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529 College Savings Plans

529 college savings plans are one of the more popular ways to save for college. You've probably read how easy and convenient they are to set up, but like most things in life, what on the surface appears simple is actually complicated once you dig a little deeper. This newsletter goes over some basic 529 information, but also focuses on the answers to when things get tricky.

What is a 529 plan?

It's a college savings account that is exempt from federal taxes and has tax benefits at the state level as well. They are generally run by the state and have specific rules and a choice of investment options that include mutual funds and money market funds. Per account there is one owner (the custodian - often the parent) and one beneficiary (usually the child.)

Note: You do not need to be related to the beneficiary of the 529 account; you may designate anyone, including yourself, as the beneficiary.

What are the tax advantages?

Your investment grows tax deferred and can be withdrawn tax free if the money is used to pay for qualified college expenses (tuition, room & board, books, computers, etc.) If you withdraw funds for any other purpose, the gains will be subject to income taxes and a 10% penalty. The 10% penalty is waived if your child qualifies as being disabled.

There are no income restrictions so those in a high income tax bracket will benefit substantially. Each state imposes its own plan limits when they will no longer accept contributions: New York's maximum is \$520,000, New Jersey's is \$305,000 and Connecticut's is \$550,000 ... **per beneficiary.**

New York and Connecticut taxpayers can who are filing jointly can deduct up to \$10,000 of their 529 contributions per year on their state return (single filers can deduct \$5,000). New Jersey taxpayers with gross income of \$200,00 or less can deduct \$10,000 per taxpayer per year. If money is withdrawn for non-college expenses and you took a state tax deduction, you may be subject to additional penalties on your contributions.

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529 plans are not guaranteed by any state or federal agency. By investing in a 529 plan outside of the state in which you pay taxes, you may lose the tax benefits offered by that state's plan. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary.



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The following will help you navigate some of the complex rules of gifting and the impact it may have on financial aid.

Gifts

It may not feel like you're making a gift, but it is when you deposit money in your child's 529 account so you need to be aware of the limits. The IRS allows any individual to give \$19,000 per year to any other individual without incurring gift taxes or dipping into your lifetime exemption (a topic for another day.) As a couple, you can contribute \$38,000 per year per child without exceeding the IRS gift limit.

Keep in mind: if a grandparent (or any non-parent relative) is the custodian/owner of the account, they are gifting to their grandchild. If the grandparent wants to contribute to a 529 plan that was set up by you the parent, then they are making a gift to you. This is potentially a way to gift more than \$19,000 per grandchild.

Note: Tuition payments made directly to the school by the grandparent is not considered a gift so there is no dollar limit nor any potential gift tax.

Parent Contributions and the Effect on Financial Aid

529 plans have little effect on financial aid when owned by parents. 5.64% is the maximum amount of the 529 plan's assets that is taken into account. The distributions are ignored for FAFSA purposes and are not considered income. If you give money directly to your child or have an old UTMA/UGMA account for your child, the FAFSA formula assumes almost half will be used for tuition and will result in a proportional reduction of financial aid.

Grandparent Contributions and the Effect on Financial Aid

A grandparent (or any non-parent) owned account is ignored as an asset but the withdrawals are considered to be the student's income and therefore can reduce the financial aid by as much as half the amount withdrawn from the 529 account. This is also true for direct payments to the school made by anyone other than the parent; it's considered untaxed income for FAFSA purposes.

One strategy to consider is to wait until after the FAFSA form is filed before taking a 529 distribution.

For information beyond the states mentioned, www.savingforcollege.com/compare_529_plans is a great website for all state plan details.
