PRESENT LAW AND DATA RELATING TO TAX-PREFERRED ACCOUNTS FOR EDUCATION AND OTHER PURPOSES

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on May 21, 2024

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

May 20, 2024
JCX-25-24

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing for May 21, 2024, titled "Child Savings Accounts and Other Tax-Advantaged Accounts Benefiting American Children." This document,[1] prepared by the staff of the Joint Committee on Taxation, describes present law rules relating to three kinds of tax-preferred programs – section 529 qualified tuition programs, qualified ABLE programs,[2] and Coverdell education savings accounts[3] – to which individuals may make cash contributions when saving for education expenses and certain other specified expenses of designated beneficiaries, including children. The document also presents data about the amount of assets held in qualified tuition programs, the number of accounts with respect to qualified tuition programs, and the sizes of the tax expenditures for qualified tuition programs, qualified ABLE programs, and Coverdell education savings accounts.

Unless otherwise indicated, all section references in this document are to the Internal Revenue Code of 1986, as amended (the "Code").

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[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Data Relating to Tax-Preferred Accounts for Education and Other Purposes* (JCX-25-24), May 20, 2024. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[2] Sec. 529A.

[3] Sec. 530.

I. PRESENT LAW

A. Overview

Three present law provisions –section 529 qualified tuition programs, section 530 Coverdell education savings accounts, and section 529A qualified ABLE programs –allow individuals to make cash contributions to tax-preferred accounts to save for, among other expenses, the education expenses of beneficiaries of the accounts. These three provisions share the following common features:

- an account is owned by one person (for example, a parent or grandparent) typically for the benefit of another person (for example, a child or grandchild).

- earnings on amounts held in an account generally are tax-exempt;

- distributions from an account during a year of up to the amount of qualified expenses of the account beneficiary in that year generally are excluded from income;

- qualified expenses include certain education expenses; and

- to the extent the total amount of distributions from an account in a year exceeds the account beneficiary's qualified expenses in that year, the portion of each distribution that represents earnings generally is included in income, and an additional tax of 10 percent of the amount of the inclusion is imposed.

Each of the three provisions also has distinct features. This document describes some of these distinct features.

B. Tax-Preferred Accounts for Education and Other Purposes

1. Section 529 qualified tuition programs

To describe programs that are known colloquially as 529 plans, the Code uses the term "qualified tuition programs" and distinguishes between two types of programs.[4] One type of program, colloquially referred to as a prepaid tuition program, allows a person to purchase on behalf of a designated beneficiary tuition credits or certificates that entitle the beneficiary to the waiver or payment of the beneficiary's qualified higher education expenses.[5] Prepaid tuition programs are established and maintained by State governments (or their agencies or instrumentalities) and eligible educational institutions.[6] The other type of program, sometimes referred to as a college savings plan, allows a person to make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account.[7] A college savings plan may be established and maintained by State governments (or their agencies or instrumentalities), not by educational institutions.[8]

A qualified tuition program generally is exempt from Federal income taxation (but, like Coverdell education savings accounts and qualified ABLE programs (described below), is subject to unrelated business income tax).[9] As a consequence, contributors to, and beneficiaries of, these programs (whether prepaid tuition programs or college savings plans) generally have no taxable income inclusions from earnings on assets held in the programs.

To be treated as a qualified tuition program that is generally exempt from Federal income taxation, a program must satisfy several requirements. The program must provide that purchases of tuition credits or certificates or contributions to a program must be made only in cash.[10] The program must provide separate accounting for each designated beneficiary.[11] The program must provide that a contributor to, or a designated beneficiary under, the program may direct the investment of any contributions to the program (or earnings on those investment) no more than twice a year.[12] The program must not allow any interest in the program to be used as a security

[4] Sec. 529(a), (b).

[5] Sec. 529(b)(1)(A)(i).

[6] *Ibid.*

[7] Sec. 529(b)(1)(A)(ii).

[8] *Ibid.*

[9] Sec. 529(a).

[10] Sec. 529(b)(2).

[11] Sec. 529(b)(3).

