

COLLEGE

529 Plan FAQs

We've got answers to your frequently asked questions about 529 plans.



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The U.S. government has given favorable tax treatment to so-called 529 plans for 25 years. Still, just a little more than a third of Americans know 529s are a potentially powerful educational savings tool, according to a 2021 study by Morning Consult with financial services firm Edward Jones. Just 20% of parents reported using or planning to use 529 plans to save for their children's education.

As of June 2021, there were more than 15 million 529 accounts owned around the country and more than \$464 billion has been saved through the plans, according to the College Savings Plan Network.

Could your family take advantage of the tax savings of a 529? This quick guide should help you understand the basics of 529 plans and answer your questions:

How Does a 529 Plan Work?

Sometimes also called qualified tuition programs, 529 plans take their name from a section in the Internal Revenue Service Code and are administered by individual states and some private financial institutions. Their main advantage: While contributions have to be made with after-federal-tax money (unlike some retirement and health savings plans, there's no federal deduction), 529 investments *grow* free from federal or state tax. To be eligible for this tax

treatment, withdrawals have to be for qualified educational expenses (we'll get into more detail of what those are.)

Unlike the federal government, many states do offer a limited deduction for contributions as well, so long as the account holder resides in the state administering the account.

While there are no limits on how much you can contribute each year to 529 plans, contributions are considered gifts and subject to gift taxes when they exceed certain limits. In 2021, gifts of up to \$15,000 a year for an individual and \$30,000 for a couple are not taxed. That limit applies to each individual who is receiving a gift. So if you have 529 plans for three children, you can contribute up to \$15,000 or \$30,000 to each child's plan each year without owing gift tax. With 529 plans, there's even a way for someone feeling really generous (hello, grandparents?) to do what's called "superfunding" a 529 by combining multiple years, but this is complex and you'll want a good understanding of the laws governing gift taxes.

But don't get carried away. There are also total contribution limits, as contributions are not supposed to exceed what a beneficiary would spend on education. State plan limits range from more than \$200,000 to more than \$500,000.

What Can I Spend 529 Money on?

While originally conceived as a way to save for college, 529 plan funds can now go to a wider array of programs and institutions, including public and private colleges and universities, graduate schools and trade schools, and even elementary or secondary school (for K-12 education, only \$10,000 a year can be withdrawn and only for tuition). There are no age limits for recipients and money can be held in the plan indefinitely. The tuition-only restriction doesn't apply to higher education expenses, which follow the federal guidelines also applied to programs like the American Opportunity Credit. According to the Internal Revenue Service, in addition to college tuition, these funds can be used to pay a variety of educational expenses, including expenses required for participation in an apprenticeship program certified by the Department of Labor, which covers fees, books, supplies and equipment, and up to \$10,000 in student loan debt per year.

However, there are also 529 plans that are created exclusively to cover tuition expenses. These are known as prepaid tuition plans, as opposed to 529 savings plans. More below on the differences between these two types of 529 plans.

What is a 529 Saving Plan?

A 529 savings plan works in some respects like a Roth retirement savings plan. This kind of 529 allows account holders to open an account and invest after-tax savings in different mutual funds, bond funds and exchange-traded funds for the benefit of a designated child's future qualified education expenses.

This will require making investing decisions: What is your risk tolerance? When will you need the money? Most 529 savings plans will offer an age-based solution in which you can just pick a year, or date range, when you expect your child to go to college, and the portfolio will be rebalanced from stocks (more aggressive but riskier) to bonds (lower return, but more stable)

during that time. While this "set and forget" option is popular, it is not without its detractors, some of whom argue that it is too conservative, given the rising cost of higher education.

Only a few state-operated 529 savings plans have residency requirements for savers or beneficiaries. You can invest in any state's plan, but most state plans convey state tax benefits and other incentives only to residents of that state.

You can move money between plans as often as once a year for any reason. Contact the plan you'd like to switch into to get the forms you'll need to make the transfer. Because many states continue to improve their plans, it's smart to check out the options every year or so.

What is a 529 Prepaid Tuition Plan?

Prepaid tuition plans are less popular and much more tied to state residency than savings plans. These plans allow depositors to pay tuition ahead of time for specific colleges or college systems at current tuition rates — the goal being to get ahead of inflation. As of April 2020, there were 18 state-sponsored prepaid tuition plans and one sponsored by a private financial institution, according to Savingforcollege.com. However, just nine of the plans were accepting new applicants. And of those, eight required plan beneficiaries to be residents of the states that offered them. Among the states accepting in-state applicants into their prepaid plans were:

- Florida
- Maryland
- Michigan
- Mississippi
- Nevada
- Pennsylvania
- Texas
- Washington

The outlier that accepts non-state residents into its prepaid plan is Massachusetts, but it has its own foibles: contributions to the Massachusetts U. Plan are invested in state-issued bonds that can be exchanged for tuition at participating institutions in the commonwealth (no, not Harvard). Finally, not tied to any state is the nonprofit Tuition Plan Consortium's Private College 529 Plan that allows you to prepay for hundreds of private colleges across the country. Unlike 529 savings plans, prepaid tuition plans usually cannot be used to pay for future room and board at colleges and universities and cannot be applied to elementary and secondary schools. There are also limitations on where the funds in one of these plans may be spent. If the beneficiary decides to go to a different school, the fund may not pay the full cost of tuition.

How Does a 529 Plan Affect Financial Aid?

