Ten Things You Should Know About 529 Plans

While the cost of living is steadily increasing, higher-education costs are rising at a faster rate, approximately twice the rate of general inflation,[1] with the cost of attendance at a private four-year college averaging $60,420 annually.[2]

There are several options available to help you prepare for this important milestone, including 529 plans, which have revolutionized the way families invest for college and other qualified education expenses. These plans offer a significant degree of flexibility and control and provide benefits that other education savings programs don't offer.

SECURE 2.0 Act

With the passage of the SECURE 2.0 Act, 529 account owners may be able to roll over their leftover 529 plan assets to a Roth IRA—for a designated beneficiary—making 529 plans an even more robust solution for long-term financial planning*.

There are, however, a number of requirements and limitations applicable such a rollover, including (but not limited to) the requirement that rollover come from a 529 plan of a designated beneficiary, which has been maintained for at least 15 years prior to the rollover, and limitations on the annual and aggregate amount that is eligible to be rolled over to a Roth IRA from a 529 plan.**

Here's what you should know if you are considering a 529 plan:

1. THEY'RE NOT ONLY FOR KIDS.

Although most 529 plans are typically used to fund higher education for children, they are ideal for anyone with education funding needs. Whether you're a retiree who wants to pursue lifelong learning or a professional who is returning to school to advance your career, 529 plans may have a place in your investment portfolio.

2. IT'S AN INVESTMENT VEHICLE THAT ALLOWS TAX-DEFFERED ACCUMULATION OF SAVINGS AND TAX-FREE WITHDRAWALS FOR QUALIFIED EDUCATION EXPENSES

Money in a 529 plan generally accumulates free of federal and state income taxes. Further, as long as funds are used for qualified education expenses, the withdrawals from your account are also federal income tax-free.[3]

* This change to 529 plan assets is effective January 2024.
** This material does not address the impact of state and local income taxes. The state and local income tax treatment of a 529 plan may differ from the federal tax treatment. You should consult with and rely on your own independent tax advisor.

3. 529 PLANS TYPICALLY HAVE HIGH MAXIMUM CONTRIBUTION LIMITS, WHICH ALLOW YOU TO INVEST MORE FOR EDUCATION EXPENSES.

Most 529 plans have contribution limits in excess of $500,000 per account/beneficiary, enabling you to accumulate sufficient assets to cover a wide range of education expenses.[4]

4. IF YOU'RE THE ACCOUNTOWNER, YOU HAVE COMPLETE CONTROL OVER IF/HOW 529 ASSETS ARE USED.

Some vehicles traditionally used for education funding, such as uniform gift to minors' accounts (UGMA), require that the assets be turned over to the beneficiary at a certain age. With a 529 plan, you— not the beneficiary—control if and how the money is used, thus ensuring that it is spent according to your wishes. This means that if it is not utilized for the beneficiary's educational purposes, you have several other options, including choosing another eligible beneficiary or using the plan for your own educational funding needs.

5. THERE ARE NO AGE OR INCOME RESTRICTIONS.

Unlike some education funding vehicles with age and income restrictions, which limit the amount you can save, generally anyone can own or contribute to 529 plans for education purposes—parents, grandparents, aunts and uncles, or even friends. You can even change the beneficiary without penalty.[5]

6. CONTRIBUTING TO A 529 PLAN CAN REMOVE TAXABLE ASSETS FROM YOUR ESTATE FOR FEDERAL ESTATE TAX PURPOSES, WHICH MAY REDUCE YOUR ESTATE TAX LIABILITY.

Your contribution is treated as a completed gift to the named beneficiary for gift-tax and generation-skipping transfer-tax purposes and qualifies for the $18,000 annual gift-tax exclusion and $36,000 for married couples in 2024 (increasing to $19,000 and $38,000 respectively in 2025), allowing you to make fairly large contributions without incurring the federal gift tax.

