James Zahansky, AWMA®
Principal/Managing Partner
& Chief Goal Strategist

Saving for College? A 529 Plan Can Help

The value of an education extends far beyond the cost of tuition or the completion of your diploma. An education provides a framework for your career and is proven to have a positive relationship with an individual's income. However, with rising costs, providing an education for children or grandchildren can be difficult. Knowing that education may just be one of your financial life goals, how will you plan to achieve it?
At Weiss & Hale Financial, we understand that each family may face unique situations when trying to achieve their education planning goals. What savings vehicles are best for my situation? How can I project future earnings to support this goal? Throughout August, we will address these questions and more so you may Plan Well for your education savings goals.

Section 529 of the Internal Revenue Code established two types of qualified tuition savings programs: college savings plans and prepaid tuition plans. In the prepaid tuition plan category, plans are offered by states or private colleges and universities. This article focuses on state-sponsored prepaid plans.

The fundamental purpose of prepaid tuition plans is to pay today for tuition costs incurred in the future. These plans allow families to lock in tuition costs at current rates, with a guarantee to match tuition inflation. Participants purchase tuition credits or certificates that entitle the account's beneficiary to a waiver of tuition costs at qualifying colleges when the enrolls in school at some future date.

Plan types

There are two types of prepaid tuition plans: contract plans and unit plans. With a *contract plan*, the participant agrees to purchase a specified number of years of tuition. The plan then pledges to cover that predetermined amount of future tuition expenses at a public college within that state. Contract plans for younger children usually offer lower prices on the premise that the state has a longer time horizon to invest the money.

697 Pomfret Street, Pomfret Center, CT 06259 | TEL 860.928.2341 TOLL FREE 866.928.2341 FAX 860.928.5271
www.weissandhale.com

With a *unit plan*, contributions are used to purchase units that represent a percentage of the average yearly tuition costs at public colleges in the state sponsoring the plan. One unit usually equals 1 percent of tuition costs. Units purchased do not have a predetermined value; instead, they fluctuate in value each year, commensurate with the average tuition increases for that state's public colleges.

Contributions

Contributions to prepaid plans are made with after-tax dollars and then grow income tax deferred at the federal and state levels. Contributions also qualify for the annual federal gift tax exclusion ($15,000 in 2018). Under a special election, a donor can contribute up to five times the annual gift tax exclusion amount ($75,000 in 2018) and deem the gift to be spread equally over five years to avoid gift tax. Certain plans may impose limits on annual contributions, and all plans limit the total lifetime contribution, typically to the projected cost of five years of tuition at the most expensive, public, in-state college.

The effect on financial aid

529 prepaid tuition plans are treated as an asset of the account owner and reported on the federal financial aid application, just as 529 savings plans are. Parent-owned plans have minimal effect on financial aid because they are assessed at a maximum rate of 5.64 percent. Plans owned by grandparents are not required to be disclosed on the financial aid application. It is important to note, however, that 50 percent of the distributions from these plans are reported as untaxed income to the student beneficiary on the following year's Free Application for Federal Student Aid form, causing a significant impact on financial aid.

Important considerations

In recessionary periods, when state tax revenues may decline, and stock market returns may be lower than expected, state-sponsored prepaid tuition plans may have difficulty fulfilling their obligation to investors. Historically, under these conditions, prepaid plans have either closed to new investors or increased their pricing for new investors. Nevertheless, the risk that prepaid plans may not be able to fulfill their obligation to investors does exist.

Also, keep in mind that state-sponsored prepaid plans provide maximum benefits when the student attends an in-state public college. If the student attends an in-state private school or an out-of-state school, the plan may yield only a refund of contributions without interest or a refund with a small amount of interest.

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Plan Well

There are many different plans and options to helping make college more affordable for you or a loved one. So many that it can be hard to know what is best. Our unique process will identify your exact goals and needs to determine what the necessary next steps are to take. To learn more about our process, visit www.weissandhale.com/our-process.

**The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that a college-funding goal will be met. In order to be federally tax-free, earnings must be used to pay for qualified education expenses. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10-percent penalty. By investing in a plan outside your state of residence, you may lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.*

Presented by James Zahansky, AWMA, researched through ©2018 – Commonwealth Financial Network. Weiss & Hale financial Managing Partners Laurence Hale and Jim Zahansky offer securities and advisory services through Commonwealth Financial Network®, Member FINRA/SIPC, a Registered Investment Adviser. They practice at 697 Pomfret Street, Pomfret Center, CT 06259, 860.928.2341.

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