Overall, since most 529 plans are owned by parents, they have minimal impact on student financial aid. The first \$10,000 of parents' assets are not counted at all when calculating the Expected Family Contribution or EFC. Beyond that, the assets in a 529 plan reduce aid eligibility by, at most, 5.64% of the amount of the funds in the account. Any distributions made from parent-owned 529 accounts for dependent children are not counted as income against financial aid.

Grandparent-owned accounts and accounts owned by people other than the student or parents have been treated differently, however. While assets in grandparents' 529 accounts are not counted and are not reported on Free Application for Federal Student Aid (FAFSA), distributions are reported as untaxed income. This can reduce aid eligibility by up to 50% of the amount of the distribution.

This can be mitigated by postponing any distribution until the third semester of a four-year college plan because FAFSA evaluates income from the previous two years.

Rules governing distributions from accounts owned by grandparents or those other than parents are in flux, as they are tied to an effort to simplify the FAFSA process.

Are 529 Plans Insured? Could I Lose My Money?

It's important to remember that 529 savings plans are an investment, and require judgment on risk versus return. Age-based portfolios are popular choices in 529s and are designed to reduce risk as you get closer to the time you expect your child to go to college; this lowers the chance that a stock market swoon will take a big bite of your savings just as you need cash for the bills.

Some 529 savings plans offer ultra-conservative options that allow you to put your money in federally-insured certificates of deposit. Here, your chances of loss are close to zero, but now you risk not having the money you put aside grow quickly enough to keep up with the rising cost of education. 529 prepaid plans are different, as they are essentially a futures contract promising you that future tuition will be covered by money contributed now. According to the Securities and Exchange Commission, some state prepaid plans are not guaranteed, meaning you may lose money if the plan sponsor has financial troubles.

What Happens if You Don't Use 529 funds?

Withdrawals from the funds for non-qualified reasons will be subject to federal income taxes on earnings and an additional penalty of 10%. But there are many ways to avoid that fate.

You could designate another child or grandchild or even a first cousin to be the beneficiary. Or yourself. For example, if you want to change careers or increase your employment qualifications, you can use 529 money to fund your own education and training, as long as the schooling comes from a program that meets requirements for accreditation.

There are exceptions to the penalty (though not taxes on earnings): If your child gets a scholarship, the value of that grant can be taken out.

- If your child is permanently disabled (or dies).
- If your child gets a slot at a competitive military service academy.

Is a State 529 Plan the Way to Go?

There are advantages and disadvantages to using 529 plans to save for your child's education. For many people, the advantages, including favorable tax treatment, will outweigh any

downside, including potential penalties for early withdrawals or for using the money in a way that is not approved.

It's worth paying attention to future changes, including possible federal government forgiveness of student loans and potential availability of free college education. This may affect details relating to 529 accounts and their usefulness.

Also, in selecting a plan, you should make sure you understand the fees and expenses associated with the particular plan. This information will be contained in the plan's disclosure statement.

For now, though, on balance, the accounts can benefit families and students by providing tax and other financial advantages that allow money to grow more quickly while creating an incentive to save for educational expenses.

Which State Has the Best 529 Plan?

Each state determines how to administer and structure its own 529 plan. This includes state tax treatment and investment options.

Increasingly, states have offered incentives to residents to invest in 529 plans. A total of 15 states now offer matching contributions, seed money or other financial incentives for residents who invest in their plans.

For example, CollegeInvest in Colorado matches up to \$500 in contributions a year for five years for accounts with beneficiaries who are 8 years old or younger when parents enroll and when parents meet financial limits. The plan offers a \$100 incentive for creating an account for a newborn.

So, when deciding where to invest your 529 money, you might first consider your own state and look into incentives your state's plan offers for its residents. In addition to the previous examples, these incentives can include special tax treatments, scholarship opportunities and reduced fees. What this can mean is your state's plan may be the best for you. But don't assume that as a given.

Compare your state's offerings with highly rated plans offered elsewhere. Consider the plans' past performance, fees and costs and financial stewardship in making your assessments.

Savingforcollege.com, which looked at fees and returns, gave the following plans its best ratings:

- Ohio's 529 Plan College Advantage
- New York 529 Direct Plan
- Virginia Invest 529

Morningstar rated the following as top state-offered plans for their "low costs, strong stewardship and exceptional investment options":

- Michigan Education Savings Program
- Illinois Bright Start
- Utah's My 529

How do I Enroll in a 529 Plan?

Every state (except Wyoming) offers a 529 savings plan, along with the District of Columbia.

Parents and others wanting to save for a child's education can open the plans for a designated beneficiary. Contributions can be made through payroll deductions or automatic bank account transfers, and most plans can be started with minimal sums.

To enroll, go to the website for your chosen plan and follow instructions to enroll online. Some plans have financial advisors who can guide you in making a selection and help you enroll. But keep in mind that that help may come at a price.

Some plans allow you to open an account with as little as \$25 or \$50. Each account has an owner — sometimes joint owners — and that person controls the assets, regardless of how many people contribute. The owner doesn't have to be a parent.

Can I Use 529 Plan Money for Any School?

Money from a 529 savings plan can be used at any school approved by the U.S. Department of Education to accept Title IV student aid. Approximately 6,000 schools participate in this program. This includes hundreds of foreign colleges and most colleges and universities in the United States.

Excel spreadsheets with information about those colleges can be found on this Department of Education website. You can also look up eligible schools on savingforcollege.com.

NYSUT Note: Need help with financial planning? The NYSUT Member Benefits Corporation-endorsed Financial Counseling Program offers access to a team of Certified Financial Planners® and Registered Investment Advisors. [Click here for more information](#) on these fee-based financial counseling services available to all NYSUT members.

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