What's more, if you contribute as much as $90,000 for a beneficiary -you can elect to treat the contribution as if it were made over a five-calendar-year period for gift-tax purposes (up to $180,000 for married couples).[6] And the best part? Even though the asset leaves your estate, it doesn't leave your control if you are the owner of the 529 plan.[6]

7. THEY'RE NOT JUST FOR IN-STATE COLLEGES AND UNIVERSITIES.

You can start taking tax-free withdrawals for education expenses beginning with kindergarten and going past graduate school. For college, whether the goal is to spend a semester abroad or pursue a degree stateside, you can use a 529 plan at any in-state, out-of-state, or international institution, if it's used with an accredited program. Now, federal income tax-free withdrawals from 529 plans of up to $10,000 per year per student can be used to pay expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. Additionally, qualified education expenses for federal income tax purposes include (a) up to $10,000 used to repay qualified student loans and (b) certain costs for qualifying apprenticeship programs.[3] The state income tax treatment vary by state. Account owners should consult with a qualified tax advisor prior to making such withdrawals, as they may be subject to adverse tax consequences.

8. YOU MAY BE ELIGIBLE FOR ADDITIONAL TAX BENEFITS OFFERED BY YOUR STATE.

Many states offer income tax deductions or credits to residents for contributions to 529 plans, including many only for contributions to their own state's plan. Your Financial Advisor can help you select a plan from the available options. State laws vary, so consult with your tax advisor.[7]

9. PLANS ARE PROFESSIONALLY MANAGED AND OFFER A RANGE OF INVESTMENT OPTIONS.

With 529 plans, you have access to professional money managers with years of experience managing assets. While most offer age-based portfolios that become more conservative as the beneficiary nears their college attendance date, there are many other investment options available, giving you much choice.

10. ONLY A SMALL PERCENTAGE OF 529 ASSETS ARE INCLUDED IN FINANCIAL AID CALCULATIONS.

A 529 account owned by a parent for a dependent student is reported on the federal financial aid application (FAFSA) as a parental asset and is assessed at a (maximum) 5.64% rate in determining the student's Student Aid Index (SAI).[8] 529 accounts owned by grandparents and others has no assessment under new FAFSA guidance.

A Range of Investment Strategies to Help You Achieve Your Goals

Your 529 account helps you put a loved one on the path to success, while providing you with multiple benefits. Morgan Stanley offers a robust platform of 529 Plan options, including the Morgan Stanley National Advisory 529 Plan – a first-of-its-kind advisory 529 plan that enables you to benefit from fiduciary oversight of your education funding strategy within the context of your broader portfolio and life goals.

Your Morgan Stanley Financial Advisor or Private Wealth Advisor can answer your questions about 529 plans and provide guidance on developing an approach to help you achieve your education savings goals.

[1] Source: Bureau of Labor Statistics, Morgan Stanley Wealth Management Global Investment Committee as of March 2023.

[2] Represents the annual cost of a private four-year institution for tuition, fees, room and board, books and supplies, transportation and other expenses. Source: College Board, Annual Survey of Colleges, Fall 2023.

[3] Assets in a 529 plan potentially grow on a tax deferred basis and can generally be withdrawn federal income tax-free only if they are used to pay for qualified education expenses. Qualified expenses include tuition, fees, room and board, books and supplies at virtually any accredited post-secondary school. Effective for distributions made on or after January 1, 2018, the definition of qualified education expenses for federal income tax purposes expanded to include tuition for K-12 schools, as a result of the 2017 Tax Cuts and Jobs Act. The tax law limits qualified 529 withdrawals for eligible K-12 tuition to $10,000 per beneficiary per year. Effective for distributions made on or after January 1, 2019, the definition of qualified higher education expenses for federal income tax purposes was expanded to include certain costs associated with qualifying apprenticeship programs and up to $10,000 (lifetime limit per individual) in amounts paid towards qualified student loans of the 529 plan designated beneficiary (or such beneficiary's sibling). Note, however, using 529 plan distributions to repay qualified student loans may impact the deductibility of student loan interest. The state tax treatment of 529 plans (including the state tax treatment of distributions) may be different from the federal tax treatment and may vary based on the 529 plan in which you participate and your state of residence. If the applicable state tax law does not conform with the federal tax law, 529 plan distributions used to pay certain expenses, such as K-12 tuition expenses, principal and interest on qualified student loans and/or qualifying apprenticeship costs, may not be considered qualified expenses for state tax purposes and may result in adverse state tax consequences to the account owner or designated beneficiary. Non-qualified distributions of earnings will be subject to ordinary income tax and may be subject to a 10% federal income tax penalty. Many states allow a partial or full state income tax deduction or credit for 529 plan contributions to a 529 plan but may limit the availability of such credit or deduction to only those contributions made to that state's sponsored 529 plan.

