

NSPA Scholarship Program Toolkit Resource Guide

Source: Mark Kantrowitz, Publisher of Fastweb.com and FinAid.org

Technical Aspects of 529 Ownership as a Scholarship Tool

The College Cost Reduction and Access Act of 2007 modified section 480(a)(2) of the Higher Education Act of 1965 effective July 1, 2009 and reads:

And no distribution from any qualified education benefit described in subsection (f)(3) that is not subject to Federal income tax, shall be included as income or assets in the computation of expected family contribution for any program funded in whole or in part under this chapter

Section 480(f)(3) reads:

A qualified education benefit shall be considered an asset of—

(A) The student if the student is an independent student; or

(B) The parent if the student is a dependent student, regardless of whether the owner of the account is the student or the parent.

Thus the exclusion of distributions from need analysis is ONLY for those described in section 480(f)(3) of the HEA. Section 480(f)(3) of the HEA describes the 529 plans that are reported as assets on the FAFSA. A grandparent-owned or scholarship program-owned 529 plan is not reported on the FAFSA. As such, any distributions from such a plan are reported as untaxed income to the beneficiary on the subsequent year's FAFSA.

If a 529 plan is reported as an asset on the FAFSA, qualified distributions are not reported as income. If a 529 plan is not reported as an asset on the FAFSA, qualified distributions are reported as untaxed income to the beneficiary on the subsequent year's FAFSA. In both cases non-qualified distributions are included in AGI.

The US Department of Education has published guidance that is consistent with this interpretation of the statute in the 2009-2010 and 2010-2011 Application and Verification Guides. The following is an excerpt from page AVG-18 of the 2010-2011 Application and Verification Guide:

Qualified education benefits

Qualified tuition programs (QTPs, also known as section 529 plans because they are covered in section 529 of the IRS tax code) and Coverdell education savings accounts are grouped together in the law as qualified education benefits and have the same treatment: they are an asset of the owner (not the beneficiary because the owner can change the beneficiary at any time), except when the owner is a dependent student, in which case they are an asset of the parent. When the owner is some other person (including a non-custodial parent), distributions from these plans to the student count as untaxed income, as "money received."

As long as distributions from QTPs and ESAs do not exceed the qualified education expenses for which they are intended, they are tax-free, so they will not appear in the next year's AGI. They should not be treated as untaxed income (except in the cases mentioned above) or as estimated financial assistance. For more information on these benefits, see the IRS's Publication 970, Tax Benefits for Education.