Savings Plans Expanded to Include Apprenticeships, Private K-12 Schools

529 Plans: New and Improved

by Alexandra Armstrong, CFP®, CRPC®, and Christopher Rivers, CFP®, CRPC®

Following our discussion of financial aid last month, we thought it was time to take a fresh look at Section 529 plans. In addition, recent regulatory changes have expanded how these plans may be used, opening up new opportunities for families planning for higher education expenses.

529 Savings Plans Provide a Tool For Funding Education

A 529 plan is a trust account that allows you to fund future educational expenses for a designated beneficiary. Typically, the account owner is the parent or grandparent, and the beneficiary is a child or grandchild, but these accounts may be set up for anyone.

Each state offers its own state-sponsored plan and contributions are invested into a menu of options provided by the plan. The primary benefit of the 529 savings plan is that the these investments grow in the plan tax-free, as long as the distributions are used for qualified education expenses. In addition, in some states you obtain a tax deduction for your investment when you invest in a 529 plan.

Historically, 529 plans were focused on post-secondary education. Recent changes have expanded the use of these accounts considerably. Before we address these changes, we'll focus on the benefits and mechanics of 529 savings plans.

Do I Have to Invest in a 529 Plan Sponsored by My State of Residence?

While each state sponsors its own 529 plan, you don't have to invest in your home state plan. Regardless of the plan you choose, you can use the money to fund expenses at any eligible school. You're not limited to using the money at schools within your state or the state of the plan. The fees, expenses, investments and tax benefits of 529 plans vary from state to state.

What Can Distributions From 529 College Savings Plans Be Used for?

Money withdrawn from these plans is fully tax-free if used for qualified education expenses. These are defined as: tuition, room and board costs, student activity fees, as well as computers, internet access and related equipment at an eligible educational institution. An eligible educational institution is any college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

Eligibility includes virtually all accredited public, private and for-profit postsecondary institutions. In addition, certain schools outside the United States are eligible.

Expenses for course-related books, supplies and equipment are also included in qualified education expenses, if the expenses must be paid as a condition of enrollment or attendance. Students living off-campus can include expenses in lieu of "room and board," up to a FAFSA (Free Application for Federal Student Aid) limit on room and board published by each school.

You can check online with the FAFSA to see whether your institution qualifies, using their "Federal School Code Search."

But Wait, There's More …

In recent years regulatory changes have expanded what expenses 529 plans can be used for, tax-free. Distributions from 529 plans now can be made for up to $10,000 per year to pay for kindergarten through 12th grade private school tuition.

In addition, up to $10,000 per student can be withdrawn tax-free to pay down student loans. It's important to note that in this case $10,000 is a lifetime limit. However, an additional $10,000 can be drawn down to pay student loans held by the beneficiary's sibling.

> **"Students living off-campus can include expenses in lieu of 'room and board' up to a FAFSA limit on room and board published by each school."**

Finally, a recent change added apprenticeships to the list of qualified education expenses.

Will Investing in a 529 Plan Negatively Impact Eligibility for Financial Aid?

We covered this issue in depth in last month's article, as the rules are changing next year.

FAFSA rules determine how the assets in 529 plans are counted when calculating aid and the calculation changes depending on who owns the 529 plan.

If a parent owns the 529 plan, it's counted similar to other parental investment accounts, with 5.64% of the value included in the aid calculation. If the student owns the 529 plan, the asset is counted as a student asset at 20% of the assets in the 529 plan and the payment to the school is counted as student income as well.

In the past, grandparent-owned 529 plans had a significant negative effect on need-based aid, but the rules are changing. In 2023 and beyond, grandparent assets are no longer part of the financial aid calculation. Thus, there is a clear incentive to have the grandparents own the 529 plan, whenever possible.

Do I Get a Tax Deduction for Investing in a 529 Plan?

Although the amount of your contribution in these plans isn't federally tax-deductible, it's often partially tax-deductible on your state income tax, up to certain limits. This state tax break is typically only available if you use your home state's plan. However, seven states (Arizona, Arkansas, Kansas, Minnesota, Missouri, Montana and Pennsylvania) offer tax deductions for contributions to any 529 plan.

What Is the Maximum I Can Invest in a 529 Plan?

Currently each individual may contribute as much as $80,000 at one time into a 529 plan for a particular beneficiary without exceeding the annual gift tax exclusion ($16,000 in 2022), using a technique called five-year forward gifting.

But be aware that "front-loading" the 529 plan with $80,000 means you're using five years of your annual gift tax exclusion at one time, and this requires the filing of an Internal Revenue Service Form 709 gift tax return. Any further contributions you make to the plan within five years would then be subject to the gift tax. Gifts by others to the plan would not be subject to this limit.

A husband and wife can contribute twice that amount per child for a total of $160,000 in a lump sum. This also requires filing a Form 709 gift tax return to acknowledge that the gift is being split.

Under federal law contributions to a 529 plan cannot exceed the expected cost of qualified higher education expenses. This limit varies by state, from a low of $235,000 (Georgia, Mississippi) to a high of $550,000 (Missouri). Once you reach that limit no further funds may be added.

