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A Brief Guide to 529 Plans

Frequently Asked Questions

A recent survey determined that clients have a number of concerns regarding 529 plans. We've answered the most common questions below:

1 How will a 529 plan affect my income taxes?

Earnings on assets in a 529 plan are tax-deferred. In addition, qualified withdrawals[1] for higher education expenses, such as tuition, room and board and certain other expenses, are federal tax-free.

With the Tax Cuts and Jobs Act, 529 plan benefits can now be applied to tuition expenses up to $10,000 per year at elementary and secondary public, private or parochial schools. Before withdrawing money, check that the state where you started your 529 has agreed to the federal tax change.

More than 30 states also offer a tax credit or deduction for contribution to a 529 savings plan. In most cases, investors must use their home state's plan in order to qualify.

2 How much can I contribute to a 529 plan?

Each state sets its own 529 contribution limits; the highest is New York's $520,000 per beneficiary.

Keep in mind, however, that the IRS considers plan contributions as gifts from the taxpayer to the beneficiary of the 529 plan. As of 2018, the annual limit has increased to $15,000 ($30,000 if married) per beneficiary without triggering a federal gift tax. Additionally, a special federal gift tax exemption for 529 plans permits you to contribute an amount equal to five years of gifts in just one year.

This means, you can transfer up to $75,000 into a 529 account ($150,000 for a married couple) with zero gift tax liability.[2]

3 Will a 529 plan affect my beneficiary's eligibility for financial aid?

Yes, but to a lesser extent than you might think. A family's income, not its savings, is the greatest factor in determining eligibility for financial aid. Federal financial aid is generally a long shot for families with incomes of $150,000 or more with any investments outside of retirement accounts.

If the plan beneficiary is a dependent of the parent who owns the account, then the account is considered a parental asset. As a result, the plan's assets will generally be counted at a rate of only 5.6% of their value for the Expected Family Contribution (EFC) calculation in the federal FAFSA formula.

Note that financial aid programs offered by educational institutions and other non-federal sources may have their own guidelines for the treatment of 529 plan accounts.

Common Misconceptions

As with most tax benefits or financial products, there are common misconceptions about the features and uses of 529 plans:

I can only invest in my home state's 529 plan.

NOT TRUE You can invest in a 529 plan offered by any state or the District of Columbia.

For residents of some states and D.C., an advantage of using your home state's plan may be a full or partial state tax exemption on qualified withdrawals. However, that state exemption may by outweighed by the investment choices, performance record and/or fee structure offered by another state's plan.

I'll lose money if the beneficiary of my account does not attend college.

NOT TRUE In fact, you have several options if your beneficiary decides college is not for them. You can change beneficiaries to another eligible member of your family. Or the 529 account can be left in the first beneficiary's name, creating an education legacy that can be passed down between generations.[3] 529 funds can also be used at any institution that accepts Federal Student Aid, FAFSA, including many technical and trade schools. As a last resort, it's also possible to take a non-qualified withdrawal of your account balance.[4]

If my beneficiary is in high school, it's too late to start a 529 plan.

NOT TRUE 529 plans have no age limit—so it's never too late to open an account. Even if the account is held for just a few years, you can benefit from tax-deferred growth and tax-free qualified distributions. The funds in a 529 account can also be used for graduate schools that are eligible based on the Federal School Code.

The bottom line is that if you currently have children or grandchildren of pre-college age (or will have in the future), it's worth considering a 529 plan as part of your overall financial plan. You should shop around for the 529 plan that best meets your individual needs and consult your financial advisor.

Learn more by accessing **Education Savings Conversation: A Funding Solutions Road Map**.
This guide can help facilitate advisor conversations with parents, grandparents and young professionals about using 529 plans to meet their unique funding needs.

[1] Earnings on non-qualified withdrawals are subject to federal income tax and may be subject to a 10 percent federal penalty tax, as well as state and local income taxes. The availability of tax or other benefits may be contingent on meeting other requirements.

[2] In the event the donor does not survive the five-year period, a pro-rated amount will revert to the donor's taxable estate. Rules regarding gifts and generation skipping transfer tax may apply in the case of a change in beneficiary. You should consult with your tax advisor when considering a change of beneficiary.

[3] Rules regarding gifts and generation-skipping transfer tax may apply in the case of a change of beneficiary. You should consult with a tax advisor when considering a change of beneficiary.

[4] Earnings on non-qualified withdrawals are subject to federal income tax and may be subject to a 10 percent federal penalty tax, as well as state and local income taxes. The availability of tax or other benefits may be contingent on meeting other requirements.

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