Improvements to 529 Plans with the PATH Act of 2015

On December 18, 2015, Congress passed the PATH ACT which introduced several improvements to 529 college savings plans.

The following is an excerpt from the final bill.

TITLE III – MISCELLANEOUS PROVISIONS

Family Tax Relief

2. Modification of rules relating to section 529 programs (sec. 302 of the bill and sec. 529 of the Code)

Explanation of Provision

The provision makes three modifications to section 529.

First, the provision provides that qualified higher education expenses include the purchase of computer or peripheral equipment (as defined in section 168(i)(2)(B)), computer software (as defined in section 197(e)(3)(B)), or Internet access and related services if the equipment, software, or services are to be used primarily by the beneficiary during any of the years the beneficiary is enrolled at an eligible education institution.

Second, the provision repeals the rules providing that section 529 accounts must be aggregated for purposes of calculating the amount of a distribution that is included in a taxpayer's income. Thus, in the case of a designated beneficiary who has received multiple distributions from a qualified tuition program in the taxable year, the portion of a distribution that represents earnings is now to be computed on a distribution-by-distribution basis, rather than an aggregate basis, such that the computation applies to each distribution from an account. The following example illustrates the operation of this provision: Assume that two designated savings accounts have been established by the same account owner within the same qualified tuition program for the same designated beneficiary. Account A contains $20,000, all of which consists of contributed amounts (i.e., it has no earnings). Account B contains $30,000, $20,000 of which constitutes an investment in the account, and $10,000 attributable to earnings on that investment. Assume a taxpayer were to receive a $10,000 distribution from Account A, with none of the proceeds being spent on qualified higher education expenses. Under present law, both of the designated beneficiary's accounts would be aggregated for purposes of computing earnings. Thus, $2,000 of the $10,000 distribution from Account A ($10,000 * $10,000/$50,000) would be included in the designated beneficiary's income. Under the provision, the accounts would not be aggregated for purposes of determining earnings on the account. Thus, because Account A has no earnings, no amount of the distribution would be included in the designated beneficiary's income for the taxable year.

Third, the provision creates a new rule that provides, in the case of a designated beneficiary who receives a refund of any higher education expenses, any distribution that was used to pay the refunded expenses shall not be subject to tax if the designated beneficiary recontributes the refunded amount to the qualified tuition program within 60 days of receiving the refund, only to the extent that such re-contribution is not in excess of the refund. A transition rule allows for re-contributions of amounts refunded after December 31, 2014, and before the date of enactment to be made not later than 60 days after the enactment of this provision.

Effective Date

The provision allowing computer technology to be considered a higher education expense is effective for taxable years beginning after December 31, 2014. The provision removing the aggregation requirement in the case of multiple distributions is effective for distributions made after December 31, 2014. The provision allowing a re-contribution of refunded tuition amounts is effective for tuition refunded after December 31, 2014.