How 529 Plan Contributions Affect Gifting and the Estate Tax

Presented by Warren Wealth Associates

The dramatic rise in education costs often leads to this financial planning question: how can families balance college savings with their immediate needs and long-term estate plans? Fortunately, 529 education savings plans are an income tax–efficient investment for your child's or grandchild's future that can be integrated into an estate plan.

Income Tax Planning

The term 529 plan refers to Section 529 of the Internal Revenue Code (IRC). It became part of the federal tax code in 1996. Its provisions are the source for state-sponsored education savings plans that have various investment options. 529 plans have three distinct income tax advantages:

1. Many states offer a state income tax deduction for contributions to a 529 plan. (Some states allow the deduction for a contribution to any state 529 plan, whereas others allow a deduction only for contributions to their own 529 plan.)
2. Investments in a 529 plan grow tax free.
3. Distributions from a 529 plan for qualified education expenses also are not taxable income.

Benefits of Qualified Education Expense Distributions for All Family Members

Every 529 account has a single owner and beneficiary. As the original owner's plans change, they may designate a successor owner. As their family grows, they can roll all or a portion of the 529 to another family member, provided that a rollover from the same 529 plan has not occurred in the past 12 months. The IRS broadly defines the term family member to include the following relatives of the initial beneficiary:

- Son, daughter, stepchild, foster child, adopted child, or a descendant of any of them
- Brother, sister, stepbrother, or stepsister
- Father or mother, or ancestor of either
- Stepfather or stepmother
- Son or daughter of a brother or sister
- Brother or sister of father or mother
- Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
- Spouse of any individual listed above
- First cousin

Enhanced Use of 529 Accounts

Thanks to the expansion of qualified education expenses in the Tax Cuts and Jobs Act (TCJA), the Setting Every Community Up for Retirement Enhancement (SECURE) Act, and SECURE 2.0 provisions within the Consolidated Appropriations Act, 2023, 529 plans can benefit family members with different skills, career paths, and resources.

Section 529 generally defined qualified education expenses as college and graduate tuition, fees, room, board, books, supplies, and computer equipment. In 2017, the TCJA added provisions for federal income tax–free distributions for K–12 school qualified education expenses. Be sure to confirm how your state's tax laws define education expenses before taking a distribution for K–12 school expenses because not every state follows the federal definition, and some states may tax distributions for K–12 expenses as income.

The TCJA's additions to Section 529 of the IRC may also help family members with special needs. Before the TCJA, assets could not be rolled from a 529 to a 529A ABLE account. Under the TCJA, assets in an amount equal to the federal gift tax exclusion, which is $19,000 in 2025, can now be rolled to a 529A ABLE account from a 529. This change effectively allows a family member who is later diagnosed with special needs to use 529 contributions that were originally made for their benefit. More recently, the SECURE Act further expanded qualified education expenses to include apprenticeship programs that are registered with the Secretary of Labor's National Apprenticeship Act. You can use the U.S. Department of Labor's search tool to verify that an apprenticeship program is registered and eligible for an income tax–free 529 distribution.

The SECURE Act also addresses the problem of rising student debt and its impact on a graduate's financial stability. Its enhancements allow a onetime $10,000 distribution from a 529 plan to repay student loan debt. The original beneficiary and their siblings may receive a lifetime $10,000 distribution from the same 529 plan to repay their own student loans. For example, suppose Sybil, the youngest of three sisters, graduates from college with $30,000 remaining in her 529 account. Her older sisters, Mary and Edith, finished college, but all three sisters have student loans. Each sister can receive $10,000 from Sybil's 529 account to repay student loans as long as they haven't already used funds from another 529 account to pay off their student loans.

SECURE 2.0 also provides an avenue to roll funds from a 529 account to a Roth IRA in the name of the 529 account beneficiary. The ability to roll funds into a Roth is subject to annual Roth IRA contribution limits ($7,000 in 2025) and a $35,000 lifetime maximum. To be eligible for the rollover, the 529 must have been open for at least 15 years, the amount rolled over must have been in the 529 account for at least 5 years, and the beneficiary must have earned income up to the rolled-over amount. The income limitations that would otherwise be applicable to that beneficiary, however, do not apply for a 529-to-Roth rollover.

Estate Planning with the Power of 529 Superfunding

Contributions to a 529 plan represent a completed gift for federal estate and gift tax purposes. Each year, the IRS exempts gifts at or below a certain amount from federal gift tax. In 2025, $19,000 is exempt from federal gift tax, and the IRC allows a single individual to make multiple tax-exempt gifts. Section 529 of the IRC contains a unique funding feature that Uniform Transfers to Minors Act (UTMA) accounts or Coverdell accounts lack. Superfunding allows five years of annual tax-exempt gifts to be made as a lump sum in a single year. This superfunding feature, also known as the five-year front load, yields an investment designed to grow with the beneficiary and reduces the value of a taxable estate. Here's how it works:

A parent or grandparent can fund a 529 with $95,000 in one year (i.e., $19,000 x 5). Together, spouses can superfund a 529 with $190,000 (i.e., $38,000 x 5) through a gift split. Gift splitting deems that one-half of a whole gift came from each spouse. An election is made on IRS Form 709 to report the superfunding front load and allocate it pro rata over a five-year period.

Parents and grandparents who elect to split their gifts must each file a gift tax return and consent to the gifts on the other spouse's return. Any additional gifts to the beneficiary child or grandchild made during the five-year period must be reported on Form 709 and deducted from the donor's unified federal estate and gift tax lifetime exemption.

Superfunding has one potential disadvantage with respect to long-term care and asset protection planning. Although the IRC allows the five-year front load, Title XIX of the Social Security Act (i.e., Medicaid) has a five-year eligibility look back. The two five-year periods are *not* complementary. The Medicaid eligibility rules will penalize a gift to a 529 as a "transfer for less than fair market value" if it occurs within the five-year look back.

This material has been provided for general informational purposes only and does not constitute either tax or legal advice. Although we go to great lengths to make sure our information is accurate and useful, we recommend you consult with a tax preparer, professional tax advisor, or lawyer.

The fees, expenses, and features of 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that an education-funding goal will be met. In order to be federally tax free, earnings must be used to pay for qualified education expenses. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10 percent penalty. By investing in a plan outside your state of residence, you lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.

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