[12] Sec. 529(b)(4).

for a loan.[13] The program must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary that exceed the amount necessary to pay the beneficiary's qualified higher education expenses.[14]

Under rules similar to those for qualified ABLE programs and Coverdell education savings accounts, when there is a cash distribution under a qualified tuition program, the portion of the distribution that is considered to be earnings on contributions to the account is includible in the gross income of the recipient of the distributions only to the extent that the total amount of cash distributions during the taxable year exceeds the amount of qualified higher education expenses of the account beneficiary during that year.[15] The income tax that is imposed on a recipient of a distribution that is included in the recipient's gross income is, with certain exceptions, increased by 10 percent of the amount of the inclusion.[16]

Qualified higher education expenses include, among other expenses, tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the account beneficiary at an eligible post-secondary educational institution; in the case of a beneficiary who is at least a half-time student, reasonable costs for room and board; expenses for the purchase of computer equipment and software to be used primarily by the beneficiary when enrolled at an eligible educational institution; fees, books, supplies, and equipment required for a beneficiary's participation in an eligible apprenticeship program; up to a $10,000 lifetime maximum in payments of principal and interest on a beneficiary's student loan; and, for certain purposes of section 529, expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school.[17] There is a $10,000 limitation on the total amount of nontaxable cash distributions that may be made in a taxable year from all qualified tuition programs with respect to a beneficiary to pay for that beneficiary's elementary or secondary school tuition.[18]

A contribution to a qualified tuition program is treated as a completed gift for gift tax purposes (and, as a consequence, may benefit from the gift tax annual exclusion).[19] If an individual's total contributions to a qualified tuition program during a year exceed the gift tax annual exclusion amount in that year, the individual may elect to take the total amount of the contributions into account for purposes of the annual exclusion ratably over the five-year period

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[13] Sec. 529(b)(5).

[14] Sec. 529(b)(6).

[15] Sec. 529(c)(3)(A), (B)(ii). A payor of a distribution generally is required to report to the IRS and the recipient of the distribution on Form 1099-Q the amount of the distribution and the portions of the distributions representing contributions and earnings.

[16] Sec. 529(c)(6).

[17] Sec. 529(c)(7), (c)(8), (c)(9), (e)(3).

[18] Sec. 529(e)(3)(A).

[19] Sec. 529(c)(2)(A).

beginning with the year of the excess contributions.[20] An individual's interest in a qualified tuition program generally is excluded from the individual's gross estate for estate tax purposes.[21]

A distribution from a qualified tuition program that otherwise would be included in the income of the recipient of the distribution (for example, the beneficiary of the account) may be excluded under rules allowing, subject to limitations, tax-free rollovers to, among other alternatives, an ABLE account of the beneficiary or of a member of the family of the beneficiary, a Roth IRA of the beneficiary, or the credit of another beneficiary of a qualified tuition program who is a member of the family of the beneficiary with respect to whom the distribution was made.[22]

2. Coverdell education savings accounts

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.[23] Annual contributions to a Coverdell education savings account may not exceed $2,000 and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary).[24] A contributor's contribution limit is reduced ratably to $0 over a $30,000 income range starting at $190,000 of modified adjusted gross income in the case of a married taxpayer filing a joint return and over a $15,000 income range starting at $95,000 of modified adjusted gross income for any other taxpayer.[25]

A Coverdell education savings account is subject to the unrelated business income tax but is otherwise exempt from income tax.[26] Generally, when there is a distribution from a Coverdell education savings account, the portion of the distribution that is considered to be earnings on contributions to the account is includible in the gross income of the recipient of the distribution only to the extent that the total amount of distributions during the taxable year exceeds the qualified education expenses of the account beneficiary during that year.[27] The income tax that

[20] Sec. 529(c)(2)(B).

[21] Sec. 529(c)(4)(A).

[22] Sec. 529(c)(3)(C), (E).

[23] Sec. 530.

[24] Sec. 530(b)(1)(A) (including applicable flush language of paragraph (b)(1)).

[25] Sec. 530(c)(1). For this purpose modified adjusted gross income means adjusted gross income plus any amount excluded from gross income under section 911 (foreign earned income exclusion), 931 (exclusion for certain income from Guam, American Samoa, or Northern Mariana Islands), or 933 (exclusion for certain Puerto Rico source income). Sec. 530(c)(2).

[26] Sec. 530(a).

