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Introduction to 529 Plans

A 529 plan is a tax-advantaged savings plan designed to help individuals and families save for education expenses. These plans are named after Section 529 of the Internal Revenue Code, which governs their tax treatment. 529 plans are typically sponsored by states or educational institutions and come in two main types: prepaid tuition plans and education savings plans.

1. Prepaid Tuition Plans: Prepaid tuition plans allow you to purchase units or credits at participating colleges and universities in advance. These credits usually cover a certain percentage of future tuition costs, locking in today's tuition rates. They are a way to hedge against future tuition increases. However, they are more limited in terms of where they can be used and what expenses they cover. If the beneficiary decides to attend a different institution or wants to use the funds for expenses other than tuition, there might be limitations or penalties.

2. Education Savings Plans: Education savings plans are investment accounts that allow you to contribute money on behalf of a designated beneficiary, usually a child or grandchild. The funds can be used for a broader range of educational expenses, including tuition, room and board, books, and other qualified education-related expenses. These plans offer more flexibility in terms of the choice of educational institution and the types of expenses covered.

Both types of 529 plans offer tax advantages:

· Tax-Deferred Growth: Any investment gains within the plan are not subject to federal income tax, as long as the funds are used for qualified education expenses.

· Tax-Free Withdrawals: When you withdraw money from the plan to pay for qualified education expenses, those withdrawals are generally not subject to federal income tax.

· State Tax Benefits: Many states also offer additional tax incentives for their residents to invest in 529 plans. These incentives might include deductions on state income tax returns or matching grant programs.

It's important to note that while 529 plan withdrawals are tax-free when used for qualified education expenses, using the funds for non-qualified expenses can result in taxes and penalties. Additionally, 529 plans have contribution limits, which vary by state.

One of the many benefits of saving for a child's future college education with a 529 plan is that contributions are considered completed gifts for tax purposes. In 2023, gifts totaling up to $17,000 per individual will qualify for the annual gift tax exclusion. Remember, the annual gift tax exclusion amount also includes non-529 gifts so be sure to include any cash or property gifts in your total. Parents and grandparents can also front load contributions to a 529 plan. Individuals may contribute as much as $85,000 to a 529 plan in 2023 if they treat the contribution as if it were spread over a 5-year period. The 5-year election must be reported to the IRS on Form 709.

Qualified education expenses are specific costs that can be paid for using funds from a 529 plan without incurring taxes or penalties. These expenses are eligible for favorable tax treatment as long as they meet the criteria outlined in the Internal Revenue Code.

Qualified education expenses typically include:

1. Tuition: This includes tuition and fees required for enrollment or attendance at eligible institutions. The institution must be an accredited post-secondary educational institution, such as a college, university, vocational school, or other eligible post-secondary educational institution.

2. Room and Board: If the beneficiary is enrolled at least half-time, room and board expenses can be considered qualified education expenses. However, the amount eligible for the 529 plan withdrawal cannot exceed the higher of the school's published room and board costs or the actual amount charged if the student is living in housing owned or operated by the educational institution.

3. Books and Supplies: Costs for required textbooks, supplies, and equipment needed for enrollment and attendance at the educational institution.

4. Technology: Expenses related to the purchase of computers, laptops, software, and internet access if required for enrollment and attendance at the educational institution.

5. Special Needs Services: Expenses related to special needs services for beneficiaries who have disabilities, as long as these services are necessary for enrollment and attendance at an eligible institution.

6. K-12 Education: Starting in 2018, the definition of qualified education expenses was expanded to allow up to $10,000 per year per beneficiary to be used for tuition expenses at elementary or secondary public, private, or religious schools. However, not all states conform to this federal provision, so it's essential to check your state's rules.

7. The SECURE Act of 2019 expanded tax-free 529 plan withdrawals to include registered apprenticeship program expenses and up to $10,000 in student loan debt repayment for both account beneficiaries and their siblings.

