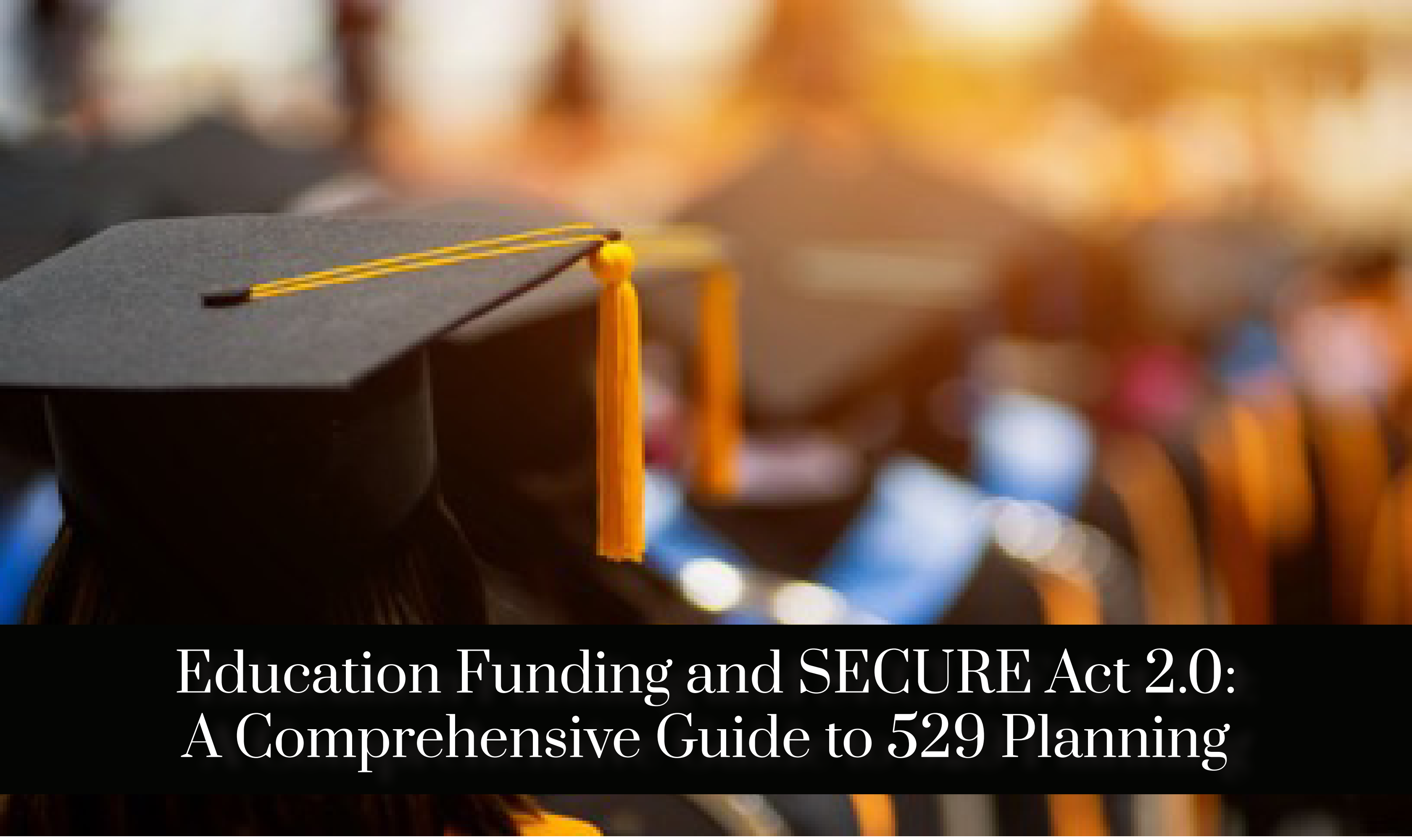

Education Funding and SECURE Act 2.0: A Comprehensive Guide to 529 Planning

Introduction

Education is a valuable investment in our future. As parents, grandparents, guardians, and close relatives or family friends, we want to ensure that our children and loved ones have the opportunities they need to succeed.

One important aspect of education funding is the 529 plan, a powerful tool that can help you save for a child's education. In this white paper, we will explore the nuances of 529 plans, their benefits, and how to utilize them effectively. We will also discuss the Florida Prepaid Plan for comparison purposes and SECURE Act 2.0 and its effects on education funding.

In addition, we address the topmost practical questions centered around 529s to get you ready to start now or maximize them more effectively if you are already an account owner.

Whether you're a parent, grandparent, or anyone interested in planning for the costs of education, this guide will provide you with the information you need to make informed decisions. So, let's dive into the world of education funding and discover the potential of 529 plans.

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Why a 529 Plan and What are the Benefits?

