SPOTLIGHT

A WEALTH MANAGEMENT PUBLICATION OF FERGUSON WELLMAN, OCTAVIA GROUP AND WEST BEARING

WHAT TO DO WITH EXCESS 529 PLAN FUNDS

Are you holding back on funding your child's or grandchild's 529 account because you aren't sure how much they will use? Or have you been funding a 529 account and investing wisely, only to now find that you have excess funds that won't be used because your child isn't attending college, received scholarships, or chose a less expensive option than expected? The good news is that there are several options for transferring or withdrawing excess funds from your 529 account. Additionally, unlike other educational savings options, there is no timeframe to withdraw. Therefore, you have flexibility as you consider how to address excess funds.

Before initiating any transfers or withdrawals, make sure you've exhausted all the options available to you for taking tax-free and/or penalty-free withdrawals from a 529 plan. In recent years, there have been changes to federal 529 plan rules that allow for expanded distribution options.

Pay for K-12 Education

The One Big Beautiful Bill Act (OBBBA), signed into law in July 2025, expanded the definition of qualified expenses and increased the annual per-child distribution cap for K-12 expenses. Taxpayers may now use up to $20,000 per child annually for K-12 education expenses. This can be an effective way to spend your excess 529 plan funds without incurring income tax or penalties. Keep in mind that paying K-12 expenses will reduce the amount left over to pay for college when the child is ready to attend. This rule can be particularly helpful for those with excess funds from an older child who has a younger child in private school. We recommend that you check with your tax and financial professionals as some states, including Oregon and California, have unique rules regarding 529 plan funds that may reduce or eliminate the tax benefits when using these funds for K-12 education.

Repay Student Loans

Another recent expansion of the 529 plan rules came via the SECURE Act, which allows 529 plan funds to be withdrawn to repay up to $10,000 worth of student loans. The rules allow for a lifetime maximum of $10,000 for the beneficiary plus $10,000 for each sibling of the beneficiary. Keep in mind, you must make the student loan payment in the same year you withdraw money from your 529 account. Additionally, when you use a 529 to make student loan payments, you cannot also take a tax deduction for interest paid on student loans.

Rollover to an Able Account

An Achieving a Better Life Experience (ABLE) account is a special tax-advantaged savings account for individuals with disabilities. Similar to a 529 account, assets in an ABLE account grow tax-free and withdrawals are tax-free if they are used for certain qualified expenses of the disabled beneficiary. ABLE accounts with a value of up to $100,000 (in 2026) are also excluded from certain government means-testing and thus may not reduce other government benefits available to the beneficiary.

OBBBA extends and makes permanent several of the TCJA tax provisions and advantages that could help make ABLE accounts more attractive to savers. For example, a previous provision of the TCJA that allows 529 plan assets to be rolled over into an ABLE account for the beneficiary, or a family member of the beneficiary, was set to sunset on December 31, 2025. However, the new legislation has removed the expiration date which will allow taxpayers to continue pursuing this strategy beyond 2025. The maximum rollover per year is equal to the annual gift tax exclusion amount and counts toward the maximum annual ABLE contribution ($20,000 in 2026). Due to the specific nature of an ABLE account, this strategy may not be applicable to you, but for individuals with disabilities, it is a great way to provide tax-advantaged support to the beneficiary.

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Scholarship Withdrawals

If the beneficiary of a 529 plan is awarded a qualified scholarship, an amount equal to the scholarship value can be withdrawn without penalty. Scholarships or tuition received under veterans or employer-paid educational assistance may also qualify for the same penalty waiver. These withdrawals need to occur in the same calendar year as the scholarship or educational support is provided. While they avoid the penalty, income tax will be due on the earnings portion of any distributions.

Rollover to a Roth IRA

Beginning in 2024, 529 account owners could transfer funds from a 529 plan into a Roth IRA for the benefit of the 529 plan beneficiary tax and penalty free. This existing provision remains the same under the new legislation. Rollovers are subject to the maximum annual Roth IRA contribution limits, with a lifetime maximum of $35,000 per beneficiary. While income limits don't apply to 529-to-Roth IRA rollovers like they do for Roth contributions, the beneficiary must have earned income equal to the rollover amount in the year of the transfer.

Additionally, the annual Roth IRA contribution limit ($7,500 in 2026) still applies, so total contributions, including rollovers, cannot exceed that limit. Finally, the 529 plan must have been in existence for at least 15 years prior to the rollover, and any 529 contributions or earnings on contributions from the last 5 years are ineligible for transfer.

Important Note

As you assess the right strategy for your excess 529 plan funds, keep in mind that not all states follow federal 529 plan regulations. For example, neither Oregon nor California consider distributions for K-12 expenses as qualified expenses. Any prior state tax benefit is recaptured, plus taxes or penalties may be charged on earnings. It is important to review rules for the specific state in which a 529 plan resides before making any withdrawals. The state's 529 plan custodian should be able to provide clear guidance regarding how any withdrawal will be treated according to the specific state plan and rules.

If you have explored and exhausted all your distribution options, including those above, and still have excess funds, below are some simple options to consider.

Save for Later

The first and simplest solution is to save the money for later. Many students go on to pursue additional degrees, post-graduate programs, or other forms of training that may qualify for 529 plan distributions. 529 plan funds can be used for qualified vocational schools and apprenticeships. Keeping funds in the account will allow them to continue accumulating tax-free and can be used to finance those future educational pursuits. It is important to note that if the 529 plan assets now have a new time horizon, the asset allocation should be also reviewed.

Transfer to Another Beneficiary

While a 529 plan can only have one beneficiary at a time, the plan owner can change the beneficiary to a qualifying family member at any time. The IRS provides a rather broad definition of family members, which includes the beneficiary's blood relatives and relatives by marriage and adoption. Changing the beneficiary generally involves a simple form with the 529 plan custodian and can allow you to put those funds to good use for other children, siblings, nieces, nephews, and so on. You can even make yourself the beneficiary. Consult with your portfolio manager if you are considering changing the beneficiary as doing so may limit other options, such as the 529 plan to Roth IRA rollover.

Take a Nonqualified Withdrawal

The final option is to simply withdraw the funds from the account as a non-qualified withdrawal. Your original

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contributions can be withdrawn tax and penalty free, but any earnings will be subject to ordinary income tax and a 10% penalty for nonqualified withdrawals. While not ideal, there are times when this is the only choice.

If you find yourself with excess funds in a 529 plan, or are still developing your college savings plan, please reach out to your portfolio manager to discuss setting an appropriate savings target and investment plan, or to review and assess withdrawal strategies for excess funds.

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