Plans Provide a Tool for Funding Education

The Basics of 529 Plans

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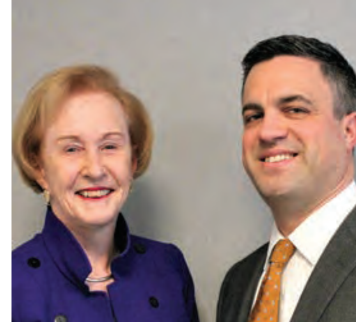

As summer winds to a close, millions of students across the country are returning to school and millions of parents are planning for current or future college tuition bills. Section 529 college savings plans, introduced in 1997, are one of the most popular tools available to help save for college. Although the benefits can be powerful, it's important to understand how these plans are set up, how they work with financial aid and what requirements must be met to get the most out of them.

A 529 plan is a trust account that allows you to fund future college, graduate or vocational school expenses for a designated beneficiary. Typically, the account owner is the parent or grandparent and the beneficiary is a child or grandchild, but these accounts may be set up for anyone.

The primary benefit of the 529 savings plan is that the appreciation of the assets in the plan is tax-free, as long as the distributions are used for qualified higher education expenses. In addition, in some states you obtain a tax deduction for your investment when you invest in a 529 plan.

Although the plans were historically focused on postsecondary education, recent changes now allow limited use of these accounts for kindergarten through 12th grade expenses. Before we address these changes, we'll focus on the benefits and mechanics of 529 savings plans.

How Can You Use Distributions From 529 College Savings Plans?

Money withdrawn from these plans is fully tax-free if used for qualified higher education expenses. A QHEE is defined as tuition, room and board costs, and student activity fees as well as computers, internet access and related equipment.

Expenses for course-related books, supplies and equipment are also included in qualified education expenses, if the expenses must be paid as a condition of enrollment or attendance.

Students living off-campus can include expenses in lieu of "room and board," up to a FAFSA (Free Application for Federal Student Aid) limit on room and board published by each school.

An eligible educational institution is any college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. Eligibility includes virtually all accredited public, private and for-profit postsecondary institutions. In addition, certain schools outside the United States are eligible. You can check online with the FAFSA to see whether your institution qualifies, using its Federal School Code Search.

Will Investing in a 529 Plan Negatively Impact Eligibility for Financial Aid?

Yes, it will. But in most cases, if done correctly, chances are that the benefits will far exceed the minimal effect on financial aid. First, it's important to note that setting up a 529 plan doesn't affect chances for a merit based scholarship.

FAFSA rules determine how the assets in 529 plans are counted when calculating aid. How much federal financial aid you receive is based on family and student earnings and assets. The higher the assets and income, the less financial aid.

If a parent owns the 529 plan, it's counted as a parent's asset at up to 5.64 percent, but there's no income to the student for payment to the school.

If a grandparent owns the 529 plan, the asset itself isn't counted at all. But when payment to the school is made from the grandparent-owned plan, it can be counted as income to the student at 50 percent.

For example, if a parent owns a 529 plan worth \$10,000, the most that's counted against financial aid is \$564. If \$10,000 were paid from the grandparent-owned plan for freshman year tuition, \$5,000 would be counted against financial aid.

If the student owns the 529 plan, the asset is counted as a student asset at 20 percent of the assets in the 529 plan and the payment to the school is counted as student income up to 50 percent.

The details of how financial aid is calculated are beyond the scope of this article, but it's important to note that with some diligent planning around when 529 assets are withdrawn, you can lessen the impact of non-parent-owned 529 assets on financial aid eligibility. It's important to talk to your financial planner as the student approaches enrollment to determine the best strategy for 529 plans and financial aid.

Do I Have to Invest in a 529 Plan Sponsored by My State of Residence?

Although each state sponsors its own 529 plan, you do not have to invest in the plan from your home state. Regardless of what state's plan you choose, you can use the money to fund expenses at any eligible school. You aren't limited to schools within your state, or the state of the plan. Further, you don't have to contribute all your money for one child into one state's 529 savings plan. You can divide your money for the same child among different plans. The fees, expenses and features of 529 plans can vary from state to state.

Do I Get a Tax Deduction for Investing in a 529 Plan?

Although the amount of your contribution in these plans isn't federally tax-deductible, it's often partially tax-deductible on your state income tax, up to certain limits. This state tax break is typically only available if you use your home state's plan. But six states (Arizona, Kansas, Minnesota, Missouri, Montana and Pennsylvania) offer tax deductions for contributions to any 529 plan.

What Is the Maximum I Can Invest in a 529 Plan?

Each individual currently may contribute as much as $75,000 at one time into a 529 plan for a particular beneficiary without exceeding the annual gift tax exclusion ($15,000 in 2019), using a technique called five-year forward gifting.

Be aware, however, that "front-loading" the 529 plan with $75,000 means you're using five years of your annual gift tax exclusion at one time; this requires the filing of an Internal Revenue Service Form 709 gift tax return. Any further contributions you make to the plan within five years would then be subject to gift tax. Gifts by others to the plan wouldn't be subject to this limit.

A husband and wife can contribute twice that amount per child for a total of $150,000 in a lump sum. This also requires filing a Form 709 gift tax return as an acknowledgment that the gift is being split.

