Breaking Down 529 Accounts
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Parents, grandparents and others approach us often to help them decide the best way to fund an account to benefit a child's future educational endeavors. 529 accounts have become an increasingly popular way to fund a child's education. However, there are a variety of decisions to be made related to 529 accounts.

Here is some information answering some of the questions we often hear about 529 accounts.

The Basics

Meant for higher education expenses, there are a wide range of post-secondary educational pursuits for which 529 assets can be used. The account holder gets to choose who the beneficiary of the account is and can change the beneficiary if they desire, and they decide how the account is invested.

Contributions to 529 accounts grow tax-deferred, with distributions available free of federal income tax for qualified higher education expenses. Many states also allow state income tax-free distributions for educational purposes. Several states offer state income tax deductions for 529 contributions.

Funds can be withdrawn with no federal income tax for qualified higher education expenses. Many states also allow state income tax-free distributions for educational purposes.

Financial Aid Considerations

Compared to other similar savings vehicles, 529 plans are looked on more favorably in determining federal financial aid eligibility. Only 5.6 percent of 529 account assets owned by parents count against federal financial aid eligibility, as opposed to custodial accounts (think UTMA or UGMA accounts) which count against aid at a much higher rate of 20 percent.

How 529 accounts are owned can directly impact a student's financial aid eligibility. A non-parent owning a 529 can actually negatively impact a child's eligibility for federal financial aid. Distributions from a 529 account owned by a non-parent count as income for the child's FAFSA application, decreasing their eligibility for aid as compared to distributions from a 529 account owned by a parent.

Financial Aid Planning Solutions

A couple of planning tools can avoid this negative aid impact. If financially feasible, distributions from a 529 owned by a non-parent could be delayed until the spring semester of the child's junior year, assuming they had already submitted a FAFSA application for their final year in college. Alternatively, a non-parent could transfer

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ownership of the account to the child's parent. The non-parent would have already received the tax and estate benefits of the gift, and distributions from the 529 would count against the child's financial aid eligibility at a lower, more favorable percentage than when distributed from an account owned by a non-parent.

Estate and Tax Issues

Estate and tax planning considerations can make 529s attractive. Individuals can contribute $70,000 and married couples filing joint tax return can contribute $140,000 in lump sum amounts into a 529 plan by opting to use five years of their annual gift tax exclusion. This gives the donors the benefit of maximizing their gift and reducing their estate value while avoiding a reduction in their estate tax exemption. The beneficiary benefits by having a longer time frame for a larger sum to be growing and compounding. After five years have passed, this same strategy can be deployed again.

Depending on the amount and goal of the gift and overall circumstances, other account types like a custodial account, an education savings account or a transfer-on-death account may make more sense than a 529. Our advisory team is well-versed in these issues and can help you formulate a strategy to benefit the children who are important to you.

Sources:

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