[27] Sec. 530(d)(1), (2).

is imposed on a recipient of a distribution that is included in the recipient's gross income is, with certain exceptions, increased by 10 percent of the amount of the inclusion.[28]

Tax-free transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted if the new beneficiary is a member of the family of the earlier beneficiary and (except in the case of a special needs beneficiary) is under age 30.[29] In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date on which the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date on which the beneficiary dies).[30]

Qualified education expenses are (1) qualified higher education expenses within the meaning of that term for purposes of the qualified tuition program rules[31] and (2) qualified elementary and secondary education expenses.[32] The term "qualified elementary and secondary education expenses" means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items and services (including extended day programs) required or provided by such a school in connection with the beneficiary's enrollment or attendance; and (3) the purchase of any computer technology or equipment or Internet access and related services, if the technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school.[33] Computer software designed for sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is predominantly educational in nature.[34]

3. Qualified ABLE programs

A qualified ABLE program is a program that, among other requirements, is established and maintained by a State or an agency or instrumentality of a State and that allows a person to make contributions to an account (an "ABLE account") for paying the qualified disability

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[28] Sec. 530(d)(4).

[29] Sec. 530(d)(5).

[30] Sec. 530(b)(1)(E), (d)(8).

[31] Sec. 529(e)(3).

[32] Sec. 530(b)(2)(A).

[33] Sec 530(b)(3).

[34] Sec. 530(b)(3)(A) (flush language).

expenses of the designated beneficiary of the account.[35] In contrast with the requirements for 529 accounts and Coverdell accounts, which permit an individual to be a beneficiary of more than one account, an individual may be a beneficiary of only one ABLE account.[36]

An individual may be a designated beneficiary of an account only if, among other requirements, the individual is entitled to benefits based on blindness or disability under title II or XVI of the Social Security Act and the blindness or disability occurred before the individual attained age 26.[37] This age 26 threshold increases to age 46 for taxable years beginning after 2025.[38] An individual also may be a designated beneficiary of any account if a disability certification with respect to the individual is filed with the Treasury Secretary and includes statutorily prescribed information (including that the disability occurred before the individual reached age 26 (or, after 2025, before age 46)).[39]

Qualified disability expenses are any expenses related to an ABLE account designated beneficiary's blindness or disability that are paid for the benefit of that beneficiary.[40] These expenses include expenses for education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, and funeral and burial expenses.[41]

The amount of contributions that may be made to an ABLE account in a taxable year generally is limited to the gift tax annual exclusion in effect for that year ($18,000 for 2024).[42]

Income tax benefits for a qualified ABLE program include exemptions for earnings on amounts held in an ABLE account and for distributions from the account that do not exceed the qualified disability expenses of the designated beneficiary of the account.[43] Like section 529 qualified tuition programs and Coverdell education savings accounts, a qualified ABLE program is subject to unrelated business income tax.[44] Under rules similar to those for qualified tuition programs and Coverdell education savings accounts, when there is a distribution from a qualified

[35] Sec. 529A(b)(1).

[36] Sec. 529A(b)(1)(B).

[37] Sec. 529A(e)(1)(A), (3).

[38] Pub. L. No. 117-328, Division T, sec. 124(a), December 29, 2022.

[39] Sec. 529A(e)(1)(B), (e)(2).

[40] Sec. 529A(e)(5).

[41] *Ibid.*

[42] Sec. 529A(b)(2)(B)(I).

[43] Sec. 529A(a), (c).

[44] Sec. 529A(a).

ABLE account, the portion of the distribution that is considered to be earnings on contributions to the account is includible in the gross income of the recipient of the distribution only to the extent that the total amount of distributions during the taxable year exceeds the qualified disability expenses of the account beneficiary during that year.[45] The income tax that is imposed on a recipient of a distribution that is included in the recipient's gross income is, with certain exceptions, increased by 10 percent of the amount of the inclusion.[46]

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[45] Sec. 529A(c)(1)(A), (B).

[46] Sec. 529A(c)(3).

II. DATA RELATED TO QUALIFIED TUITION PROGRAMS, QUALIFIED ABLE PROGRAMS, AND COVERDELL EDUCATION SAVINGS ACCOUNTS

1. Qualified tuition programs

As described previously, there are two types of qualified tuition programs (together also referred to below as "529 plans"), college saving plans and prepaid tuition programs. Of the two types of 529 plans, college savings plans are responsible for most of the growth in overall 529 plan assets. In 2023, college savings plans had $446.6 billion of assets under management and pre-paid tuition programs had $24.4 billion. Table 1 displays amounts of assets in both types of plans.

