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TAX STRATEGIES FOR FUNDING HIGHER EDUCATION

There are many benefits to parents utilizing 529 accounts to pay for their children's education. Contributions enjoy tax-deferred growth, while withdrawals remain tax-free when utilized for qualified educational expenses like tuition, fees, books, supplies and computers. Additionally, with a 529 account, parents can allocate up to $10,000 towards K-12 tuition and another $10,000 for student loan repayments. [1]

Potential State Tax Deductions

When it comes to 529 plans, more than 30 states allow for a state tax deduction to fund them. And, some states offer tax credits, while others offer a deduction up to a flat, maximum figure or limit the deduction based on your income. It's important to note that some states offer higher deductions than others. For example, New York residents can deduct $5,000 (single) and $10,000 (married filing jointly) for 529 contributions. In Arizona, those residents can only deduct $2,000 (single) and $4,000 (married filing jointly) per beneficiary.[2]

While in most instances you must contribute to your state's 529 plan and pay taxes to receive the tax benefits, nine states give you the same tax benefit no matter which 529 you contribute to, even if it's sponsored by another state. Those states include Arizona, Arkansas, Kansas, Maine, Minnesota, Missouri, Montana, Ohio and Pennsylvania.[2]

Gift Tax Exclusion

While you can contribute any amount annually to a 529 plan, contributions are considered gifts for tax purposes, which means to qualify for the annual gift tax exclusion in 2024, individuals can contribute up to $18,000, and married couples filing jointly can contribute $36,000. For example, if you have three grandchildren, you can jointly give $108,000 without triggering the gift tax. Keep in mind that the annual gift tax exclusion includes non-529 gifts, such as cash or property. Without having to pay federal estate or gift tax, an individual's lifetime estate and gift tax exemption maximum is $13.61 million in 2024.[3]

In addition, there is no joint gift tax return, so you and your spouse would each need to file a return. Also, you can contribute any amount above the annual limits noted ($18,000/$36,000), but you'll have to report those contributions to the IRS, and the amount will count against your $13.61 million individual exemption.

Front Loading Your 529 Plan

One way to protect a larger amount from estate taxes is to "front-load" a 529 account to fund a beneficiary's education. Individuals can front-load a 529 with the equivalent of five years of annual exclusion gifts. In other words, you could contribute $18,000 x 5 to equal as much as $90,000 as an individual or $36,000 x 5 to equal $180,000 as a married couple in a single year.[4] This can help high-wage earners limit their income tax liability. If you choose to frontload an account, you will need to file a gift tax return and make no additional annual exclusion gifts for five years.

Plan Flexibility

While a 529 plan is typically funded by a parent or grandparent, anyone can open an account for nearly any child, even if the child is not a family member. Most plans, regardless of which state, are open to anyone to invest in, although residents in the states mentioned above receive a tax deduction if they invest in their state's plan.

Plan For Your Future

Whether you just had a child, or your child is getting ready to go off to K-12 school or college, a 529 plan is a tax-deferred investment vehicle that can give high-net worth individuals a way to lower their income and estate tax liabilities.

[1] “What You Can Pay for With a 529 Plan” savingforcollege.com
[2] "How much is your state's 529 deduction really worth?" savingforcollege.com
[3] “Estate and Gift Tax” irs.gov
[4] “Why You Should Frontload Your 529 Plan” Investopedia.com

Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer’s official statement, which should be read carefully before investing.