What is a 529 Plan?

A 529 tax-advantaged savings plan is designed to help families save for education expenses. These plans are named after Section 529 of the Internal Revenue Code. The primary goal of a 529 plan is to provide families with a dedicated account to save for qualified education expenses, such as tuition, fees, books, and room and board.

Why use a 529?

One of the key advantages of a 529 plan is the tax benefits it offers. Contributions to a 529 plan grow tax-free, meaning you won't owe any taxes on the earnings as long as the funds are used for qualified education expenses. Some states also offer tax deductions or credits for contributions to their specific 529 plans.

Another benefit of 529 plans is their flexibility. The funds in a 529 plan can be used at eligible educational institutions nationwide, including colleges, universities, vocational schools, and even some foreign institutions. The funds can still be utilized if your child decides to pursue education outside your home state. You can even utilize 529 Plan funds for K -12 education expenses within certain limits.

Start with Your "Why"

Before diving into the details of a 529 plan, it's crucial to understand your motivations and intentions. Ask yourself why education funding matters to you and your loved ones. Consider the long-term goals and how education plays a role in shaping your family's future. By clarifying your objectives, you can ensure that a 529 plan aligns with your vision.

Utilizing a 529 Plan Wisely

Once you have determined your "why," it's important to utilize a 529 plan wisely. Think of it as planting seeds and nurturing their growth over time. Just as you carefully water and prune a plant, you should consider when and how to make contributions and withdrawals from your 529 plan. By strategically managing your funds, you can maximize their growth potential and ensure they are utilized effectively.

Maximizing Family Wealth

A 529 plan provides financial benefits and fosters important conversations about the value of education and continuous learning within your family. You are amplifying your family's overall wealth by utilizing a 529 plan to invest in education. This goes beyond monetary wealth and extends to the knowledge, skills, and opportunities that education brings. Engage your loved ones in discussions about the importance of education and its benefits to their lives.

Confidence and Peace of Mind

Utilizing a 529 plan can bring a sense of confidence and peace of mind. Proactively planning for your child's education can make you feel more secure about their future. Just as a confident golfer stands over the ball with a sense of assurance, you can approach education funding with the same confidence. A well-managed 529 plan can give you peace of mind, knowing you have taken a proactive step toward securing your child's education.

The Nuances of 529 Plans

While 529 plans offer great benefits, it's important to understand their nuances to make the most of them and optimize their benefits.

For the 529 plan to be most effective, it should be utilized for its intended purpose, funding education costs, not for miscellaneous expenses. Otherwise, potential penalties and taxes will come into effect. Wise utilization of Plan assets eliminates unnecessary penalties and taxes.

In addition to possible penalties and taxes on withdrawals, 529s have contribution limits (annual gift exclusion amount and can be "supercharged" 5 years' worth) and gift tax considerations for high-net-worth families. Once contributions are made, balances and withdrawals from 529 Plans impact financial aid calculations, as discussed later in this article.

Let's explore some key considerations when utilizing 529 plans for education funding.

How to Get Started

Selecting the right 529 plan involves considering fees, investment options, and historical performance. Each state offers its own 529 plan, and some may offer additional tax benefits for residents. Researching and comparing different plans is important to find the one that suits your specific needs.

Who can open a 529 plan?

Anyone over 18, who is a U.S. citizen or resident alien can open a 529 plan. This includes, of course, the parent, but also a grandparent, aunt, uncle, cousin, friend, etc. There is a great deal of flexibility with the owner, and there can be multiple 529 accounts held by different owners with all the same beneficiaries as well. Unlike Roth IRA contributions, there are no income restrictions for contributing to a 529.

How much should I contribute?

Once you choose the right 529 plan for you, one of the first questions parents/owners often ask is how much they need to save for their child's education. Anticipating the costs of specific schools can be challenging, but it is essential to have a rough estimate. The Cost of Attendance (COA) provides a baseline for estimating expenses. By projecting future costs based on inflation rates, such as 4%, you can get a sense of the amount you need to save.

Determining the contributions needed to reach your education funding goals requires careful planning. Let's consider an example. Suppose you have a child named Kate, who is nine years away from college, and your goal is to save $132,000. Based on an assumed 6% return, you could make a lump sum contribution of $78,000 now. Alternatively, you could contribute $11,500 annually or $960 per month. If you have a baby 18 years away from college, and you aim to save $187,000 with a 4% inflation rate, you will need to contribute $6,000 per year or $500 per month.

> Another consideration is whether it is better to start with a "large" amount, such as $5,000 to $10,000 at birth, or to make monthly or annual contributions. The dominant strategy points to starting larger early, but that is cash flow permitting and may not be easy mentally for some investors. It is also important to have realistic expectations for the rate of return over time. While a 6% return is commonly used, you may want to use lower rates for older children and higher rates for younger ones, given the difference in horizons of time before funds will be needed.

