Many Americans may be unfamiliar with how 529 Plans work. Consequently, a lot of investors may be hesitant about setting up a 529 plan. And with over 100 different plans now in existence\(^1\), there is even more reason to be confused. That’s why we have created this 529 plan primer. It is designed to demystify what many college savings experts believe is “the best way to save for college today.”

Q. What is a 529 Plan?
A. Like 401(k) accounts, which millions of Americans use for their retirement savings, 529 plans are tax-advantaged savings accounts named after a section of the Internal Revenue Code. Unlike 401(k)s, 529s are an after-tax contribution that are intended for qualified education expenses only.

Q. What do the states have to do with 529 Plans?
A. Section 529 of the Internal Revenue Code enabled each state to create their own 529 savings plan “mandate.” And, while the federal tax code stipulates how investors are treated from a federal tax standpoint, how investors are treated from a state tax standpoint is up to each individual state. Furthermore, the federal code merely creates a suggested framework for 529 plans, leaving many of the decisions to the states. This is why each plan looks different—with different minimums, maximums, age restrictions, etc.

Q. Can I claim a deduction on my federal and state tax filing, if I make a contribution to a 529 Plan?
A. There is no federal tax deduction for making contributions to 529 plans, though some states offer a deduction. Because each state has created their 529 plan independently, residents may be entitled to a state tax deduction—ranging from $250 to an unlimited deduction—while many states offer no deduction at all.

Q. Do I have to pay tax on the earnings in a 529 Plan account?
A. Your earnings on the money you invest in your account are not subject to federal or state taxes before they are distributed. Withdrawals from a 529 Plan for qualified expenses are free from federal and state income tax. (See “What are ‘qualified’ expenses?” below.)

Q. What are “qualified” expenses?
A. You can use the money from your 529 account to pay for “qualified education expenses” of the person who is the Designated Beneficiary of the account. “Qualified” college expenses are defined in the Internal Revenue Code as tuition, room and board, books, equipment and fees necessary to attend an institution of higher education. In addition, starting January 1, 2018, 529 Plan account owners can withdrawal assets to pay for K-12 tuition (public, private or religious) up to $10,000 per year per beneficiary.

Q. What if I need the money for something else?
A. As account owner you can withdraw all or any portion of the money in a 529 account at any time for any purpose, however, withdrawals for purposes other than paying a Designated Beneficiary’s qualified education expenses are deemed to be “non-qualified.” Non-qualified withdrawals of investment earnings are subject to federal income tax and a 10% penalty tax on earnings, with some exceptions, and may also be subject to state tax. Speak to your tax or financial advisor.

Q. What if my child (the Designated Beneficiary) cannot use the assets for educational purposes, or if the account assets exceed my child’s education expenses?
A. You have several options: a) use the funds for the Designated Beneficiary’s graduate or professional school expenses, b) designate a new beneficiary who is a member of the Designated Beneficiary’s family, c) close the account by withdrawing all the funds (withdrawals are subject to federal income tax and a 10% penalty), or d) leave the account open indefinitely, until you, as account owner determine the proper course of action.

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Q. What if my child gets a scholarship, or can’t use the money because she gets hurt and can’t attend college?
A. The normal 10% federal penalty is not assessed if you terminate the account because the Beneficiary has died or is disabled, or if you withdraw funds not needed for college because the Designated Beneficiary has received a scholarship.

Q. Who can I designate as Beneficiary?
A. You can open an account for the benefit of any individual person — of any age — who is either a) a U.S. citizen (residing in the U.S. or abroad) or b) a legal U.S. resident (a “resident alien”) with a valid Tax ID Number (TIN). The so-called “Designated Beneficiary” may be your child, your grandchild, another relative, such as a niece or nephew, your spouse, or even someone unrelated to you. You can even open an account for yourself. Some plans may require the Designated Beneficiary to be a resident of the state sponsoring such plan.

Q. Can I open more than one account?
A. You may open more than one account. But, except in limited circumstances (e.g., where the second account is a custodial account) you may open only one account for each Designated Beneficiary, in the same state plan. You may, however, open another account for the same Beneficiary in another state plan (so long as the combined savings do not significantly exceed the projected educational cost needs of the Beneficiary).

Q. Can others open an account for the same Beneficiary I have designated?
A. Yes, other people may also open their own account(s) for the same Designated Beneficiary — in either the same state or a different state.

