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Tax planning: Education saving

Understanding how the tax law affects education savings plans

Given the complexity of changes to the tax code in the United States, there is much to consider in determining the impact tax legislation will have on education savings plans.

OVERVIEW

Passed in late 2017, tax-reform legislation made sweeping changes to the tax code in the United States, including changes to individual and corporate income tax rates. Known as the Tax Cuts and Jobs Act, the legislation first took effect in 2018, with many of its provisions set to expire on Jan. 1, 2026.

With regard to individuals interested in funding future education costs for family members or friends, generally, the legislation could create or enhance previously-existing tax planning opportunities. It created additional planning opportunities for disabled individuals.

EDUCATION SAVING

Section 529 savings plans: Since 529 plans now cover primary and secondary (or K-12) public, private or religious education expenses for up to $10,000 per year per student – in addition to postsecondary expenses – you may want to open and fund, or add to, existing accounts for children, grandchildren or other family members. You should consult with your tax advisor regarding any federal gift tax return filing requirements.

Accelerated 529 funding: You can make a single contribution to a 529 account, and it will effectively be treated as if it were made over five years for gift tax purposes. In other words, you can gift the equivalent of five years' worth of annual gift tax exclusions – $75,000 for individuals, $150,000 for married couples – in a single year without using any gift tax exemption. You should consult with your tax advisor regarding any federal gift tax return filing requirements.

State income tax benefits: While contributions to 529 accounts are non-deductible for federal income tax purposes, many states allow a state income tax deduction or credit for funding their state plan. Depending on your objectives, you should consult your tax advisor before making a contribution to determine if this benefit is available in your state.

IMPORTANT TOPICS

Section 529 plans
Accelerated funding
Tax-free gifts
Rollovers to ABLE accounts

CARES ACT

1. The CARES Act created a special new qualified distribution from 529s which allows a lifetime maximum of $10,000 to be used income tax and penalty free from 529s when paid toward student loans.
2. Sometimes clients who have lower AGI are eligible for education tax credits such as the American Opportunity Tax Credit and/or the Lifetime Learning tax credit. If the client uses all 529 money to pay the school bills, then they are not allowed to also receive those tax credits. In those cases, it may be best to figure out how to maximize the tax credits by paying a portion of the education with cash or taxable accounts, and the remainder from 529s. This varies on a case-by-case basis.

Tax-free gifts for tuition expenses: Consider making unlimited tax-free gifts for tuition for family members or friends. As long as the gifts are made directly to the educational institution, the payments don't count against your annual gift tax exclusion, nor are they limited to the annual exclusion amount.

Tax-free rollover for disabled individuals: The legislation allows tax-free rollovers from a 529 account to an Achieving a Better Life Experience (ABLE) account in an amount up to the annual gift tax exclusion, currently $15,000. Individuals with disabilities and their families can use ABLE accounts to save without disqualifying themselves from income, healthcare, food or housing assistance programs. ABLE account earnings are tax-deferred and are tax-free when withdrawn for qualified disability expenses.

Let's work together with your tax and legal professionals to determine how the legislation affects you directly.

Rules and laws governing 529 plans are varied and subject to change. As with other investments, there are generally fees and expenses associated with participation in a 529 plan. There is also a risk that these plans may lose money or not perform well enough to cover college costs as anticipated. Most states offer their own 529 programs, which may provide advantages and benefits exclusively for their residents. Investors should consider, before investing, whether the investor's or the designated beneficiary's home state offers any tax or other benefits that are only available for investment in such state's 529 college savings plan. Such benefits include financial aid, scholarship funds, and protection from creditors. The tax implications can vary significantly from state to state.

While we are familiar with the tax provisions of the issues presented herein, as financial advisors of Raymond James, we are not qualified to render advice on tax or legal matters. You should discuss tax or legal matters with the appropriate professional.

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