The Benefits of 529 Plans

by Sally Taylor, CPA, PFS, MSFP, CFP®

If you haven't thought about 529 plans in a while, now might be a good time to think about them again and consider offering them to your clients. Since 529 plans were introduced federally through the Taxpayer Relief Act of 1997, they have become the principal way for Americans to save for college. Not only have their tax advantages made them popular savings tools for many families, the simplicity of creating new 529 plan accounts has also made them popular for every family, no matter their income level. Creating an account can be as easy as opening one online or downloading a form, completing it, and mailing it in.

529 plans continue to be operated either by the states or by educational institutions through prepaid tuition programs. Long gone are the days when there were limited investment options in 529 plan accounts. There are currently 95 savings programs offered by the states, with more than 3,000 portfolios with $165 billion in assets. Another $15 billion in assets is held by the 20 prepaid tuition programs that exist today.

Federal and State Tax Breaks

Hands down, 529 plans offer the best opportunity for tax-advantaged savings for college expenses. Although contributions are not federally tax deductible, the investment grows tax-deferred and even tax-free if the distributions are paid out for the beneficiary's college costs.

The State of Arizona provides a valuable incentive to save for college using 529 plan accounts. Beginning with the 2013 tax year, Arizona significantly increased its tax incentive for college savers. The state increased the deductions from $750 to $2,000 for individual tax filers and from $1,500 to $4,000 for joint filers. Arizona is currently one of only four states that provides tax deductions for any state's plan, not just its own.

Planning with 529 Plan Accounts

Saving for College. Because college expenses are rising faster than inflation and family income, using the best tools and investment options available for saving for college is a critical component of a family's financial plan. Using a 529 plan usually stands out as a family's best choice for college savings.

Funds from any state's program can be used at any accredited institution anywhere in the country, as long as it is used for postsecondary education expenses including tuition, fees, supplies, room and board, books and required equipment. If the beneficiary does not attend or finish college, or does not spend the entire balance in his or her 529 plan account, then another member of the beneficiary's family can be designated as a new beneficiary. In the event a non-qualified withdrawal is taken, then the investment earnings will be subject to federal and state income tax, and a federal 10% penalty will be imposed on the earnings. If the beneficiary receives a scholarship and no longer needs the account, then penalties will not apply when the funds are withdrawn. Owning a 529 plan account can affect financial aid eligibility, but there are often favorable asset and income treatments for the accounts that are included in the formulae used for eligibility.

Estate Planning. You may be surprised to know that there are ways to use 529 plans in a family's estate plan to reduce their estate tax exposure while also providing the traditional benefits of a 529 plan for their children or grandchildren.

By contributing to a plan, your client can get money out of his (or her) estate, potentially saving on federal estate taxes and even state estate taxes if your client lives in a state with an estate tax. A common strategy for reducing a donor's estate is to use accelerated gifting to a 529 plan account. An individual can give five years' worth of $14,000 annual exclusion gifts at once—that's the amount the Internal Revenue Service allows as a tax free gift from one individual to another. So grandma and grandpa could fund an account for a grandchild with $140,000 (multiply that times the number of grandchildren) and it's out of their estate. There is a catch—if the donor were to die within the five years following the gift, then a prorated portion of the contribution would be recaptured into the estate for estate tax purposes. Also, the individual will need to file a Form 709 and make an election for a large contribution. A bonus, however, is that the donor/account owner will retain full control over the assets until they are distributed.

That control is an additional estate planning benefit of using 529 plans. Because contributions to 529 plan accounts are considered completed gifts, current assets and future accumulation can be excluded from the donor's taxable estate even though the donor remains in full control during his lifetime as the account owner. This is a departure from the typical estate plan that includes irrevocable trusts where the donor gives up control of the assets to reduce his estate or future earnings in an estate. With a 529 plan, the account holder, not the beneficiary, decides when to take distributions for various qualified college expenses covered by the 529 plan, how much money to spend, and to whom the check should be made payable. The account owner can name and change beneficiaries, choose investments, control withdrawals, and can even choose to return the assets to his estate, subject to taxes and penalties. Using a combination of irrevocable trusts and revocable 529 plan accounts can provide unique flexibility options in estate planning.

The State of Arizona has a maximum account balance limit of $396,000 for contributions to the accounts of each designated beneficiary. There are no limits to the number of 529 plan accounts a person can set up, and just about anyone can be a beneficiary – a child, a grandchild, a niece, nephew, even a friend. In fact, if a client is interested in taking personal life enrichment courses, he can set up a 529 plan account for himself.

It is easy to change account beneficiaries, so if your clients are wealthy and don't yet have children or grandchildren, they can set up accounts for themselves as the initial beneficiaries and then transfer them to their grandchildren at some later point in time. Beneficiaries can only be changed once every 12 months, and beneficiary changes are restricted to the beneficiary's family members.

The Arizona Family College Savings Program (529 Plan)

Arizona's Family College Savings Program (529 Plan) includes a competitive group of investments offered through three plan providers. Waddell and Reed's Ivy Funds InvestEd 529 Plan was named as one of the best performing advisor-sold 529 plans—Arizona's plan ranked 1 out of 30 over a one-year period ending December 2013. Fidelity Investments has some of the lowest cost 529 plan index fees in the nation and offers a wide range of investment choices directly to the public. College Savings Bank offers FDIC insured CDs and savings accounts that are also directly available. The Arizona plan has a very helpful website located at *www.az529.gov.* Also, if you're looking for other great resources for researching 529 plans and how to use them, you should check out *http://www.savingforcollege.com* and *www.collegesavings.org.* AZ CPA

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