MENNINGER & ASSOCIATES
Financial Planning

TRICKS OF THE TRADE

USE OF 529 PLANS AS A CONDUIT

Prepared by Michael Menninger, CFP

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Since its introduction into law in 1996, the 529 college savings plan has continued to gain popularity, and has essentially made all other savings plans (specifically, the Coverdell / Education Savings Account (ESA) obsolete. For good reason, too.

The 529 plan refers to Section 529 of the Internal Revenue Code, which essentially states that these accounts can be used to save / invest for college and receives tax-preferential treatment. Specifically, if used for qualified education (typically for college tuition, room & board, and even trade schools), the interest or growth in these accounts grows tax-deferred and can be withdrawn tax-free. They are effectively treated the same as the Roth IRA, except instead of being used for retirement, its purpose is for higher education. More recently in 2018, the rule allows 529 savings plans to be used for private school and K – 12, but limited to $10,000 per year for tax-free withdrawals.

In order to qualify for preferential tax treatment, deposits must be made to a state-sponsored plan, and all 50 states have a 529 plan available for their residents, which can even be purchased by non-residents of that particular state. Some states even provide additional tax incentives for their residents, such as tax deductions up to a certain dollar amount.

Here in Pennsylvania, there are two types of 529 plans, but 3 methods in which you can purchase them.

1. GSP 529 Plan: This is the Guaranteed Savings Plan (formerly known as the Tuition Assistance Program). The GSP 529 plan is run through the state government, and essentially allows the owner to purchase college credits at today's prices, so the "growth" is the inflation of the cost of college credits. This is a simple, low-risk way to keep pace with rising post-secondary tuition costs.

2. The 529 Investment Plan: The owner has the option to choose from a variety of different investment, much like in one's 401(k) plan. PA uses Vanguard as their investment manager to administer the 529 plan, allowing the participant to purchase investments. PA does not specify that you must use their plan, so an owner may purchase a 529 plan from any other state and may also use advisor-sold funds sponsored by other states.

In Pennsylvania, the tax treatment for 529 plan withdrawals is the same as for the Federal tax laws, in that all withdrawals (both the principal and the growth) are tax-free if used for qualified higher education expenses. However, PA allows for a state tax deduction of up to $15,000 per year for contribution to the 529 plan, and $30,000 per year if both parents have earned income exceeding $15,000 per year each.

This now leads to this month's "Trick of the Trade" – Using a 529 Plan as a Conduit

One might ask the question, "Why would I use a 529 plan if I don't have much time to save for college?" The simple answer to that is one can use the 529 Plan as a "pass-through" to get a state tax deduction. For example, if one wished to fund tuition for the current semester, they could place the money into a 529 plan and quickly withdraw it to pay for the tuition. This gives him / her the state tax deduction by simply placing the money into the account. If dealing with a shorter time horizon, one would consider placing the funds into a money market account so there is no risk of capital depreciation associated with the investment. For example, if one were to contribute $15,000 worth of tuition via a "pass-though", the contributor would receive a 3.07% PA state tax deduction.

If you have any specific questions about 529 plans, feel free to call us for advice.