Topic Brief: What is a 529?

PlumTree
FINANCIAL PLANNING

In a nutshell: A 529 plan is an education savings plan operated by a state or educational institution designed to help families set aside funds for future college costs.

529 plans can be used to pay for qualified higher education expenses at most colleges nationwide, and at many international schools. As of January 1, 2018, 529 plans can also be used to pay for tuition at K-12 schools. With most plans your choice of school is not affected by the state your 529 savings plan is from. For example, you can be a CA resident, invest in a VT plan and send your student to college in NC. Nearly every state has at least one 529 plan available, and 529 plans can differ from state to state.

Tax benefits

Earnings in a 529 plan grow federal tax -free and will not be taxed when the money is taken out to pay for qualified education expenses. Over 30 states offer residents a full or partial tax deduction or credit for 529 plan contributions.

Control

With few exceptions, the named beneficiary has no legal rights to the funds, unlike UGMA/UTMA accounts where the child takes ownership at majority.

A 529 account owner can withdraw funds at any time for any reason, though the earnings portion of non-qualified withdrawals may be subject to tax and/or penalty.

Flexibility

You can change your 529 plan investment options twice per calendar year.

You can rollover your funds into another 529 plan one time in a 12 -month period. (Tip: There is no limit on the frequency of these changes if you replace the account beneficiary with another qualifying family member at the same time.)

Financial Aid and 529 Plans

When a school calculates the Expected Family Contribution (EFC), only a maximum of 5.64% of 529 plan assets are counted if owned by the parent or dependent student. Student assets outside a 529 may be counted as high as 20%. Higher EFC means less financial aid. Distributions are excluded from the "base year income" that would otherwise reduce the following year's financial aid eligibility.

Assets held in a 529 account owned by a 3 rd party will have no effect on the student's Free Application for Federal Student Aid (FAFSA). However, when withdrawn for college expenses it will be counted as student income on the FAFSA. Student income is assessed at 50% in the EFC formula.

Qualified expenses

College tuition, fees, books, supplies, room, board, computers & related equipment, and special needs services are all qualified, as well as up to $10,000 in tuition expenses for elementary and secondary schools.

Non-qualified withdrawals include but are not limited to travel costs, sports & activity fees, student loans, electronics, and insurance.

Leftover funds

Funds can remain in the account to be used at a later date. However, if the owner makes a non - qualified withdrawal at any point, the earnings portion will be subject to income tax as well as a 10% penalty.

For more information on these and other topics related to college savings, visit us at Savingforcollege.com.

This information does not constitute tax advice and is provided for informational purposes only. Please consult your tax advisor, financial advisor, local taxing authority, and/or plan provider or sponsor for more information.

529 savings plans are not FDIC-Insured, and do not provide bank, state, or federal guarantees unless specified by the respective plan. These plans may lose value.