When Should I Start Contributing to a 529 Plan?

As with most investments, the earlier you start the better. If you're able to start when the child is born and contribute annually the benefits can mount up. For example, let's assume you contribute $5,000 each year to the 529 fund and that you earn a relatively modest 5% annual return. If you started five years before college, you would have $27,932 available at the time of enrollment. But if you started contributing at the child's birth, you would have $141,234 available at enrollment (*see chart*).

$ Growth in 529 Plan Based on Start Date, 5% Return, Adding $5K Contribution Annually

5 Years	10 Years	18 Years
$27,932	$63,277	$141,234

How Are Distributions Made?

Withdrawals from a 529 savings plan can be paid to the account holder, the beneficiary or directly to the educational institution. The paid education costs and the matching reimbursement withdrawal must take place in the same calendar year.

What Are the Penalties if I Withdraw Money and Don't Use It for Qualified Higher Education Expenses?

In this case, the gains will be taxable at the account holder's tax bracket and will be subject to a 10% federal surcharge, with exceptions for the beneficiary's death, disability or receipt of a scholarship.

What Happens if I Set Up a Fund for Someone Who Doesn't Go to College?

In most states these plans can remain in existence indefinitely. There's no age limit for distributions. Further, the unused benefit can be transferred to another member of the designated beneficiary's family:

- **spouse;**
- **son or daughter or descendant** of the beneficiary's son or daughter;
- **stepson or stepdaughter**
- **brother, sister, stepbrother** or stepsister;
- **father or mother or** ancestor of either parent;
- **stepfather or stepmother;**
- **niece or nephew;**
- **aunt or uncle;**
- **the spouse of any individual** listed above;
- **first cousin;**
- **anyone for whom the home of the beneficiary** is his or her primary home for the entire tax year.

The beneficiary may be changed only once every 12 months.

Continued on page 29

since Florida's annual tax holiday for hurricane supplies.

From the company's then year-to-date high of $608.05 on April 7, shares of Costco plummeted to $416.43 by May 20 for a loss of 31.5%, or $191.62 per share.

But fewer than two weeks later on June 2, the big box behemoth's stock price had recovered over 17%, while also spinning off a dividend that yields $0.90 per share each quarter.

Takeaway

Costco's stock has an average daily trading volume — or ADTV — of 2.9 million shares. But between April 7 and May 20, there were numerous volatility-induced outliers. On May 18, 9.5 million shares were traded, with sellers vastly outnumbering buyers. Between May 18 and June 2, during which the stock recovered over half the value it shed, ADTV was 4.8 million shares per day.

As shares tumbled, investors panicked and sold; as shares recovered, wiser, more seasoned — and perhaps institutional — investors scooped them up at a steep discount. This is a pattern that's evident in the major exchanges' data. According to a Reuters analysis of the New York Stock Exchange, the average investor now only holds shares for five and a half months. That figure is down drastically since the 1950s, when the average hold time was eight years.

So while the deluge of zero-commission online brokerages and smartphone apps have increased both the accessibility and convenience of trading and investing, they've also significantly contributed to a deviation from time-tested buy-and-hold strategies.

The result?

Self-proclaimed Robinhood day traders are left wishing they hadn't sold, while knowledgeable investors endure market volatility — or use it to buy discounted shares — and have portfolios that reflect the likes of Costco's five-year, +195% gain.

FINANCIAL PLANNER

Continued from Page 11

Who Selects the Investments in the 529 Plan?

Each state has an arrangement with an investment company to provide a menu of investment options within the plan. The account owner then chooses how to invest from the investment menu offered in the plan. Plan investments may only be changed two times per year.

Are There Estate-Planning Benefits for Contributing to a 529 Plan?

Once you've contributed to a Section 529 savings plan, the assets in that account are excluded from your taxable estate unless you've elected five-year forward gifting.

In that case, the gifts for future years are called back as estate assets until the donor outlives the five-year period. If the donor doesn't outlive the five-year period, there's a pro rata recapture back into the estate of the donor.

Conclusion

It's important to talk to your financial planner about how a 529 plan might fit with your situation, and to plan carefully around which plan you select, and who owns the account. When used properly, 529 plans can provide a tremendous boost to the ability to pay for every increasing education costs.

The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that a college-funding goal will be met.

In order to be federally tax-free, earnings must be used to pay for qualified higher education expenses.

The earnings portion of a non-qualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10% penalty.

By investing in a plan outside your state of residence, you may lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.

Alexandra Armstrong is a CERTIFIED FINANCIAL PLANNER® professional and Chartered Retirement Planning Counselor® and founder and Chairman Emeritus of Armstrong, Fleming & Moore, Inc.

Christopher Rivers, a CERTIFIED FINANCIAL PLANNER® professional and Chartered Retirement Planning Counselor® and co-author of this article is a principal of Armstrong, Fleming & Moore, Inc., located at 1800 M St. NW, Suite 1010-S, Washington, D.C. 20036-5813, 202/887-8135.