529 Planning:
A Tax-Advantaged Savings Plan

Key Highlights

- Overview of college savings or 529 plan accounts
- Benefits and drawbacks of establishing these accounts
- Use of plan before, during, and after college/post-secondary education

What are 529 plans?

529 plans are tax-advantaged, savings accounts that can be used for post-secondary education expenses including tuition, books, and room and board. They are called 529 plans as it relates to the IRS code section that provided the rules around the establishment of these types of accounts. The inception of the 529 plan was in 1996.

Beginning in 2018, these accounts can also cover tuition expenses for grades K- 12 with a $10,000/year cap. This newer provision was included in the Tax Cuts and Jobs Act of 2017 (TCJA).

There are a variety of tax benefits available with 529 plan accounts. Accounts are funded with gifts from individuals who can be family members or non-family members. Once the account is funded, the value of the account may increase over time. The income earned and the potential growth of the account is tax-free. Anything withdrawn from the account for qualified education expenses are done so without the owner or beneficiary of the account recognizing any tax. Meaning, an individual can earn income on the account, sell positions in the account, and remove funds from the account without paying any income taxes (again, only if the withdrawals are used for qualified education expenses).

In addition, depending on an individual's state of residency and the 529 plan utilized (e.g. Ohio Savings Plan, my529, etc.), they may receive a current year deduction on state income tax returns. Based on the state rules, they may be limited to contributing funds to their resident state 529 plan to obtain the tax benefit. We recommend researching each plan carefully and consulting a tax expert.

While the 529 plan provides tax benefits, there are some potential downsides. One possible drawback is that the account can be overfunded and once the funds are deposited, the individual making the gift to the beneficiary cannot access the funds for personal use. Another issue could be if the beneficiary does not attend private school or qualified institution and the 529 plan is not utilized. Depending on the value of that account when the beneficiary turns age 18 or 19, funds that were intended for education expenses will be locked up into the 529 plan structure limiting the use of the funds.

Lastly, it is possible the value of the 529 plan account will be includable in the student's financial aid calculation. Starting in 2024, if a grandparent is the owner of the 529 plan (not the parent), the value of the account will not count against the beneficiary's calculations for federal financial aid. However, it can still count against a student for purpose of the CSS profile, an online application used by more than 200 college and universities to award non-federal institutional aid. As a result, it is important to evaluate who should be the owner of the account if federal aid is a factor in funding higher education expenses.

What is considered a qualified expense?

Qualified expenses can include anything charged by the institution to attend, including:

- Tuition
- Room and Board – on and off campus (*off campus subject to a limit = what the institution charged for room and board)
- College Textbooks
- School supplies

Travel (e.g. flights home) is *not* considered a qualified expense.

What is considered a qualified institution?

A qualified institution is any institution that provides Federal Student Aid (FAFSA). This includes four-year universities, community colleges, trade, technical and vocational schools, certificate programs, and apprenticeships.

You may be thinking, “What if the beneficiary does not attend a qualified institution?”. Students attending university in foreign countries may run into roadblocks using 529 plans. If that specific university or institution does not provide Federal Student Aid (FAFSA), then withdrawals from the 529 plan will be subject to the 10% penalty and income tax.

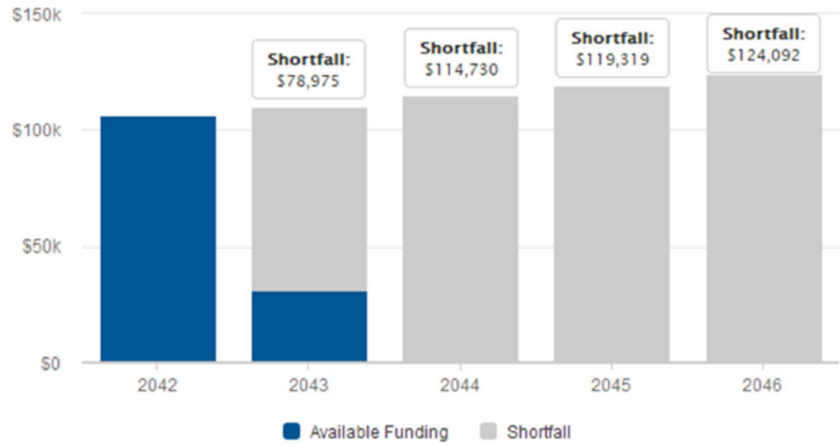
Are there contribution limits?