8. And the SECURE Act of 2022, passed as part of the 2023 Omnibus funding bill, will permit rolling over up to $35,000 of unspent funds in a 529 account into a Roth IRA account, starting on Jan. 1, 2024. To qualify, the account must be at least 15 years old

The custodian of a 529 plan is typically the person responsible for managing the account and making investment decisions on behalf of the beneficiary. The custodian is often referred to as the "account owner" or "participant."

Here's a breakdown of who can be the custodian of a 529 plan:

1. Parent or Legal Guardian: In most cases, a parent or legal guardian of the beneficiary is the primary choice for the custodian of a 529 plan. Parents have the authority to open and manage the account for their child, and they can make decisions about contributions, investments, and withdrawals.

2. Grandparent: Grandparents can also serve as the custodian of a 529 plan for their grandchild. Recent changes to the FAFSA reporting rules now make it easier for grandparents to be the owner of a 529 plan without impacting eligibility for financial aid.

3. Other Relatives or Individuals: Other relatives or individuals can also be the custodian of a 529 plan, as long as they meet the eligibility requirements set by the plan provider. This could include aunts, uncles, family friends, or even the beneficiary themselves once they reach the legal age of majority.

It's important to consider a few key points when designating the custodian of a 529 plan:

· The custodian has control over the account, including making investment decisions and requesting withdrawals.

· The Social Security number or tax identification number of the custodian is used for tax reporting purposes related to the 529 plan.

· It's possible to change the custodian of a 529 plan under certain circumstances, such as if the original custodian becomes unable or unwilling to manage the account.

The ability to change the beneficiary is one of the flexible features of a 529 plan. Here are the key points to know:

1. Family Member Transfers: 529 plans typically allow you to change the beneficiary to another eligible family member without tax consequences. Eligible family members usually include siblings, parents, children, step-siblings, step-children, nieces, nephews, and even certain in-laws.

2. Non-Family Transfers: If you want to change the beneficiary to someone who is not an eligible family member, it might be considered a non-qualified distribution. This means you could potentially face taxes and penalties on the earnings portion of the distribution. However, some plans might offer more flexibility in this regard, so it's a good idea to check with your specific 529 plan provider.

3. No Time Limit: There is typically no time limit on when you can change the beneficiary. You can do it at any point as long as you meet the plan's requirements.

4. Documentation: When changing the beneficiary, you will likely need to provide some documentation to verify the new beneficiary's relationship to the original beneficiary or account owner.

5. Process: To change the beneficiary, you usually need to contact the 529 plan provider and follow their specific procedures. This might involve submitting a beneficiary change form.

6. Rollovers: In some cases, you might choose to do a rollover from one 529 plan to another in order to change the beneficiary. This can help you consolidate accounts or take advantage of different plan features. However, there are rules and limitations on how often you can do this, so be sure to understand the rules of both the old and new plans.

It's important to note that while these are the general rules for 529 plans, there might be some specific rules and nuances depending on the state and the 529 plan. It's recommended to review the specific details of the 529 plan you're considering and to consult with a financial advisor or tax professional to ensure you understand the rules and implications of your specific plan.

Charles Schwab offers the Kansas 529 program and Virtue can act as the investment advisor. Account pricing is as follows:

1. $0 account open or maintenance fees. Other account fees, fund expenses, and brokerage commissions may apply.

2. No account service fee – The Schwab 529 Education Savings Plan has no account service fee or enrollment fee. Other account fees, fund expenses, brokerage commissions and service fees may apply.

3. Portfolio fee – The portfolio fee includes a program management fee plus underlying fund expenses. The annual total portfolio fees for the Schwab 529 Education Savings Plan range from 0.20% - 0.86%, depending on the investment you select.

When choosing a 529 plan, it's crucial to consider factors such as fees, investment options, and the reputation of the plan provider. While 529 plans can be a great way to save for education expenses, it's advisable to do thorough research and consult a financial advisor to determine which type of plan best suits your financial goals and situation.