February 3, 2014 – Benefits of 529 Plans

With college tuition costs constantly on the rise, taxpayers with dependent children are searching for any and all means they can use to save money for education. One way that Congress and the IRS have established for parents to save money for college is through the 529 plan. A 529 plan (also referred to as a qualified tuition program) is an educational savings option operated by a state or educational institution, with tax advantages that make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild.

There are two types of savings regimes for 529 plans. The first allows taxpayers to prepay tuition costs at today's rates; the second type enables taxpayers to contribute funds to an account that will be used later to pay qualified education expenses at an eligible educational institution. All 50 states offer at least one type of 529 plan, and each state's plan requirements vary.

Contributions to a plan are not deductible from a taxpayer's income. However, the earnings from a 529 plan are not subject to federal tax and are generally also not subject to state tax when used for the qualified education expenses of the beneficiary. Anyone can set up a 529 plan and name anyone as a beneficiary—a relative, a friend, even oneself. There are no income restrictions on either you, as the contributor, or the beneficiary. There is also no limit as to the number of plans you can establish.

Contributions cannot exceed the amount necessary to provide for the qualified education expenses of the beneficiary. If you contribute to a 529 plan, however, be aware that there may be gift tax consequences if your contributions, plus any other gifts, exceed $14,000 to a particular beneficiary during the year. There are no tax consequences if you change the beneficiary to another member of the family.

Qualified education expenses include tuition, fees, books, and room and board for students who attend school at least half-time.

A 529 plan may be a state plan or a private plan. A state plan is a program established and maintained by a state (or its agency), under which a contributor may either purchase tuition credits or certificates that entitle the beneficiary to a waiver of qualified higher education expense; or contribute to an investment account in which the contributions and earnings are used to pay qualified education expense. A private plan can only offer prepaid educational contracts; it cannot offer investment accounts.

Although the beneficiary is generally not limited to attending schools in the state that sponsors their 529 plan, be sure to check with the plan before setting up an account. Your state's 529 plan may offer incentives to win your business, but the market is competitive and you may find another plan you like more. Be sure to compare the various features of different plans.

125 E. De La Guerra St., Ste. 201, Santa Barbara, CA 93101 Phone: 805.563.0821

529 plans are not for everyone, and they are not the only option available for paying for college. This is an investment decision, which means that both the benefits and drawbacks must be considered, along with alternative ways of accomplishing the same thing. Please call our office for a consultation regarding 529 plans and educational savings options.