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The Stevens Advisor

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UNDERSTANDING 529 PLANS

529 plans are intended to help taxpayers pay for college by providing a way to avoid taxes on money used for college expenses. (The plans are named for section 529 of the Internal Revenue Code 26 U.S.C. § 529.) Dollars in the plan are invested and grow: when the money is withdrawn for education expenses, no federal taxes are owed on the increased value. The expenses that qualify are costs required to attend a college, university or other post-secondary institution, and also tuition costs of up to $10,000 per year per child for K-12 private schools.

Parents or grandparents (or anyone, really) can open a 529 with a child as the beneficiary. Contributions of up to the gift limit of $15,000 per year per donor per child can be made without triggering a gift tax (as long as no other gifts are made to the child). There is also a 5-year election to allow larger gifts of up to $75,000 per donor per child (often used by grandparents to shelter assets from estate tax).

For Minnesota residents there is also a state tax benefit. A credit of up to a maximum of $500 is available to those under certain adjusted gross income limits (single filers $100,000 or joint filers $160,000). Otherwise, a subtraction is available of up to $1,500 for single filers and up to $3,000 for joint filers. The amount that may be claimed is equal to your contributions to a 529 plan during the year, minus any distributions from the plan.

Parents looking to take advantage of the many benefits of saving for college with a 529 plan will want to know the full details of which educational expenses qualify for tax-free distribution status -- and which do not. In Publication 970, the IRS gives detailed guidance on qualified expenses. Here are a few important points.

What's Covered for College and Graduate School Expenses

- Tuition and fees are covered in full.

- Room and board is covered if the student is enrolled at least half time. But such expense must be not more than the greater of (1) the allowance for room and board, as determined by the school, that was included in the cost of attendance; or (2) the actual amount charged if the student is residing in housing owned or operated by the school.
- Food. If you spend a certain amount for a meal plan, that entire amount can be deducted, even if used for coffee or ice cream and not a full meal. Weekend meals can also be included if the dining halls are not open.
- Books and supplies. Any fees associated with purchasing school textbooks are considered qualified, as are required equipment or supplies such as notebooks and writing tools.
- Computer technology or equipment. Computers; related equipment such as printers, etc.; Internet access; software used for educational purposes are qualified expenses. Equipment used primarily for amusement or entertainment is not.
- Special needs services required by special-needs students that are incurred in connection with enrollment or attendance at school.

What's Not Covered

- Student loans. Interest on or repayment of student loans is not considered a qualified expense by the IRS.
- Insurance, sports or club activity fees, and many other types of fees that may be charged to students but are not required as a condition of enrollment.
- Transportation to and from school.
- Concert tickets or other entertainment costs, unless attendance is requisite to a course or curriculum.

Note that expenses must apply to a qualified college, university, or vocational school for post-secondary educational expenses. Also keep in mind that taxes and a possible 10% penalty will apply to all distributions that are not considered qualified educational expenses by the IRS, so be sure to check first.