Money Matters

July 1, 2017

Skloff Financial Group Question of the Month:
Top 10 Most Frequently Asked Questions (FAQs) on 529s
By Aaron Skloff, AIF, CFA, MBA

Q: What are the top 10 most frequently asked questions about 529 higher education savings plans?

The Problem – Misunderstanding 529s
Like many sections of the Internal Revenue Code, section 529 involves more than meets the eye. Misunderstanding or underutilizing its capabilities can present problems or forego opportunities.

The Solution – Understanding 529s
I answer the top 10 most frequently asked questions about 529 higher education savings plans below.

1. Who can establish a 529 plan and how many plans can be established? You can establish and name anyone as a beneficiary — a relative, a friend or even yourself. There are no income restrictions on you, as the contributor, or the beneficiary. There is also no limit on the number of plans you can establish.

2. How much can you contribute to a 529 plan? The annual contribution limit for 2017 is $14,000. This limit is per contributor, per beneficiary. For example, a married couple could contribute $28,000 each year to each of their children's 529 plans. If the couple utilizes the accelerated gift method, they could contribute $140,000 to each of children's 529 plans and then repeat the process after five years.

3. How frequently can you change investments inside a 529 plan? You can make changes twice a year. An often-overlooked solution to this limit is available when you change the beneficiary. Upon changing the beneficiary, you reset the investment change limit.

4. Are there taxes on 529 plan withdrawals? No. Withdrawals of principal (contributions), interest, dividends and capital gains are all tax free is used for higher education. Be sure to match withdrawals with payments of qualifying higher education expenses in the same tax year.

5. What are qualified higher education expenses? The most common qualified education expenses include: required tuition and fees, room and board, off campus housing (up to the school's room and board allowance for federal financial aid), required textbooks and computers.

6. What happens if the student does not pursue higher education? If the student does not pursue a higher education, the 529 can be left intact and continue to grow on a tax free basis for a different student. Change the name of the student before taking withdrawals by changing the beneficiary on the 529 plan

7. When changing the beneficiary, what type of beneficiaries would be classified as a tax free transfer? The most common tax free transfer beneficiaries are: son, daughter, descendant of son or daughter, stepson or stepdaughter, brother sister, father, mother, stepfather or stepmother, son or daughter of brother or sister, brother or sister of father or mother, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law, spouse of any individuals described above, spouse or first cousin.

8. What if the 529 account owner dies before the 529 balance has been withdrawn? You can and should name a successor to your 529 account. In doing so, you can create a multi-generational account exempt from capital gains taxes, income taxes and estate taxes. Since the successor will own the account and can change the beneficiary, choose wisely.

9. What happens if the student receives a scholarship? The 529 can be left intact and continue to grow on a tax free basis for future higher education expenses (e.g.: business school, law school or medical school) for the same student or for a different student (by changing the beneficiary). You can take withdrawals up to the amount of a scholarship and avoid the 10% penalty on a nonqualified higher education expenses. Note, while you will still pay income taxes on the earnings portion of those withdrawals, your contribution portion (principal) is tax free.

10. What happens if I withdrawal the money from the 529 and do not use it for higher education expenses? With very few exceptions (i.e.: the beneficiary becoming incapacitated, attending a U.S. Military Academy or receiving a scholarship), non-qualified withdrawals are subject to income taxes and a 10% penalty. Note, income taxes and penalties apply to the earnings portion of those withdrawals. Your contribution portion (principal) is still tax free.

Action Steps
Work closely with your Registered Investment Adviser (RIA) to determine if a 529 plan is an appropriate college planning, tax planning and estate planning vehicle.

Aaron Skloff, Accredited Investment Fiduciary (AIF), Chartered Financial Analyst (CFA), Master of Business Administration (MBA) is CEO of Skloff Financial Group, a Registered Investment Advisory firm specializing in financial planning, investment management and benefits for small to middle sized companies. He can be contacted at www.skloff.com or 908-464-3060.