Is There a Maximum Amount I Can Have in a 529 Plan per Beneficiary?

The maximum account value for a beneficiary varies depending on which state's plan you use, from a low of $235,000 (Georgia) to a high of $529,000 (California).

When Should I Start Contributing to a 529 Plan?

As with most investments, the earlier you start, the better. If you're able to, start as early as when the child is born and contribute annually. The benefits can mount up. For example, let's assume you contribute $5,000 each year to the 529 fund and that you earn a relatively modest 5% annual return. If you started five years before college, you would have $27,932 available at the time of enrollment. If you started contributing at the child's birth, however, you would have $141,234 available at enrollment.

- **5 years,** $27, 932
- **10 years,** $63, 277
- **18 years,** $141, 234

Are There Estate-Planning Benefits for Contributing to a 529 Plan?

Once you've contributed to a Section 529 savings plan, the assets in that account are excluded from your taxable estate unless you've elected five-year forward gifting. In that case, the gifts for future years are called back as estate assets until the donor outlives the five-year period. If the donor doesn't outlive the five-year period, there's a pro rata recapture back into the estate of the donor.

How Are Distributions Made?

Withdrawals from a 529 savings plan can be paid to the account holder, the beneficiary or the educational institution. If financial aid is involved, we suggest not paying the educational institution directly, as some schools reduce a student's financial aid by the amount of the Section 529 distribution.

In this case, we recommend the account holder pay the tuition bill, then reimburse himself with a 529 withdrawal. Note that it's important that the paid education costs and the matching reimbursement withdrawal take place in the same year.

What Are the Penalties if I Withdraw Money and Don't Use It for Qualified Higher Education Expenses?

In this case, the gains will be taxable at the account holder's tax bracket and will be subject to a 10% federal surcharge, with exceptions for the beneficiary's death, disability or receipt of a scholarship.

What Happens if I Set Up a Fund for Someone Who Doesn't Go to College?

In most states these plans can remain in existence indefinitely. There's no age limitation for distributions. Further, the unused benefit can be transferred to another member of the designated beneficiary's family:

- **Spouse; son** *or* **daughter** *or* **descendant** *of the beneficiary's son or daughter;* **stepson or stepdaughter; brother, sister**, **stepbrother** *or* **stepsister**; **father** *or* **mother** *or* **ancestor** *of either parent*; **stepfather** *or* **stepmother**; **niece or nephew; aunt** *or* **uncle; the spouse** *of any individual listed above*; **first cousin***; and* **any individual for whom the home** *of the designated beneficiary is his or her primary home for the entire tax year.*

The beneficiary may be changed only once every 12 months.

Who Selects the Investments Made in the 529 Plan?

Each state has an arrangement with an investment company to provide a menu of investment options within the plan. The account owner then chooses how to invest the from the investment menu offered in the plan. Plan investments may be changed only two times per year.

Changes for 2018 and Beyond: K-12 Tuition Now Partially Eligible!

In 2018, a notable change was made to 529 plan rules. Distributions from 529 plans can now be made for up to $10,000 per year in private elementary and high-school tuition expenses. The 2018 change allows additional flexibility, but it has also brought

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BetterInvesting's Ann McNeill Creates Public Day Offering

Seminar Brings Financial Empowerment to the Public

by Adam Ritt, Editor in Chief

On Saturday, May 18, the BetterInvesting National Convention hosted a financial empowerment seminar developed by longtime volunteer Ann McNeill, out of the Southeast Florida Chapter. The daylong seminar, held during BINC's Public Day, was free and open to all who were interested in learning how to take control of their financial future.

Better Educated. From left are Ann McNeill, BetterInvesting board member Eve Lewis and BINC attendee Katina McClinton.

The seminar covered understanding credit, including how to create a budget; learning the basics of saving; completing simple steps to get out of debt; and beginning the journey to take control of your financial future. The benefits of investing were also discussed.

Attendees registered separately for this event, while BetterInvesting volunteers supported the seminar. BINC Chairman Deane Jaeger welcomed the attendees and BetterInvesting board member Jackie Cummings Koski discussed basic concepts of personal financial management during the event.

Ann's daughter Ionnie led a session on investing. She walked attendees through the expected returns from investing, as well as the superior long-term returns from stocks, and detailed the other benefits of stock ownership, including the ability to participate in capital formation in the United States. William W. Towns of Benefit Chicago, which makes investments targeting the social enterprise sector of Chicago, also spoke..

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confusion. Although these withdrawals are tax-free at the federal level, more than a dozen states have yet to update their tax codes to make them tax-free at the state level. Thus, it's crucial to talk to your financial planner and accountant before making a withdrawal for K-12 tuition expenses.

Conclusion

Although we covered a lot of material here, it's important to talk to your financial planner about how a 529 plan might fit with your particular situation. When used properly, they can provide a tremendous boost to the ability to pay for higher education.

The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that a college-funding goal will be met. In order to be federally tax-free, earnings must be used to pay for qualified higher education expenses. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10% penalty. By investing in a plan outside your state of residence, you may lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.

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Consult your personal financial adviser before making any decisions. Ms. Armstrong can't answer individual inquiries, but welcomes suggestions for future article topics.

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