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4 Ways 529 Plans Offer Big Benefits Under the New Tax Law

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Tax-advantaged 529 education savings plans, one of the most popular college savings vehicles, have grown more flexible as they can now be used to fund K-12 education expenses, rolled over to 529 ABLE accounts, or used as a valuable tax and estate planning tool.

Established in 1996 under Section 529 of the Internal Revenue Code, 529 plans are versatile savings accounts that offer federal and sometimes state tax benefits, while minimizing the impact on financial aid. They are operated by state or educational institutions and are designed to help families set aside funds for future education costs. The plans are offered by most states and are typically open to all savers, not just their own residents.

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1. New K-12 Benefits

Previously limited to paying for college-related expenses, the Tax Cuts and Jobs Act of 2017 expanded the use of 529 assets to pay up to $10,000 per year, per student, for qualified elementary and secondary public, private, and religious education expenses. Currently, only 32 of the 50 states (including Ohio) have approved this federal provision, so be sure to check your state. Participation in a state plan that has ***not*** adopted this provision would cause K-12 withdrawals to be taxable and subject to penalties.

Overall, the use of the 529 plan for K-12 education expenses may prove to be a mixed blessing. While new rules provide 529 plan savers with increased flexibility, private schools want to know more about the family's 529 savings and will take this information into account when making financial aid decisions. Another cautionary note concerns the potential to diminish or deplete college savings by taking 529 withdrawals to pay for K-12 expenses, shrinking both the dollar amount and the amount of time account earnings may benefit from tax-deferred compounding, which is a primary benefit of a 529 plan.

2. 529 ABLE Account Rollovers

The new tax law also ushered in welcome relief for parents of children with disabilities. Parents can now roll over any unused 529 education plan funds to a 529 ABLE account. These accounts are savings accounts administered by the states for the benefit of individuals diagnosed with a significant disability prior to age 26. Money can be withdrawn tax-free when the funds are used to pay for qualified disability expenses.

The 529 ABLE contribution limit for 2018 is $15,000 per donor (the same amount as the annual gift tax exclusion) and many states have total contribution limits that exceed $300,000. For example, Ohio accepts contributions until all 529 account balances in the state's 529 plans for the same beneficiary reach $462,000. So funding by multiple family members, including the parents, can be an effective method of maximizing plan benefits, which are transferable.

However, keep in mind that when a beneficiary's 529 ABLE account balance exceeds $100,000, he or she is no longer eligible for Supplemental Security Income (SSI) benefits. Also, if the beneficiary dies, some or all of the remaining balance may go to the state to recoup Medicaid expenses paid.

A workaround to avoid losing the assets to the state upon the beneficiary's death is to establish a regular 529 plan and roll over funds to the 529 ABLE account as needed. This arrangement provides for tax-deferred asset growth and perhaps an estate deduction without forfeiting ownership of the assets.

3. Closing the Gap on State and Local Income Taxes

Beginning in 2018, the Tax Cuts and Jobs Act of 2017 limits the deduction for state and local taxes (SALT) to $10,000 per return, per year for those itemizing deductions on their federal returns. As a result, 529 plans may offer some relief for those seeking to lower state and local income and property taxes. That's because over 30 states and the District of Columbia offer a full or partial tax deduction for 529 contributions.[1] Seven of those states offer taxpayers a deduction for contributions to any state's 529 plan: Arizona, Arkansas, Kansas, Minnesota, Missouri, Montana and Pennsylvania.[2]

4. 529 Plans as an Estate Planning Tool

One of the many benefits of saving for a child's future college education with a 529 plan is that contributions are considered gifts for tax purposes. In 2018, gifts totaling up to $15,000 per individual will qualify for the annual exclusion. This means if you and your spouse have grandchildren, you can gift $30,000 without gift tax consequences per child, since each child can receive $15,000 in gifts from you and $15,000 in gifts from your spouse. Likewise, if you have three grandchildren, you can gift a total of $90,000.

You may also contribute up to $75,000 in a given year to a single 529 plan without incurring gift taxes as long as your contribution is at least $15,000 and you spread it over a five-year period. The amount will be prorated over the next five years, so if you contribute $50,000 it will be applied as $10,000 each year, leaving you with a $5,000 unused annual exclusion. This can be a great estate tax planning strategy for grandparents, enabling them to shelter a large amount of assets from estate taxes, while retaining control of the funds in the 529 account.

Any gifts above the annual exclusion amounts ($15,000 annually, or $75,000 prorated over five years) will have to be reported on the federal tax Form 709, and these will be counted against the lifetime exclusion (currently $11.2 million per individual in 2018). Any amounts that exceed the exclusion could trigger gift taxes of up to 40%, but if you're within the limit you won't be subject to taxes.

[1] FinAid.org
[2] SavingforCollege.com

To learn more about the important role 529 plans can play in helping you pursue your important education, tax and estate planning needs, contact Planned Financial Services toll free at 877.740.4875 or 440.740.0130. Be sure to visit us online and follow us on social media.

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