

529 Plan vs Taxable Brokerage for College Savings

Compare a 529 plan with a taxable brokerage account for college savings using a concrete 12-year scenario, tax drag assumptions, flexibility tradeoffs, and 529 overfunding risks.

CALCULATOR

529 College Savings Calculator

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ARTICLE

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The practical answer is not "529 good, brokerage bad." The right question is: **how much of this money are you confident will be used for education, and how much flexibility do you need if the plan changes?**

The short version:

- A 529 can offer federal tax-free growth and withdrawals when used for qualified education expenses.
- Some states add a deduction or credit, but state rules vary and should be checked before relying on them.
- A taxable brokerage account can be used for anything, but dividends, interest, and realized gains can create tax drag along the way.
- Overfunding a 529 is manageable, but it is still a planning issue.
- The best setup for many families is a core 529 target plus a flexible taxable or cash buffer.

You can test your own numbers in the [529 College Savings Calculator](#). The public overview page is the [529 College Savings Calculator marketing page](#).

What A 529 Plan Does

A 529 plan, also called a qualified tuition program, is a tax-advantaged account designed for education costs. The IRS describes qualified tuition programs as state, agency, or eligible institution programs that let contributors prepay or save for qualified education expenses. See [IRS Topic No. 313 on Qualified Tuition Programs](#) and [IRS Publication 970](#).

For planning purposes, the key advantage is simple: if withdrawals are used for qualified education expenses, the investment growth can avoid federal income tax. That is different from a taxable brokerage account, where interest, dividends, and realized gains may be taxable.

That does not make a 529 free money. It makes the account powerful when the use case is clear.

What A Taxable Brokerage Account Does

A taxable brokerage account is flexible. It can pay for college, a gap year, a first apartment, a car, graduate school outside the 529 rules, or a family emergency. There is no education-only wrapper around the account.

The tradeoff is tax drag. Depending on the investments and how often gains are realized, some of the return may be reduced by taxes before the money is needed. A low-turnover index portfolio may have modest drag. A high-yield or actively traded portfolio may have more.

That is why the comparison should use a scenario instead of a slogan.

Example Scenario: \$300 A Month For 12 Years

Assume a family has a 6-year-old, \$10,000 already saved, and 12 years until the first college bill. They can contribute \$300 per month.

Input	529 scenario	Taxable brokerage scenario
Starting balance	\$10,000	\$10,000
Monthly contribution	\$300	\$300
Time until college	12 years	12 years
Gross return assumption	6.0%	6.0%
Tax drag assumption	0.0% if used for qualified expenses	0.9 percentage points
Modeled after-tax return	6.0%	5.1%
Assumed state tax value	5% of annual contributions	None

This is only an example. Your state tax benefit, investment mix, and realized tax drag may be different.

Why The 529 Advantage Can Be Bigger Or Smaller

The account choice is sensitive to assumptions.

1. State 529 Benefits

Some states offer a deduction or credit for contributions. Some do not. Some require using the in-state plan. Some limit the deduction by taxpayer, beneficiary, or filing status.

The College Planner keeps state 529 assumptions editable for that reason. Do not hard-code a state benefit into your plan without checking your current state rules.

2. Tax Drag In The Brokerage Account

A taxable account invested in broad index funds may have less annual drag than the 0.9 percentage point example used here. A portfolio with taxable bond interest, frequent trading, or large realized gains may have more.

The point is not that 5.1% is the correct after-tax return. The point is that the taxable account should be modeled after taxes, not as if it were identical to the 529.

3. Confidence That The Money Will Be Used For Education

The more confident you are that the money will pay qualified education expenses, the stronger the 529 case becomes. The less certain you are, the more valuable brokerage flexibility becomes.

College Board's latest Trends in College Pricing materials are a reminder that sticker prices, net prices, room and board, and aid can vary widely by school type. Use the [College Board Trends in College Pricing research hub](#) as cost context, then model your own school target.

What If You Save Too Much In The 529?

Overfunding is not automatically a disaster, but it should be planned. For a full scenario with contribution levers, see [What If You Save Too Much in a 529?](#).

Common options may include:

- Changing the beneficiary to another eligible family member.
- Saving the account for graduate school or future qualified education expenses.
- Taking a nonqualified withdrawal, where earnings may be taxable and may face an additional tax.
- Considering a 529-to-Roth IRA rollover for the beneficiary when the rules and limits are satisfied.

Those options are useful, but they are not a reason to ignore overfunding. The better move is to watch the surplus output and adjust contributions before the account grows far beyond the target.

A Practical Split: Core 529 Plus Flexible Buffer

Many households do not need to choose one account for every dollar.

A practical structure can look like this:

Bucket	Purpose	Example rule
529 plan	High-confidence education goal	Fund the public in-state or partial-family-share target
Taxable brokerage	Flexible long-term buffer	Use for optional private-school gap, graduate school uncertainty, or non-college needs
Cash savings	Near-term stability	Keep emergency and tuition-timing needs separate from market risk

This prevents the 529 from carrying every possible college scenario. It also prevents flexibility from becoming an excuse to ignore taxes entirely.

If you are still trying to set the monthly amount before choosing the account mix, start with [how much to save for college each month](#), then come back to this account-choice test.

How To Test Your Own Plan

Open the [529 College Savings Calculator](#) and run two versions:

1. Turn the 529 planning assumptions on and enter your current balance, child age, monthly contribution, school type, return assumption, and state tax assumptions.
2. Rerun the same contribution as a taxable-account comparison by reducing the return assumption for expected tax drag and setting state 529 benefits to zero.
3. Compare the funded percentage, shortfall, surplus, and state tax savings.
4. Lower the family share from 100% to 75% or 50% if you do not intend to cover the full bill.
5. Increase and decrease the monthly contribution by \$100 to see whether the plan is fragile.

The goal is not to pick the account with the biggest number in one run. The goal is to find the account mix that still works when college cost, aid, returns, and family priorities change.

Common Mistakes

Treating Taxable Flexibility As Free

Flexibility is valuable, but it can have a cost. If a taxable account is really earmarked for college, model the after-tax return.

Treating The 529 As Risk-Free

A 529 is still an investment account unless the money is in a prepaid tuition or guaranteed option. Market returns can disappoint, and college costs can rise faster than expected.

Chasing The State Deduction Without Checking The Full Plan

A state tax benefit can help, but it should not be the only reason for the account choice. The bigger drivers are contribution amount, time horizon, school target, return assumptions, and whether the money is likely to be used for qualified expenses.

Funding 100% By Default

Some families want to cover the full bill. Others want to cover half, public in-state only, or a fixed annual amount. The calculator's family-share assumption lets you model that directly.

Bottom Line

Use a 529 for the portion of college savings you are confident will be used for qualified education expenses. Use a taxable brokerage account when flexibility is worth the likely tax drag. If you are unsure, split the goal: fund a realistic 529 core, then keep optional dollars flexible.

This article is educational, not personalized tax, investment, or financial advice. Check current IRS rules, state 529 rules, and your own tax situation before making contribution decisions.

Sources

- [IRS Topic No. 313, Qualified Tuition Programs](#)
- [IRS Publication 970, Tax Benefits for Education](#)
- [College Board Trends in College Pricing](#)