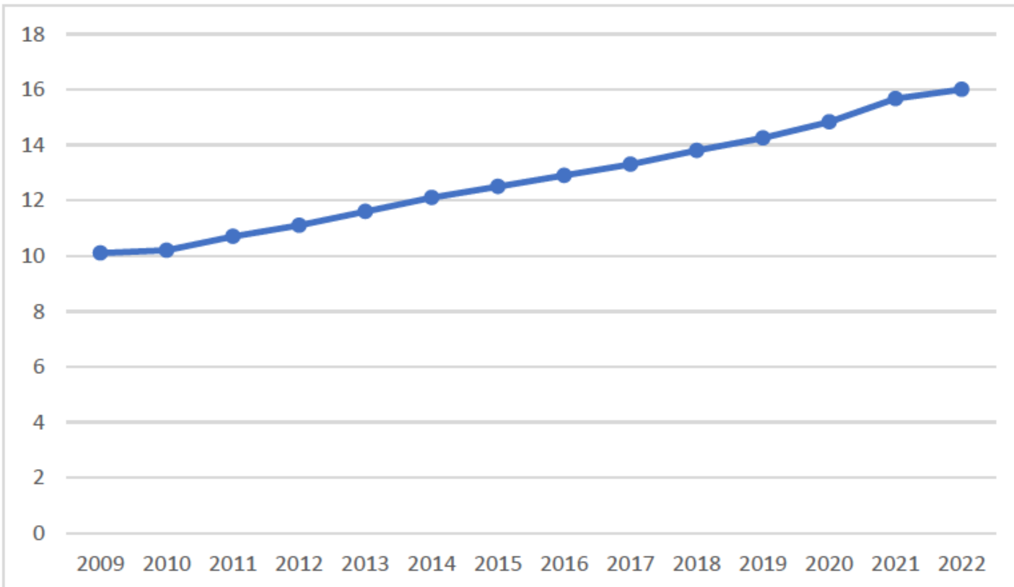
Table 1.–Assets in 529 Plans (Billions of Dollars)

Year	College Savings Plans[1]	Prepaid Tuition Programs	Total
2020	398.6	26.7	425.3
2021	452.6	27.7	480.3
2022	388.0	23.3	411.3
2023	446.6	24.4	471.0

Source: Federal Reserve Board of Governors, Balance Sheet of Households and Nonprofit Organizations, Table B.101.
Notes: Amounts are outstanding at end of period, not seasonally adjusted.
[1] Qualified education expenses include certain higher education expenses, as well as certain elementary and secondary education expenses. See Section I.B.1 of this document for a detailed account of these expenses.

The number of college savings plan accounts has also grown over time. As shown in Figure 1, there were 16 million college savings plan accounts in 2022, an increase from the 10.1 million accounts open in 2009. The average account size also increased over this period. According to the College Savings Plan Network,[47] the average size of college savings plan accounts has increased from $13,188 in 2009 to $27,741 in 2023.[48]

Figure 1.–Total Number of College Savings Accounts, 2009-2022



Source: College Savings Plan Network, 2022.

2. Tax expenditure estimates

Tax expenditures are "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[49] Tax expenditure estimates are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy.

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[47] The College Savings Plan Network, an affiliate of the National Association of State Treasurers, is a clearinghouse for 529 plan level data voluntarily disclosed to the public by plan administrators. These data form the basis of the relevant line items in the Federal Reserve Board of Governors Enhanced Financial Accounts and the Survey of Consumer Finances, as well as others.

[48] Accounting for inflation, the average size of accounts has increased approximately 48 percent from 2009 to 2023.

[49] Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, sec. 3(3), July 12, 1974.

Table 2 shows tax expenditure estimates for select tax provisions. Estimates are shown for the total tax expenditure for fiscal years 2023-2027.[50] The tax expenditure on the exclusion of tax on earnings of college savings plans is $26.3 billion over the period 2023-2027. By contrast, the tax expenditure on prepaid tuition programs is much smaller ($1.3 billion over the same period). The tax expenditures on the exclusion of earnings on Coverdell education savings accounts and on ABLE accounts are also smaller than the expenditure on college savings plans ($1.4 billion, and de minimis, respectively), reflecting the smaller amount of assets in these plans relative to college savings plans.

Table 2.–Select Tax Expenditures, Fiscal Years 2023-2027

Tax Expenditure	Total Amount (billions of dollars)
Exclusion of tax on earnings of college savings accounts	26.3
Exclusion of tax on earnings of prepaid tuition programs	1.3
Exclusion on earnings of Coverdell education savings accounts	1.4
ABLE accounts	*

Source: Joint Committee staff.
Notes: *Denotes quantitatively *de minimis* tax expenditure. For fiscal years 2023-2027, tax expenditures that are estimated to be less than $250 million are classified as *de minimis.*

[50] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2023*-2027 (JCX-59-23), December 7, 2023.