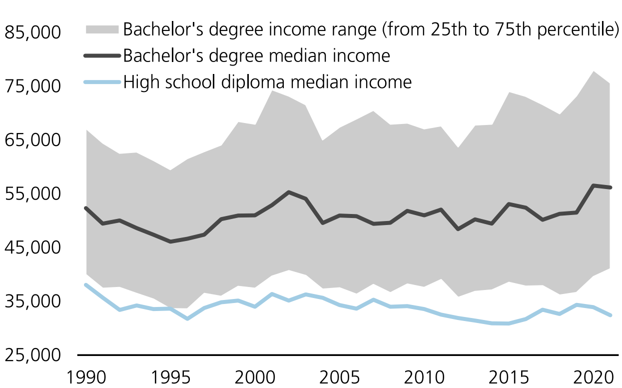
9. Is college worth the cost?

Despite the "sticker shock" that comes with some college cost estimates, research shows that a college degree can still be worth the cost.

First, a college degree often comes with a much higher level of income than the income available for a high school graduate (see Figure 1). According to research from the New York Federal Reserve, a bachelor's degree adds about $1 million to a worker's median lifetime income compared to workers with only a high school diploma, which is equivalent to an average annualized return on investment of 14%.

In addition to higher earnings potential, workers with college degrees also generally have access to careers with better workplace benefits, tend to experience fewer and shorter-lived bouts of unemployment, and have greater capacity to earn a return on their savings due to greater financial security. As a result, the additional wealth afforded by a college degree has a higher likelihood of leading to a much better lifestyle and earlier retirement, on average, than entering the workforce with a high school diploma.

Figure 1 - College graduates tend to earn more
Annual wages, in USD



Source: UBS, US Census Bureau, US Bureau of Labor Statistics, as of 19 May 2025.

Going forward, greater access to remote work may allow college graduates to derive other benefits, such as reducing the cost of their commute or choosing to live in a lower cost-of-living area, which could enhance their lifestyle and savings power even further.

If you'd like to learn more, including which college majors have the best post-graduation employment statistics, visit the New York Federal Reserve's website, *The Labor Market for Recent College Graduates*.

10. Is Congress considering changes?

At the time of writing, the House of Representatives has passed a "One Big, Beautiful Bill" law that aims to extend personal income tax elements of the 2017 Tax Cuts and Jobs Act. This law, which must still be passed by the Senate and is subject to change, proposes a few changes that are relevant to college savings strategies:

1. Expanding 529 qualified expenses to include apprenticeships and homeschooling expenses, including educational technology, tutoring, and non-tuition K-12 expenses (e.g., books, supplies, uniforms, and transportation).
2. Extending the increased limit on contributions to Achieving a Better Life Experience (ABLE) accounts ($19,000 for the 2025 tax year, not including additional contributions for those not participating in an employer retirement plan), and allowing this limit to increase annually with inflation.
3. Creating a new type of account—a "Trump account" (previous drafts of the bill had the moniker "Money Account for Growth and Advancement (MAGA)")—where parents of children under the age of 8 can contribute up to $5,000 a year to an account for the benefit of their child, with the funds to be invested in an index of US stocks. Funds in the account will enjoy tax-deferred earnings, and qualified withdrawals starting will have their growth taxed as long-term capital gains. Trump accounts for the benefit of children born between 1 January 2025 and 1 January 2029 will get a one-time deposit of $1,000 from the Treasury. Trump account beneficiaries will be able to withdraw up to 50% of the account for qualified expenses (higher education costs, post-secondary credentials, certain small business expenses, and first-time homebuyer downpayments) at age 18 and the full account value for qualified expenses starting at age 25; after the age of 30, any remaining funds can be withdrawn penalty-free without any restrictions.

These changes are still under consideration, and may not be in the final legislation. Moreover, some changes may not be available in every plan. Check with your 529 plan provider to learn more.

Conclusion

In summary, 529 College Savings Plans offer families a flexible and tax-advantaged way to prepare for future education costs. By starting early and understanding the rules and benefits, you can maximize your savings, take advantage of valuable tax incentives, and help ensure that education remains an attainable goal for the next generation. As you consider your options, remember to review your state's specific plan features and consult with your financial advisor or tax professional to develop a strategy that fits your family's unique needs and long-term goals.

To learn more, visit ubs.com/thecode, where UBS has partnered with EverFi—a leading education technology firm—to produce a series of short lessons about key investment and planning topics, including a 5-minute guide to 529 plans.

Endnotes

[1] K-12 tuition payments are generally considered to be qualified distributions at the federal level, but rules vary by state. At the time of writing, **California**, **Colorado**, **Illinois**, **Michigan**, **Minnesota**, **Nebraska**, **New York**, and **Oregon** consider K-12 tuition payments to be non-qualified 529 distributions. As with other nonqualified distributions, these states may impose state income taxes and penalties on 529 account earnings, and may require you to repay a share of the income deduction that you took on certain state and local taxes when you made the original 529 contribution. Check with individual plans and consult a tax professional for additional details.

[2] IRC § 529(c)(2)(B). It is necessary to file a gift tax return to claim this treatment by making an accelerated gifting election on IRS Form 709, to be filed with your federal tax return for the first tax year in which the accelerated gift is given. You cannot use the annual exclusion for gifts to this individual before the end of five calendar years, but subsequent rounds (i.e., every five years) of accelerated gifting is permitted.

[3] One caveat is that if a donor elects to have a 529 contribution treated as made over a five-year period, and then dies during that five-year period, a portion of the gift will be subject to estate tax. IRC § 529(c)(4)(C).

[4] The 10% penalty does not apply on account of death, disability or scholarship. The new beneficiary must be a family member of the current beneficiary. If you take a nonqualified distribution, you may also have to pay back the state's tax benefits.

[5] Not all states have approved 529-to-Roth rollovers. As the time of writing, **California**, **DC**, **Indiana**, **Massachusetts**, **Michigan**, **Minnesota**, **Montana**, **Utah**, and **Vermont** have not approved such rollovers, and **Arkansas**, **Colorado**, **Connecticut**, **Louisiana**, **Mississippi**, and **Missouri** have unclear policies or are in the process of approving rollovers. Check with individual plans and consult a tax professional for additional details.

Appendix

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