FLEISHER
PATTERSON
LAW

ESTATE PLANNING | ADMINISTRATION | PROBATE

Wells Fargo Bank Building
3333 S. Bannock St., Suite 900
Englewood, CO 80110

fleisherpattersonlaw.com

P 303-488-9888
F 303-488-9889

SECTION 529 PLANS

A Tax-Favored Method of Accumulating Funds for a Child or Grandchild's College Education

Named after the section of the Internal Revenue Code which authorizes each state to sponsor such plans, Section 529 Plans permit the tax-deferred accumulation of funds, and if used for the qualified educational expenses of the beneficiary, plan withdrawals come out income tax free.

Each state has sponsored one or more such plans. Each state plan is somewhat different, but most allow residents of other states to invest in their plans and do not limit the tax-free withdrawals to educational institutions only in their state.

Colorado's "Direct-Invest" Plan is particularly attractive to Colorado residents for at least two reasons:

- Plan investments are managed by Vanguard, one of the most successful and lowest cost mutual fund managers in America.
- Colorado residents are entitled to a state (but not federal) income tax deduction. That's like getting an immediate 4.63% return on your investment, assuming you are paying Colorado income taxes.

You can think of a 529 Plan as an investment account that has several unique features. Here is a general description of the Colorado "Direct-Invest" Plan:

1. The plan is open to all U.S. Citizens. Plan owners and plan beneficiaries are required to have a Social Security number.
2. The plan owner has full control of the account. The plan owner determines how and when plan withdrawals are made.
3. The plan owner is permitted to change beneficiaries or transfer a portion of the account to a plan with a different beneficiary without adverse tax consequences, provided the new beneficiary is a qualifying family member of the prior beneficiary. The plan owner and the beneficiary may be the same person.

4. Qualifying family members include most relatives of the beneficiary, and include ancestors and descendants, stepparents and stepsiblings, and the spouses of such persons, as well as first cousins.

5. Plan contributions may be made by anyone, but the plan owner remains in full control. There can only be one plan owner and only one beneficiary on any one account, but the plan owner can designate a successor owner in the event of the plan owner's death.

6. Plan contributions must be in cash or equivalent. You cannot contribute securities. The maximum contribution limit across all 529 Plans for the same beneficiary is $400,000, but such plans can continue to accrue earnings above and beyond this figure.

7. The plan is not included in the plan owner's taxable estate for federal estate tax purposes. Contributions are eligible for the annual gift tax exclusion ($15,000 in 2020), and contributions over that amount (up to $75,000) can be amortized over a five-year period without gift tax consequences.

8. There are several different mutual fund type investment options, all managed by Vanguard, varying from a money market fund to an aggressive stock fund. The most popular is the Stock Market Index Fund as it has the lowest expenses and some of the highest returns over various periods of time.

9. Your investment may lose money and, like all mutual fund type investments, neither Colorado nor the federal government guarantee your principal or earnings. You may change investment options only twice during any calendar year.

10. The ownership of, and distributions from, the account may adversely affect the eligibility for college financial aid. Ownership by a grandparent rather than a parent may reduce the impact, as well as limiting distributions to the last two years of college.

11. The current asset-based fee is 0.34%. The annual account fee of $20 is waived if either the owner or the beneficiary is a Colorado resident, if the account balance exceeds $10,000, or when opting for paperless statements.

12. Earnings grow free from both federal and Colorado income taxes while in the plan. There is no federal or Colorado income tax on qualifying withdrawals. Plan assets used to pay tuition, room and board, books, supplies, and equipment (including computers) at any eligible educational institution in the U.S. or abroad will be considered a qualifying withdrawal.

13. Non-qualifying withdrawals are subject to income tax on the earnings as well as a 10% penalty on the earnings.

14. Eligible educational institutions are those institutions of higher education eligible to participate in certain government student aid programs, which includes most community colleges, four-year colleges, graduate and postgraduate programs, certain vocational schools, and certain institutions in foreign countries. The federal government allows tax-free withdrawals to pay for primary school tuition up to $10,000 per year. Colorado has yet to act on such change.

Thus, 529 Plans offer the plan owner both privacy and flexibility. For instance, the beneficiary doesn't even have to know of the existence of such account. You just need the beneficiary's Social Security number to set up an account.

If your child doesn't go to college, you can transfer his or her account balance to a separate account for the benefit of another child. If neither child goes to college, or the funds aren't used for their college education (perhaps because of a scholarship or you just decide to pay those costs separately), the account balance can be changed to your grandchild, or even partially transferred to one or more accounts for the benefit of your grandchildren.

Even if the funds are never needed for your children or grandchildren's college, you can still distribute the account to yourself as the plan owner. The earnings portion will be subject to federal and Colorado income tax and to the 10% penalty. Tax-deferred investing for, perhaps, decades could more than offset the 10% penalty. The 10% penalty is waived in the event of the beneficiary's death or disability, or if the beneficiary receives a qualifying scholarship. Furthermore, non-qualifying distributions are taxed to the recipient of the withdrawal.

Fleisher Patterson Law is not affiliated with, nor is compensated by, this program. This summary is offered solely as a public service. For more information, or to obtain an application and prospectus, contact College-Invest Direct Portfolio College Savings Plan at 800-997-4295 or go to www.collegeinvest.org and click on "Direct Portfolio" under "Our Savings Plans."