529 Plan Basics

- A 529 Plan is an investment account that offers tax benefits when used to pay for qualified education expenses. Most states offer their own 529 savings plans, and you can choose other state plans without restrictions. Age limits for contributing to the plan vary by state, but contributions can be made for beneficiaries past age 18. Unlike many other types of education savings accounts or trusts, money accumulated in the plan is not required to be distributed to the beneficiary by a certain age.

Qualified Expenses

- The money in an account can be used to pay for any accredited school that is eligible for federal financial aid, such as two-year or four-year public or private colleges and universities, graduate schools, and professional schools. Qualified expenses include:
  - Tuition and fees (including K-12 tuition)
    - Eligibility and amount of funds used for K-12 tuition may vary by state.
  - Books and materials
  - Room and board
  - Computers and related equipment
  - Student loan repayments

Taxation of 529 Plans

- Contributions to 529 plans are made with after-tax dollars. The earnings grow tax-deferred, and distributions are tax-free if used for qualified education expenses.
- You may also qualify for state income tax benefits. More than 30 states offer state income tax benefits for 529 plan contributions.
- If 529 dollars are distributed for non-qualified expenses, ordinary income taxes plus an additional 10% penalty may apply (only on the appreciation and not the principal.)

Rules for Changing Beneficiaries

- The beneficiary can be changed with no penalty to a qualifying family member which includes:
  - Spouse
  - Son, daughter, stepchild, foster child, adopted child or a descendant
  - Son-in-law, daughter-in-law
  - Siblings or step-siblings
  - Brother-in-law, sister-in-law
  - Father-in-law, mother-in-law
  - Father or mother or ancestor of either, stepmother, stepfather
  - Aunt, uncle or their spouse
  - Niece, nephew or their spouse
  - First cousin or their spouse

Rules for Changing Owners

- Most states allow changing ownership of a 529 plan and there are generally no requirements for the relationship between the former and the new account owner. However, many states, only allow you to change ownership of a 529 plan when the original account owner dies or in special circumstances, such as divorce.

- If changing ownership of a 529 plan makes sense for you, you can change the account owner, or roll over the account, tax-free, one time during a 12-month window. If you change ownership of the account more than one time in a 12-month period, the transaction would be considered a nonqualified distribution and would be subject to ordinary income taxes plus a 10% penalty.

Investment Options

- Age Based
  - With age based plans the 529 plan provider creates portfolios based on a stock/bond allocation that matches the students age/time horizon. The savings then move through a series of portfolios to become more conservative over time.
- Individual Portfolios
  - With individual portfolios you can design and manage your own investment strategy, allowing you to have more control.
  - In this case the account owner is responsible for shifting the asset allocation as the student's time horizon shortens.
- Advisor managed portfolios

Potential Income and Gift Tax Consequences

- Gift
  - There are gift tax implications for large annual gifts. For contributions over $16k in 2022 (or $32k when gift splitting) the excess will count against your lifetime estate and gift tax exemption. The aggregate contribution limit for 529 plans ranges from $235,000 to $550,000.
  - Potential gift tax implications to beneficiaries
- Income Taxes
  - Earnings distributed for non-qualified education expenses are subject to a 10% penalty and income taxes.

Forward Funding

- Contributions made to a Section 529 plan can be "forward-funded" so that five years' worth of annual exclusion gifts can be contributed in the first year, without incurring a taxable gift.
- For example, individuals can gift $16,000 to others each year free from gift taxes. A father could establish a 529 plan for his son and contribute $80,000 to the plan without making a taxable gift. The father could also contribute up to $160,000 if his spouse consents to split the gift with him. Gift-splitting is available when both spouses agree to make gifts to others. Contributions made to a 529 plan will reduce the value of the contributor's gross estate, which in turn may reduce the amount of estate taxes due at their death. However, a plan owner's estate must include a portion of any contribution made within the five year period if he does not live beyond the fourth year.

Dynasty 529 Plan

- This is a strategy to over fund one or multiple 529 plans to pay for each generation's education cost. After the current generation's education is funded, the assets remain invested in the plan and grow tax-free until the assets are used to fund the next generation's education. This strategy is complex and must be implemented under the guidance of an estate planning attorney with expertise in 529 planning and gift tax rules.

FAQ

- **My child was just accepted into the United States Military Academy at West Point, which covers all education expenses. How should I use the assets in my 529 plan?**
  There are countless ways to use the assets in your 529 plan. In this particular case, your ambitious child may want to attend graduate school after their service obligation. Therefore, you may use the assets in your 529 plan to pay for your child's graduate degree so long as they attend an eligible higher education institution. However, if you would like to use that money now, the Military Tax Act waives the 10% penalty for withdrawing 529 plan assets, meaning you can withdraw the funds with no penalty if your child enters the military. You will simply have to pay taxes on the earnings.
- **My child received a scholarship and I no longer have to pay for school, how should I use my 529 plan?**Other than tuition, qualified higher education expenses include textbooks, supplies and equipment required for enrollment, special needs services, and, in most cases, room and board costs. You can use your 529 plan assets for any of these expenses.
    - For room and board expenses to qualify, the student must be enrolled on at least a half-time basis. The 529 plan can be used to cover on- or off-campus housing.
- **Can I use the savings in my 529 plan for my child's sibling if I want to?**
  Yes, this is another alternate use for your 529 plan, especially if one of your children incurs no higher education expenses. The beneficiary of a 529 plan can be switched to anybody in your family with no penalty, meaning you can even use it to pay for the education of your niece or nephew, a cousin, or a grandchild.
    - You can switch the beneficiary on your 529 plan once annually. This means that if you need to switch it back for any reason, you are able to do so.
- **Can I pay for my child's high school tuition with my 529 plan assets?**
  Yes. You can use 529 plan assets to cover up to $10,000 in pre-college tuition expenses per year. Assets in a 529 plan can also be used to pay for up to $10,000 worth of student loan debt annually.
- **My child wants to pursue trade school, can I use my 529 plan assets to pay for their schooling?**
  This is another fantastic way to use your 529 plan. 529 plan assets can be used to pay for two-year college programs, trade schools, or vocational schools, so long as the institution your child attends is eligible.
- **Can I use my 529 plan assets to pay for a vacation?**
  Since 529 plans receive special tax benefits specifically because they contribute to education expenses, you cannot use your 529 plan assets for something other than education expenses without incurring a penalty.
    - Using 529 plan assets for other than education expenses will trigger a 10% penalty and make subject to income tax all the earnings from your 529 savings account.

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