529s for K–12 tuitions: Does it work for you?

See why you may want to prioritize college savings over K–12 in your 529.

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Key takeaways

- A key benefit of 529s is the power of tax-deferred compounding. It allows your investments the potential to grow more over time without paying taxes on any earnings along the way.
- Although the December 2017 federal tax law provides the flexibility to pay K–12 tuitions from 529 accounts, depleting your 529 account prior to college may result in paying higher out of pocket costs for college later.
- Understand and carefully consider the trade-offs before you decide if you will use up to $10,000 per year of your 529 savings accounts to pay for K–12 tuition expenses.

The Tax Cuts and Jobs Act of December 2017 changed the tax code for most Americans. For parents with younger children, one of the new opportunities is the added flexibility to use traditional 529 college saving plans to help pay for K–12 tuition expenses.

Although the money may come from multiple 529 accounts, only $10,000 total can be spent each year per beneficiary on elementary, middle, or high school tuition. For amounts greater than $10,000 that are withdrawn to pay for K–12 tuition, the earnings will be subject to income tax and a 10% federal penalty. State income taxes may vary. Contact your tax advisor for details.

"The new legislation makes adding to your 529 savings more attractive because it provides additional flexibility for parents and families who value education," says Melissa Ridolfi, vice president, retirement and college leadership at Fidelity Investments. "But with these opportunities come additional considerations and potentially, some tough trade-offs."

Given the fact that college tuition, room and board, and related expenses can be some of parents' biggest liabilities, does it make sense for you to tap into your 529 to pay for elementary or high school tuitions—or wait until your kids are heading off to university?

A family looks at 2 options for their 529 savings plan

529 plans are tax-advantaged savings accounts designed to help parents and students benefit from potential growth in the market over time. In addition to certain tax advantages like the avoidance of paying capital gains taxes, the power of compounding (where 529 accounts' earnings from both capital gains and interest are reinvested to help generate additional earnings over time) make it an attractive savings vehicle for many parents and grandparents.

There are different ways to fund current and future K–12 tuition and college expenses. Let's look at 2 hypothetical scenarios for a family.

The family plans to send their daughter to a private high school next year. They have been diligent savers since she was born and they have saved approximately $100,000 in her 529 savings account. They are expecting to send her to a private college and have estimated they will pay about $32,000 for the first year of college—an amount that is likely to grow at 5% every year.

In scenario 1, (see chart) they are considering withdrawing $10,000 per year from their 529 to help pay for 4 years of private high school. With this strategy, they would lose out on potential tax-deferred compounding benefits and they would deplete their 529 account balance halfway through the 3rd year of college. The net result would be total out of pocket costs of $53,000 for their daughter’s education expenses across high school and college.

In scenario 2, the family plans to fund $10,000 in annual tuition expenses for 4 years of private high school through savings, scholarships, and other means. By not tapping into their 529 savings account until college, they are able to see the power of compounding at work over a longer time horizon. Their $100,000 in the 529 account could have the potential to continue to grow and fund the entire cost of their daughter's college education. As a result, they would have paid a total out of pocket cost of $40,000 for their daughter's educational expenses across high school and college (see chart).

By keeping more money in their 529 account for a longer period of time, the family could save approximately $13,000 ($53,000 vs. $40,000) in total out of pocket educational expenses for their daughter's high school and college education—and avoid taking out college loans to finance Year 3 and Year 4 of college for their daughter, which with interest, would further increase the total costs of college.

Scenario 1

Using 529 for K-12 and college

Age	529 balance	529 withdrawals	Out of pocket	Approximate 529 ending account balance
15	$100,000.00	$10,000.00		$95,000.00
16	$95,000.00	$10,000.00		$89,750.00
17	$89,750.00	$10,000.00		$84,238.00
18	$84,238.00	$10,000.00		$78,449.38
19	$78,449.00	$31,907.00		$50,464.80
20	$50,465.00	$33,502.00		$19,485.65
21	$19,486.00	$35,178.00	$15,692.00	$974.28
22	$0.00	$36,936.00	$36,936.00	$0.00
	Total out of pocket		**$52,628.00**	

Scenario 2

Using 529 for college only

Age	529 balance	529 withdrawals	Out of pocket	Approximate 529 ending account balance
15	$100,000.00		$10,000.00	$105,000.00

16	$105,000.00		$10,000.00	$110,250.00
17	$110,250.00		$10,000.00	$115,762.50
18	$115,763.00		$10,000.00	$121,550.63
19	$121,551.00	$31,907.00		$95,721.12
20	$95,721.00	$33,502.00		$67,004.78
21	$67,005.00	$35,178.00		$35,177.51
22	$35,1780.00	$36,936.00		$0.00
	Total out of pocket		**$40,000.00**	

For illustrative purposes only. The hypothetical scenarios assume a total annualized return of 5.0% and an increase in college costs of 5.0% per year. For this example, the child is age 15 and the current 529 saving account balance is $100,000. No further contributions are assumed in either example. The illustrations do not consider investment expenses and state tax exemption or taxation of qualifying withdrawals. The parents plan to pay for the estimated $32,000 cost of college annually starting in 4 years.

"Although the 529 does give you added flexibility to meet short-term needs like K–12 tuition bills, you may pay more in the long term due to the potential loss of the tax advantaged and compounding benefits of a 529," advises Ridolfi. "It's important to have every dollar available earning a return if you want to maximize your college savings."