[4] Contribution limits vary by state. Refer to the individual plan for specific contribution guidelines.

[5] Some plans may have age, residency or other restrictions and may charge a fee for beneficiary changes, and beneficiary changes may result in an immediate tax liability if the new beneficiary is not a member of the previous beneficiary's family.

[6] As of 2024, the annual gift tax exclusion is $18,000 for individuals, and double for married couples at $36,000 annually. An election to do so must be made on a gift tax return for the year of the gift. This assumes there are no frontloaded 529 contributions made by the gift giver for the benefit of the same individual during the prior four years. Any frontloaded 529 contributions made for the benefit of the same individual during the four years prior to the year of the frontloaded contribution may result in a taxable gift. Additionally, any gifts to the same individual during the year of the frontload 529 contribution or the four years after the frontloaded 529 contribution is made may result in a taxable gift. If the donor dies within five years of making the frontloaded 529 contribution, the estate will generally recapture a portion of the assets for federal estate tax purposes

[7] Some states offer favorable tax treatment and other benefits to their residents only if they invest in the state's own Qualified Tuition Program. Investors should consult with their financial and tax advisor before investing in any 529 plan or contact their state tax division for more information.

[8] The College Investor, How Does A 529 Plan Affect Your FAFSA And Financial Aid?, September 2024

IMPORTANT DISCLOSURES

The 529 Plan Description contains more information on investment options, risk factors, fees and expenses, and potential tax consequences, which should be carefully considered before investing. Investors can obtain a 529 Plan Description from their Financial Advisor and should read it carefully before investing.

Investments in the 529 Plan are not FDIC-insured, nor are they deposits or guaranteed by a bank or any other entity, so an individual may lose money through such investments. Investors should review a Program Disclosure Statement, which contains more information on investment options, risks factors, fees and expenses and possible tax consequences. Investors should read the Program Disclosure Statement carefully before investing.

Investors should consider many factors before deciding which 529 plan is appropriate. Some of these factors include: the plan's investment options and the historical investment performance of these options, the plan's flexibility and features, the reputation and expertise of the plan's investment manager, plan contribution limits and the federal and state tax benefits associated with an investment in the plan. Some states, for example, offer favorable tax treatment and other benefits to their residents only if they invest in the state's own qualified tuition program. Investors should determine their home state's tax treatment of 529 plans when considering whether to choose an in-state or out-of-state plan. Investors should consult with their tax or legal advisor before investing in any 529 plan or contact their state tax division for more information.

The North Carolina State Education Assistance Authority (the "Authority") is an instrumentality of the State of North Carolina sponsoring the Morgan Stanley National Advisory 529 Plan, and the 529 Plan is a component of the Parental Savings Trust Fund established by the General Assembly of North Carolina. Neither the Authority, the State of North Carolina nor any other affiliated public entity or any other public entity is guaranteeing the principal or earnings in any account. Contributions or accounts may lose value and nothing stated herein, the 529 Plan Description and Participation Agreement or any other account documentation shall be construed to create any obligation of the Authority, the North Carolina State Treasurer, the State of North Carolina, or any agency or instrumentality of the State of North Carolina to guarantee for the benefit of any parent, other interested party, or designated beneficiary the rate of return or other return for any contribution to the Parental Savings Trust Fund and the 529 Plan.

Morgan Stanley Smith Barney LLC ("Morgan Stanley") is the manager of the Morgan Stanley National Advisory 529 Plan and is responsible for its administration, distribution and investment management. For more information, please see the Morgan Stanley National Advisory 529 Plan Description and the applicable Morgan Stanley ADV brochure at www.ms.com/adv.

Morgan Stanley does not provide tax and/or legal advice to investors. Investors should consult their personal tax advisor for tax-related matters and their attorney for legal matters.