Grandparents who want to contribute to a child's education can set up a separate 529 plan in their name with the child as the beneficiary. This approach has certain advantages when it comes to financial aid. The Free Application for Federal Student Aid (FAFSA) calculates the Expected Family Contribution (EFC), which considers the assets and income of the custodial household. Contributions from a parent-owned 529 plan count towards the EFC by up to 5.6%, while contributions from a grandparent-owned 529 plan do not count at all. However, distributions from a grandparent-owned 529 plan count as income and can affect financial aid eligibility. To maximize financial aid, it is advisable to distribute from parent-owned 529 plans first and utilize grandparent-owned plans in the last two years of college.

How do I select appropriate investments, and what if the market declines?

Choosing the right investments within your 529 plan can significantly impact the growth of your education funds. It is advisable to review your investment allocation and periodically adjust as needed. However, avoiding excessive trading is important, which can result in unnecessary fees and potential tax implications.

Protecting against a market decline right before you need the funds is a valid concern for many families. One strategy is to gradually shift your investment allocation from stocks to more conservative options as your child approaches college age; typically, this is done automatically in a 529 plan's "Age-Based" portfolio. This approach helps to mitigate the impact of a market downturn on your education funds.

Should I do FL Pre-paid or a 529?

When considering education funding options, many families also wonder whether they should choose a Florida Prepaid plan or a 529 plan or if they can use both. The decision depends on various factors, including individual circumstances and preferences. Florida Prepaid plans offer the advantage of locking in today's tuition rates, while 529 plans provide more flexibility regarding eligible expenses and investment options. It's important to evaluate the pros and cons of each option and select the one that aligns with your goals and financial situation.

Some key features that 529 plans offer as differentiators include being able to be used for private, elementary, middle, and high school, as well as graduate school, certifications, and vocational schools. This flexibility allows you to support your child's educational journey at various stages.

SECURE Act 2.0 also makes 529 plans more attractive with the ability to roll over funds into a Roth IRA for the beneficiary, as detailed further in this paper.

One limitation of the Florida Prepaid Plan is the time horizon. Participants in the plan must utilize the funds within a specific timeframe, typically ten years from the projected enrollment date. This limitation may restrict flexibility if your child pursues education outside the predetermined timeline.

Utilization and Distributions of 529 Funds

One common concern among families is whether having a balance in a 529 plan will work against their eligibility for financial assistance or scholarships. While having funds in a 529 plan can affect financial aid, it is important to understand the rules and limitations.

The Free Application for Federal Student Aid (FAFSA) considers the assets and income of the custodial household, which includes parent-owned 529 plans. However, distributions from parent-owned 529 plans do not count toward the income base used for financial aid calculations. On the other hand, distributions from grandparent-owned 529 plans count as income and can reduce financial aid eligibility by up to 50%. Still, the balance of the grandparent-owned 529s is not counted toward the income base. Therefore, it is often strategic to have grandparents contribute to their “own” 529 for a grandchild instead of contributing to the parent-owned 529 for that grandchild to give more flexibility on distributions and qualifying for financial aid.

What are Qualified Education Expenses?

When utilizing 529 funds, it’s essential to understand what expenses are covered and what costs are not. Qualified education expenses include tuition, fees, books, supplies, and equipment required to enroll or attend an eligible educational institution. However, certain expenses like transportation, health insurance, application fees, and extracurricular activity fees are not covered. Additionally, 529 funds can be used for student loans up to a lifetime limit of $10,000.

Taking distributions from a 529 plan can be done in two ways: directly paid from the plan or reimbursed. It’s important to keep track of expenses and maintain proper documentation to ensure compliance with IRS regulations. For example, if you are reimbursing expenses from a previous year, you must ensure that the expenses were incurred during a qualified education period.

What if my child receives a scholarship? Are there ways to still withdraw from the 529?

If your child receives a scholarship, such as Bright Futures, you may still be able to utilize your 529 funds. While scholarship funds can be used for qualifying expenses, you can take a non-qualified distribution from your 529 plan equal to the scholarship amount without incurring the 10% penalty. However, you will still need to pay income taxes on the earnings portion of the distribution.

When I withdraw, should I consider which investments to sell?

When taking distributions from your 529 plan, you may wonder if you should select specific investments or take a pro-rata distribution from your overall portfolio. While there is no one-size-fits-all answer, it may be beneficial to consider your investment allocation and the performance of specific investments. If you have investments that have performed exceptionally well, taking a distribution from those investments can help to rebalance your portfolio and adhere to the “buy low, sell high” philosophy.