A popular choice in Fidelity-managed 529 plans includes age-based investment options that potentially help you stay on track with the goal you choose at the onset. These investment options are designed to automatically shift your investment mix from more aggressive (more stocks) to more conservative (fewer stocks) as your child approaches college age so withdrawing assets from the account before maturity can impact the effectiveness of the age-based strategy."

Tip: We understand that there may be family emergencies or other times when it may be necessary to tap into a 529 account prior to the college years. However, if you do, the key would be to contribute back those amounts annually (from other sources of personal savings) to help keep your college savings efforts on track.

Keeping your college savings on track

While many families have found a variety of ways to pay for ongoing educational expenses, it's important not to lose sight of the college savings goal for each child. To that end, we've come up with a simple rule of thumb to check whether your college savings are on track. We call it the "college savings 2K rule of thumb." Simply multiply your child's current age by

$2,000. This amount can show you whether your college savings to date are generally on track to cover 50% of the cost of attending a 4-year public college.

Another way to check your progress is to use Fidelity's college savings calculator, which allows you to change several key assumptions and then see how the outcome is affected. The results will show you approximately how much you should have saved to date, assuming this steady savings rate continues into the future. If you are behind in your savings efforts, the calculator gives you the ability to adjust your monthly savings amount and see what the impact would be in closing the savings gap.

Not on track? You're not alone. According to the 2016 Fidelity College Savings Indicator,[1] parents across the US want to save close to 70% of expected college costs—yet they are only on track for about 30% as a whole.

Can you boost your savings even more? Many parents believe they can—and should—be saving more for college in their kids' 529 plans. Thinking back over the past 10 years, 52% of parents with children in 10th grade or older say that they could have saved more each month, with a median incremental amount of $200 per month.

Tip: Increase your savings by applying for a Fidelity Investments 529 College Rewards® Visa Signature® Card.[2]

Putting college savings into perspective

"Although the new tax laws provide greater flexibility to use 529s to pay for K–12 expenses, many families will be faced with tough choices. Parents can work with a financial advisor to figure out and decide what's right for their unique situation, in order to stay on track with their long-term education goals," says Ridolfi. "A 529 is one of best ways for parents and grandparents to save because the combination of tax advantages and the power of compounding can help parents save more over the long haul."

Tip: Savings can truly be a family affair. Fidelity offers a 529 Online Gifting Service, which lets owners of Fidelity's retail 529 college savings accounts use social media and email to encourage friends and family to help them save for college.

Next steps to consider

Save for college

Open a flexible, tax-advantaged 529 college savings plan.

Are you saving enough for college?

Check to see if you're on track with our college savings calculator.

ABCs of 529 plans

Learn how college savings plans work, including tax savings.

1. The 2016 College Savings Indicator was calculated by Strategic Advisers, Inc. in collaboration with Fidelity Investments Research and Analysis.

2. You will earn 2 Points per dollar in eligible net purchases (net purchases are purchases minus credits and returns) that you charge. Account must be open and in good standing to earn and redeem rewards and benefits. Upon approval, refer to your Program Rules for additional information. You may not redeem Reward Points, and you will immediately lose all of your Reward Points, if your Account is closed to future transactions (including, but not limited to, due to Program misuse, failure to pay, bankruptcy, or death). Reward Points will not expire as long as your Account remains open. Certain transactions are not eligible for Reward Points, including Advances (as defined in the Agreement, including wire transfers, travelers checks, money orders, foreign cash transactions, betting transactions, lottery tickets and ATM disbursements), Annual Fee, convenience checks, balance transfers, unauthorized or fraudulent charges, overdraft advances, interest charges, fees, credit insurance charges, transactions to fund certain prepaid card products, U.S. Mint purchases, or transactions to purchase cash convertible items. The 2% cash back rewards value applies only to Points redeemed for a deposit into an eligible Fidelity account. The redemption value is different if you choose to redeem your Points for other rewards such as travel options, merchandise, gift cards, and/or statement credit. Other restrictions apply. Full details appear in the Program Rules new card customers receive with their card. Establishment or ownership of a Fidelity account or other relationship with Fidelity Investments is not required to obtain a card or to be eligible to use Points to obtain any rewards offered under the program other than Fidelity Rewards.

or lose money.

529 Participants may take up to $10,000 in distributions tax free per beneficiary for tuition expenses incurred with the enrollment or attendance of the designated beneficiary at a public, private, or religious elementary or secondary school per taxable year. The money may come from multiple 529 accounts; however, the $10,000 amount will be aggregated on a per beneficiary basis. Any distributions in excess of $10,000 per beneficiary may be subject to income taxes and a federal penalty tax.

If you or the designated beneficiary is not a New Hampshire, Massachusetts, Delaware, or Arizona resident, you may want to consider, before investing, whether your state or the beneficiary's home state offers its residents a plan with alternate state tax advantages or other state benefits such as financial aid, scholarship funds and protection from creditors.

The UNIQUE College Investing Plan, U.Fund College Investing Plan, Delaware College Investment Plan, and Fidelity Arizona College Savings Plan are offered by the state of New Hampshire, MEFA, the state of Delaware, and the Arizona Commission for Postsecondary Education, respectively, and managed by Fidelity Investments.

Units of the portfolios are municipal securities and may be subject to market volatility and fluctuation.

Please carefully consider the plan's investment objectives, risks, charges, and expenses before investing. For this and other information on any 529 college savings plan managed by Fidelity, contact Fidelity for a free Fact Kit, or view one online. Read it carefully before you invest or send money.

Votes are submitted voluntarily by individuals and reflect their own opinion of the article's helpfulness. A percentage value for helpfulness will display once a sufficient number of votes have been submitted.

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