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The Best College Savings Plans…

May 29th is "National 529 Day!"

Planning Properly to Pay for Higher Education

It has become increasingly difficult for students and their families to pay for college tuition due to the rate at which tuition costs have been rising. Undergraduate fees at the University of California grew at nearly five times the rate of inflation between 1977 and 2018.[1] California's higher education costs rose by 68.5% in just the last 10 years.[2]

529 Education Savings Plans are a powerful tool to help save for your child or grandchild's future college education. What is a 529 Education Savings Plan? The first 529 plan was a prepaid tuition plan established by the Michigan Education Trust in 1986. 529 plans are named after Section 529 of the Internal Revenue Code (IRC), which was added in 1996 to authorize tax-free status for 'qualified tuition programs'.[3] The tax treatment was made permanent with the Pension Protection Act of 2006.[4] These college savings investment plans are the most tax efficient way to accumulate money for higher education expenses. While contributions are not federally tax deductible, earnings grow free of Federal income tax, and will also be free of Federal income tax when used to pay for qualified higher education expenses. In California earnings also grow tax free and are tax free when withdrawn for qualified higher education expenses.

- You (or anyone else, such as a grandparent, other relative, or friend) can contribute up to the maximum of $15,000 per beneficiary account, which is the annual tax-free gift exclusion amount for 2021. A married couple may contribute up to $30,000 to any one individual this year.
- A special gifting provision for contributions to 529 plans allows you or anyone else to make a lump sum contribution to a 529 plan in a single year by treating the contributions as if it were gifted over five years. The current limit for an individual is a maximum of $75,000 ($15,000 x 5 years) under this provision. A married couple can contribute up to $150,000 in one year that accounts for five years of tax-free gifting in advance. This potentially allows for more earnings to accumulate tax-deferred because the funds are invested earlier than when making the contributions on a yearly basis. In addition, once a gift has been made the gift is no longer considered a part of the parents' or grandparents' estate for estate tax purposes.
- Qualified expense for higher education includes tuition and fees, books and supplies, computers and internet access, and room and board.[5]

- Up to $10,000 can also be used for tuition expenses for elementary, middle, or high school education, however, depending upon the state of residence the earnings may be taxable as income. (We generally do not recommend using 529 plan money to pay for education costs before high school graduation.) In California, withdrawals of earnings spent for tuition expenses other than for higher education are taxable as income and subject to an additional 2.5% California state tax.[6] There is no penalty on the withdrawal of principal.
- As a part of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, up to $10,000 (lifetime limit) can be used to pay off qualified student loans and also pay for the cost of apprenticeship programs as qualified expenses. The apprenticeship program must be registered with the Secretary of Labor's National Apprenticeships.[6] Currently, California does not recognize either as qualified expenses and is taxable as income and subject to an additional 2.5% California state tax.
- If one child does not spend all the money invested in his or her account for higher education, you may change the beneficiary to another child who may need additional funds to complete their higher education depending on where they attend undergraduate school or choose to pursue graduate school. You remain the owner of the account and control the beneficiary designations.
- The beneficiary of a 529 plan account can be changed once per year.
- If parents or grandparents who are owners decide to go back to school, money in a 529 plan account can be used to pay for your own education by changing the beneficiary to you! There is no age limit on beneficiaries.

In the worst case, if you decide not to spend these funds for higher education and decide to terminate the account in the future, the recipient of the proceeds would be subject to a 10% Federal and 2.5% California State income tax penalty on the earnings of the account (no penalty on withdrawal of principal) and pay Federal and California State income tax on the earnings.[7] In the interim, you have benefited from the funds having been invested tax deferred. The principal has already been taxed because the contributions used to invest were made with after-tax dollars.

Many clients choose to change the beneficiary from a child to a grandchild when their own children do not use all the money accumulated in a 529 plan account. This is a powerful way to furnish benefits for the next generation.

Grandparent owned 529 plan accounts are not reported as student or parent assets on the Free Application for Federal Student Aid (FAFSA) form when a student attempts to qualify for a scholarship or for financial support. Parent owned 529 plan accounts are considered the parent's assets and colleges expect parents to use up to 5.64% of their assets to pay for their children's college expenses. Due to this, parent owned 529 plan accounts can reduce aid eligibility by up to 5.62% of the value of the account as a part of the parent's available assets.

Next to a Roth IRA, a 529 Plan Education Savings Account is the most tax efficient way for investors to accumulate wealth that can grow tax deferred and be distributed tax-free for qualifying higher education expenses. These include college, vocational schools and other education related costs post high school.

Please let us know if you have any questions about these powerful savings tools. We will be glad to help you learn the best way to save for your family's higher education related future expenses.

[1.] https://calmatters.org/explainers/california-cost-of-college-explained/
[2.] https://529-planning.com/state/california/
[3.] https://www.savingforcollege.com/intro-to-529s/what-is-a-529-plan
[4.] https://www.savingforcollege.com/intro-to-529s/name-the-top-7-benefits-of-529-plans
[5.] https://www.savingforcollege.com/article/what-you-can-pay-for-with-a-529-plan
[6.] https://www.collegeadvantage.com/blog/blog-detail/posts/2020/09/15/529-plans-now-pay-for-qualified-apprenticeship-costs
[7.] https://www.savingforcollege.com/intro-to-529s/what-is-the-penalty-on-an-unused-529-plan

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