If your Plan custodian only allows pro-rata distributions, you may want to consider having multiple plans to distribute from. For example, one plan could be more conservative, and you withdraw from that plan when the market performs poorly. Conversely, when the market performs well, you could withdraw from a second, more aggressive stock allocation plan. The larger your balance, the more you might want to consider strategic withdrawal strategies from plans.

SECURE Act 2.0 and Leftover Funds

In December 2022, Congress passed the SECURE Act 2.0, introducing new rules that will significantly impact education funding and retirement planning. These changes aim to provide more flexibility and opportunities for families to save for their children’s education while also planning their future.

> One of the exciting new provisions of the SECURE Act 2.0 is the introduction of Roth options for leftover funds in a 529 plan. Under this provision, any leftover funds in a 529 plan can be rolled over into a Roth IRA. This rollover is subject to certain conditions, such as the beneficiary of the 529 plan being the owner of the Roth IRA. The rollover is limited to the annual contribution limit and a lifetime limit of $35,000. The beneficiary must have earned income exceeding the contribution amount, and the 529 plan must have been in place for at least 15 years.
>
> This new provision offers an additional avenue for families to optimize their

> education funds and provide for their children's future financial well-being. By rolling over leftover 529 funds into a Roth IRA, families can take advantage of the tax benefits associated with Roth accounts, including tax-free earnings and potentially tax-free withdrawals in retirement. It is important to consult with a financial advisor or tax professional to understand this strategy's specific implications and benefits based on your circumstances.

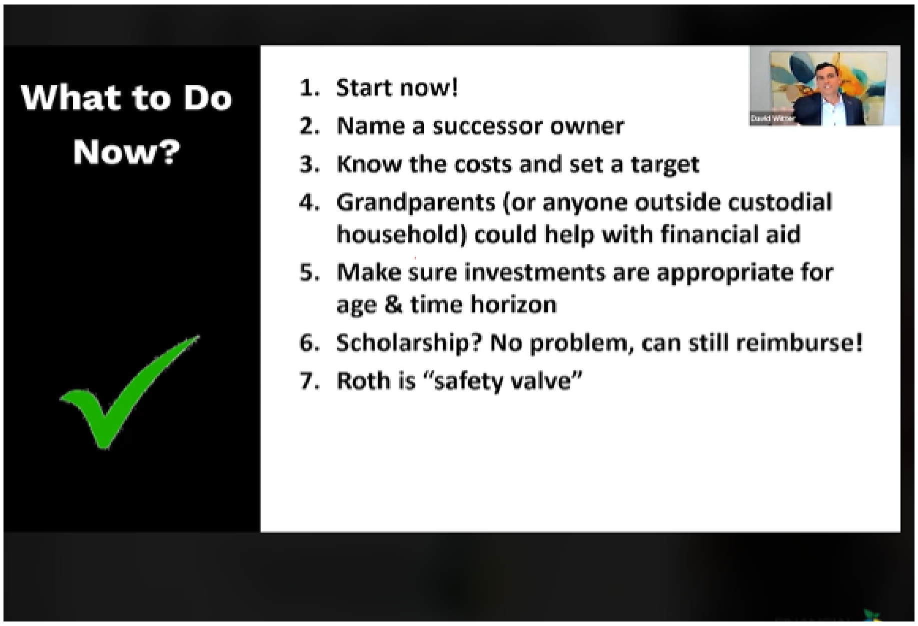
Additionally, families may wonder if it is possible to pass ownership of a 529 plan to future generations to pay for the education expenses of grandchildren or great-grandchildren. The answer is yes, with proper planning and coordination. Ensuring the 529 plan has a properly named successor owner can transfer ownership to future family members.

> This approach allows for continuing education funding and creates a multigenerational family education "endowment." It is essential to be aware of the gift tax implications and utilize strategies such as the annual gift exclusion and super funding to maximize contributions while minimizing tax consequences.

If leftover funds are in a 529 plan, such as a child receiving a scholarship, families have several options for how that money can be used. These options include changing the beneficiary to another family member, using the funds for future educational expenses, or taking a non-qualified distribution. It is important to consider the tax implications of each option and consult with a financial advisor to determine the best course of action based on your circumstances.

Conclusion

The SECURE Act 2.0 significantly changes education funding by introducing new rules for 529 plans. These changes give families more flexibility and opportunities to save for their children's education while also planning for retirement. By understanding the SECURE Act 2.0 provisions and utilizing strategies such as proper planning, investment management, and the utilization of leftover funds, families can maximize their education savings and set their children up for a bright future. It is crucial to consult with a financial advisor or tax professional to tailor these strategies to your specific needs and goals. Start planning today and secure a bright future for your family.



Next Steps/Follow-up

1. Full Webinar Replay and Blog

2. Second Opinion of your financial situation

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The information provided in this article is for informational purposes only and should not be considered financial or tax advice. It is always recommended to consult with a qualified financial advisor or tax professional before making any financial decisions.

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