529 Plan Update: New Tax Law Delivers Exciting New Changes for 529 Plans

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As you are all very well aware by now, the Tax Cuts and Jobs Act rings in 2018 with major changes to our personal tax rates and deductions. What you might not have heard is that the new legislation enhances the benefits associated with 529 plans. Currently, a 529 plan is a tax-advantaged savings plan designed to encourage saving for future college costs. 529 plans, legally known as "qualified tuition plans," are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code. They provide a means of accumulating funds on a tax-free basis. Upon withdrawal, as long as the funds are used for qualified higher education expenses (tuition, room and board, student fees, and other related expenses), withdrawals are tax-free as well.

Beginning in 2018, thanks to a provision in the new tax law, 529 plans can be used for K-12 education expenses as well. The Tax Cuts and Jobs Act allows 529 plans to be used to pay for up to $10,000 in K-12 expenses annually. This provides a valuable opportunity for families to save tax-free for private or religious schools. Anyone currently saving with a Coverdell ESA plan can rollover those funds to a 529 without adverse tax consequences.

It is important to consider that the time horizon associated with K-12 expenses can be quite shorter than that associated with college funding. For this reason, parents looking to utilize a 529 for both objectives might be best advised to consider using two separate 529s: one for K-12 and one for college. This would enable you to not only better track each goal, but also establish a suitable allocation for the anticipated time that the funds will be invested. While you might not realize a substantial federal tax benefit from using a 529 to save for elementary school, over 30 states offer a tax deduction or credit for contributions. The amount of benefit varies by state, and you typically have to use your home state's plan to qualify for the deduction or credit. Please note that if you are a plan participant, making contributions on behalf of a grandchild, niece, nephew, etc., you are entitled to any deduction or credit offered by your state as long as your plan meets the state's stipulated criteria.

The Tax Cuts and Jobs Act also allows existing 529 savings plans to be rolled into 529 ABLE accounts. An Achieving a Better Life Experience (ABLE) account is a type of tax-advantaged account that an eligible individual can use to save funds for the disability-related expenses of the account's designated beneficiary, who must be blind or disabled by a condition that began before the individual's 26th birthday. Allowing traditional 529 funds to be rolled into 529 ABLE accounts is a very valuable change in the tax code for parents who start saving for their child's college education in a regular 529 plan, but later learn that the child has a disability. Until now, these parents had limited options, since taking a distribution from the 529 plan to fund an ABLE account would have been considered a non-qualified withdrawal – triggering income tax and a 10% penalty on the earnings portion. Like traditional 529 plans, ABLE accounts offer tax-free investment growth and tax-free withdrawals when the funds are used to pay for qualified expenses. For 529 ABLE accounts, this includes things like college, job training, and healthcare and financial management.

Please do not hesitate to give us a call at (508) 630-2200 or send a note to kerri@sullivankreissfinancial.com with any questions or if we can be of any assistance with regard to understanding how the Tax Cuts and Jobs Act might impact your financial situation and planning.

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