Tax Act Helps College Savers and Disabled Children

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The Tax Cuts and Jobs Act has made 529 plans more flexible, such that parents can access these funds for younger students and to benefit their children who are disabled.

Over the past 30 years, the average price of a public four-year institution of higher education has increased by 213%, while the average price for a four-year private school has gone up by 129%. And, by 2036, four years at a private university will cost $303,000, according to CNBC.

While in the past, a college student was able to work a summer job and save throughout high school in order to pay for four years at a good public institution, those days are long gone. This drastic increase in college costs makes it all the more important for parents to start planning early, and that means saving for their children's college education even before they've entered kindergarten.

529 PLANS JUST GOT MORE APPEALING

Obviously, 529 plans are the college savings tool of choice, especially for middle- and upper-income families. In fact, people collectively had stashed some $335 billion in 529 plans. They allow annual contributions of $15,000 per year per donor, or a front- loaded contribution of $75,000.

And, due to the tax overhaul known as the Tax Cuts and Jobs Act (or TCJA), 529 savings plans just got that much more appealing. Basically, the TCJA widened the range of the 529 savings plan (not the prepaid tuition plans). Previously it had been strictly a college savings plan, but now it is more a general education savings plan.

To wit, up to $10,000 per year of the money in 529 plans can be used for K-12 private school tuition. If the money is withdrawn for this reason, the withdrawal is typically free from federal taxation. In terms of state tax, although more than 30 states have clarified that they will follow federal guidelines, California, Oregon, Michigan, New Jersey, and many others say that they will not, and that they will still tax these distributions. Make sure to check the laws of the state in which the plan is held before making any withdrawals. In some cases, there may be penalties.

While these changes provide savers with more flexibility, they also may affect financial aid calculations for private high schools. The schools may now take into account a family's 529 savings when calculating aid.

And of course, withdrawing 529 assets before the child is in college also decreases the amount of time that the assets can grow tax-free, a major benefit of a 529 plan. Parents should have a conversation with financial advisor to make sure that there won't be any regrets if the money is withdrawn before college and isn't allowed to fully appreciate. They should also make sure that there will be no penalties or tax liabilities.

There is another hidden benefit of investing in a Section 529 plan. The TCJA limits deductions for state income or sales and property taxes to $10,000 per return. Many states allow a tax deduction when contributing to the state's 529 plan, so a write-off for a 529 contribution can help lower state income taxes that may no longer be deductible on a federal return.

BENEFITING CHILDREN WITH SPECIAL NEEDS

Thanks to the TCJA, there's a new option for 529 savings specifically designed for children with special needs who will not be attending college. It's possible to withdraw money from the 529 without penalty if the child meets the IRS's definition of being disabled, although taxes must be paid on the earnings portion of the withdrawals.

The IRS's definition of a disability is also very limiting, as it follows the Social Security definition. The IRS states that the 529 beneficiary can't be able to do "any substantial gainful activity because of his or her physical or mental condition. A physician must determine that the condition can be expected to result in death or to be of long-continued and indefinite duration," in order for the IRS to consider the person "disabled."

If a child has special needs, but doesn't necessarily qualify as "disabled" under the IRS strict guidelines, there's another option. Thanks to TCJA, it's possible to roll money over from 529 accounts into state-sponsored ABLE accounts (ABLE stands for Achieving a Better Life Experience). People can withdraw tax-free from these accounts for a variety of expenses. This includes just about anything that improves "health, independence or quality of life of the person with the disability," according to Kaellen Hessel, advocacy and outreach manager at the Oregon Savings Network, which administers that state's ABLE plan.

Another benefit of having an ABLE plan for a child with disabilities is that the plan allows for significant sums of money to be put away for the child without jeopardizing federal benefits, like Medicaid. It also protects the disabled party from losing supplemental Social Security income, which generally happens if the person has more than $2,000 in their name.

By utilizing an ABLE account, they can save up to $100,000 without affecting their Medicaid eligibility or SSI benefits. ABLE accounts are open to those of any age who developed a qualifying disability before the age of 26. Tax-free rollovers of up to $15,000 per year can be made from 529 plans to ABLE accounts as well, minus any other contributions that were made to the ABLE account in that year.

ABLE accounts provide much needed flexibility in allowing the owner to use the fund for medical expenses. Just remember that, after the disabled person's death, the funds remaining in an ABLE account typically go back to the state in order to repay any benefits if the person was receiving Medicaid, which many are. However, regular 529 plans don't require this. Therefore, using the new tax law changes, it's possible for someone to fund a 529 account for a disabled person and move the money into an ABLE account when need be. By using this new strategy, families are able to achieve tax-free growth without directly giving up their ownership of any assets except what is placed into the ABLE account. This greatly helps families who started 529 plans when their child was young, but later realized that college wouldn't be the appropriate path for their child.

Thanks to the TCJA, 529 plans now come with that much more flexibility. From using 529 plans to contribute to a private K-12 education to moving the money to ABLE accounts, many more families will be provided with a variety of options as to how they want to approach their children's education and future. And as always, a 529 plan is an invaluable tool for those parents who want to start saving for a young child's education, as long as they plan ahead and do it right.

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