There are no contribution limits (although each state has different rules capping maximum account value). However, per the Federal gift tax rules, any gifts above the annual exclusion ($18,000/individual or $36,000/married couple for 2024) are subject to gift tax. There is a way to fund the account above the annual exclusion limit by using the “superfund” method:

- Contribute five years’ worth of annual exclusion gift amounts at once.
- Current superfund limits are $90,000 for individual and $180,000 if the individuals funding the accounts are married.

Once the account is funded, there are options to invest the account balance. Each plan offers different investment options ranging from cash to stocks and bonds. "Target-Date" funds options provide a diversified approach based on beneficiary's college start-date. Higher allocation to equities in early years and higher allocation to bonds as college "target-date" nears. Products are typically low-cost mutual funds like Vanguard’s Target Enrollment funds (the Vanguard Total Enrollment 2042/2043 Portfolio expense ratio is 0.14%/year).

When considering how much is appropriate to fund a new account or add to an existing account, it is important to note there is no right or wrong amount. If funds are set aside earlier, the longer the funds can appreciate over time. To help illustrate the concept of compounding returns, the next page includes an example of an account that was started with $50,000 when the beneficiary was born.



University of Hawaii at Manoa

Honolulu, HI
Out-of-State

Cost	Value
Years	2042 - 2046
Annual Cost (Today's Value)	$52,363
Cost Grows at	4.00%
Annual Cost (Future Value)	$106,074
Funding	**Value**
Dedicated Funding	$50,000
Annual Contributions	$0 / year
Growth	$87,416
Outside Funding	$0
Dedicated Funding Used	$137,416

Options for Meeting Needs

- Increase your savings by $1,656 each month
- Set aside $437,116 more in dedicated funds right now
- Reduce your annual education cost by $38,663

Education Goal Summary

Total 5-Year Cost	$574,532
Total Funding	$137,416
Total Shortfall	$437,116

Source: eMoney Advisor. This analysis must be reviewed in conjunction with the limitations and conditions disclosed in the Disclaimer page. Projections are based on assumptions provided by the advisor and are not guaranteed. Actual results will vary, perhaps to a significant degree. The projected reports are hypothetical in nature and for illustrative purposes only. Return assumptions do not reflect the deduction of any commissions. They will reflect any fees or product charges when entered by the advisor/ representative. Deduction of such charges would result in a lower rate of return. Consult your legal and/or tax advisor before implementing any tax or legal strategies.

What if the beneficiary does not use the full 529 balance?

There are a few options if the beneficiary does not use the full 529 plan balance:

- The 529 beneficiary can be changed or rolled over tax-free to another family member (allows for reallocation of resources within a family if education needs to change). Family members can be another child, grandchild, sibling, niece, nephew, etc.
- They can keep the account and decide to use it later in life for qualified education expenses. There is no expiration date to the account. If a balance exists upon the beneficiary's death, the account would be distributed to the successor owner and/or listed beneficiary on file with the 529 plan provider.
- Effective January 2024, up to $35,000 of the remaining balance can be rolled over to a Roth IRA account (provided the account is at least 15 years old and the rollover is subject to annual IRA contribution limits). The annual rollover cap for 2024 is $7,000.
- Another provision in the 2017 TCJA allows for the owners of accounts where the beneficiary is or becomes disabled, to roll over any remaining 529 plan account balances into ABLE accounts. ABLE accounts are essentially 529 plan accounts, but the funds are used for qualified disability expenses. The IRS limits the rollovers from an existing 529 plan to the annual exclusion amount each year ($18,000/individual or $36,000/married couple for 2024). The rollovers are income and gift tax free.

Overall, 529 plans can be a tax efficient way to transfer assets to the next generation while pre-funding education expenses. The structure and state specific plans will differ for each owner therefore reaching out to your financial advisor for guidance is recommended.

We appreciate the confidence you have placed in Wellspring to be your trusted advisor. Please feel free to contact us at any time to discuss changes to your financial situation.

Source:
WSJ, Cheryl Winokur Munk: www.wsj.com/public/resources/documents/f3ubZMG0DjWrP70y1Yvu-WSJNewsPaper-5-6-2024.pdf

Author: Katie Madzsar, CFP®, AEP®, Senior Wealth Advisor, Managing Director, Wellspring Financial Advisors, LLC
Information as of October 1, 2024