EXPERT CONTRIBUTOR

Maximize Your Family's 529 Account: STRATEGIES FOR EXCESS FUNDS

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SAVING FOR HIGHER EDUCATION in the United States can be an expensive affair, as every parent knows. In the late 1990s, as more high school graduates opted for college education, tuition fees increased significantly, far surpassing the inflation rate. To help families save for college in a tax-efficient manner, Congress introduced the 529 account. Many states, including Wisconsin, introduced tax-advantaged educational savings accounts between 1996 and 2000. As a result, many students who were supposed to benefit from these accounts have now completed their higher education. Those families who were fortunate enough to save too much are now asking how the funds earmarked for one individual's education can be used.

What Is a 529 Account?

A 529 account is a savings program for education, sponsored by a state, named after the Internal Revenue Code section that created it. In Wisconsin, for example, 529 accounts are maintained by Wisconsin's "Edvest" program. Currently, more than 30 states offer a state income tax deduction or tax credit for contributions to a 529 program. However, in most cases, to qualify for this tax benefit, the donor must contribute to their home state's 529 plan.

While there is no federal income tax deduction for contributions to 529 accounts, they are tax-exempt, meaning that they enjoy pre-tax growth. Additionally, qualified distributions from a 529 account to a beneficiary are income-tax-free. These qualified distributions generally include tuition and fees, textbooks, technology and equipment and, in some cases, room and board.

What To Do With Remaining Funds?

When a 529 account is opened, the account owner designates one beneficiary for the account. In most cases, the 529 account is established by a parent for the benefit of the child. If the intended beneficiary doesn't use all the funds or the family has saved more than needed, the account owner has several options for managing the remaining value.

One option is to change the beneficiary at any time, with no negative income tax consequences, as long as the new beneficiary is a "member of the family" of the prior beneficiary. A member of the family includes, but is not limited to, children, parents, siblings, nieces, nephews, cousins and family members' spouses. However, if the new beneficiary is in a lower generation than the original beneficiary, the change may be a deemed gift, and the tax implications of this gift are still uncertain.

A second option available to the account owner is withdrawing the funds and paying the taxes and penalties associated with an unqualified distribution. Specifically, the earnings portion of the account is subject to both income tax as well as a 10 percent penalty. Although the tax consequences may be burdensome, this option provides the account owner with maximum flexibility.

In conclusion, funding a 529 account is a wise investment for your child's future. However, if there are excess funds in the account, it is important to understand the options available in the account. Changing the beneficiary is an attractive option that can help keep the funds within the family while avoiding any tax consequences in most cases. Withdrawing the funds is also an option, but it is critical to consider tax implications before making a decision. Ultimately, with careful planning, families can put those excess funds to good use and secure their financial future.

If you have questions about estate planning, or related matters such as tax-advantaged educational savings accounts, please contact attorney Kelsey L. Berns or another member of the Reinhart Trusts & Estates team.