Q. Can anyone else contribute to my account?
A. Yes — in most states — persons other than the account owner may make contributions to an account, although the contribution will be directed in accordance with the account owner’s original instructions. Another contributor will not retain any control over, or rights to, his or her contribution (or any other portion of the account), after the contribution is made. The other contributor will not receive any statements or other information with respect to the account.

Q. Can I use my account to pay for any college?
A. Yes, you can get the full benefits from a 529 savings program if your Designated Beneficiary attends any accredited institution of higher education.

Q. What expenses are involved?
A. Generally, there are two levels of expenses that apply to 529 contributions.

Q. How are my contributions invested?
A. Account owners choose from a selection of portfolios offered by the program. Most programs offer one or more of the following types of portfolios: a) “age-based” — a diversified portfolio of mutual funds whose risk/return profile automatically gets more conservative as the child gets closer to college age, b) “static” — a diversified portfolio of mutual funds, which maintains its risk/reward profile, until the account owner exchanges for a different one, and c) “individual investment” — a portfolio with a single underlying mutual fund.

Q. How are my contributions invested?
A. For each contribution that is made to your account, you can elect how such contribution is invested.

Q. How often can I change how the existing assets in my account are invested?
A. You may reallocate the existing assets in your account twice every calendar year. Alternatively, you may reallocate whenever you change the account’s Designated Beneficiary.

2. State taxes apply to qualified withdrawals for residents of Alabama participating in another state’s plan. Speak to your tax or financial advisor.
owned by a parent or a student reduces the student’s eligibility for financial aid by up to 5.64% of the account’s balance. A withdrawal from an account owned by grandparents (aunts, uncles and other relatives) reduces a student’s financial aid by 50 cents per dollar withdrawn.

Q. Can I transfer my existing Coverdell ESA (Education Savings Account) or Series EE and I U.S. Savings Bonds into a 529 plan tax-free?
A. Yes, most rollovers of this nature are not considered taxable events. But, there may be ownership issues or a “phase-out” of the favorable tax treatment, depending on your income. You should speak to your financial advisor or your tax advisor before taking any action.

Q. Can I transfer my child’s existing UGMA (custodial) account into a 529 plan?
A. Yes, most 529 plans accept funds coming from an existing UGMA (or UTMA) account. However, because these accounts are irrevocable “gifts,” any withdrawals from the UGMA/UTMA — that is then used to fund a 529 account — must be for the benefit of the same minor only. As such, state laws generally prevent you from making any future Beneficiary changes to this “custodial” 529 account. And, the minor will assume ownership of the account when they reach the age of majority (generally dictated by the laws of the state that sponsors your 529 plan).
For this reason, parents who are nervous about a child getting their hands on money in a 529 account, should open a second (non-custodial) 529 account — which the parent would control — for any subsequent contributions. The transfer of UGMA/UTMA funds into a 529 account can provide all the tax and investment benefits associated with 529 plans, this can still be an advantageous move for many investors. Remember, however, that a 529 plan can only accept cash. So, any appreciated securities in the UTMA would first have to be sold, and capital gains would be reportable on the minor’s tax return.

Q. Can I move my child’s existing 529 account from one 529 program to another?
A. Yes. The Internal Revenue Code allows you to “rollover” from one plan to another — once every 12 months — without having to pay federal tax or the 10% penalty associated with non-qualified distributions. (State taxes may apply.)
Most plans will even take care of the paperwork for you. Make sure, if you make the liquidation yourself, that you make the contribution to the new plan within 60 days, otherwise the tax and penalty will apply.
Also, make sure the existing plan will treat the transaction as a non-taxable event. Some states treat rollovers as a non-qualified distribution, so state tax would apply to the earnings.
And, check to see if the plan imposes any fees.

Q. Do I have to send my receipts to the program manager when I make a withdrawal?
A. No. The program manager reports the full distribution to the IRS and the recipient is responsible for the recordkeeping for qualified expenses.

New Tax Law Changes for 2018
On December 22, 2017, the Federal Tax Cuts and Jobs Act of 2017 was signed into law. This Act includes new provisions that allow 529 Plan account owners to withdraw assets to pay for K-12 tuition (public, private or religious) up to $10,000 per year per beneficiary. Withdrawals from your account for this purpose will have no federal tax impact. In addition, 529 account owners can roll over 529 Plan assets into ABLE Plan accounts, subject to the annual contribution limit. It has not yet been determined whether such withdrawals may have State tax consequences. We encourage account owners to consult a qualified tax advisor about their personal situation. If you have any questions about the CollegeAccess 529 Plan, please contact us at 1-866-529-7462 Monday through Friday from 8:30 a.m. to 6 p.m., Eastern Time.