529 Plans: A Powerful Tool to Save for Education

Courtesy of Craig Cunningham, Managing Director, Wealth Management, Senior Portfolio Management Director, Financial Advisor – The Chicagoland Group at Morgan Stanley

Of all the things that keep parents awake at night, their children's looming college costs are among the most daunting. For the 2022-2023 school year, the costs for a four-year private college averaged $57,570 per year for tuition, fees, room and board, books and supplies, transportation and other expenses.[1] Assuming a college-cost inflation rate of 6%, a parent may need $425,500 in 2031 to pay college expenses for today's 9-year-old.[2] And that's for just one child.

With costs so high, many students and parents are taking on significant student loan debt to pay for college. Over half of college seniors who graduated in 2020 did so with loans, with an average debt burden of $28,400.[3]

Starting the process early to save toward the college costs of a child or grandchild can help limit how much your future student will have to borrow. Consider putting those funds into a 529 education plan, a tax-advantaged way to invest toward education expenses.

What is a 529 Plan and Why Consider One?

Named after Section 529 of the Internal Revenue Code, a 529 plan is a tax-advantaged vehicle, which allows you to invest for future education expenses. A 529 plan creates an incentive for families to invest toward education costs because earnings in the plan can be tax-deferred, with withdrawals being exempt from federal and, in most cases, state income taxes if you use the funds for qualified expenses, such as tuition, fees, room and board, and supplies. Many states provide additional state tax deductions or tax credits. Additionally, assets in a 529 plan are outside of the account owner's estate for estate-tax purposes.

A 529 plan can also offer flexibility. Some investments that are used for education funding require that the assets be given to the beneficiary when they reach a certain age. If you open a 529 plan, as the owner of the account, you continue to make all of the decisions. For example, if your daughter earns a scholarship and won't fully drawdown the money in the account, you can choose a different beneficiary within the same family, or even use the funds for your own education needs.

The definition of qualified education expenses now includes tuition for K-12 schools because of the Tax Cuts and Jobs Act of 2017. Note that qualified withdrawals for eligible K-12 tuition are limited to $10,000 per beneficiary per year. Tax treatment will vary by state. [4]

Igniting a Movement to Save for Education

Still, many are unaware of 529 plans and their benefits. More than two-thirds of people surveyed nationally in 2019 said they haven't heard of 529 plans.[5] "Many people want to save for college, but don't know where to start," says Jennifer Tierney, Executive Director, Morgan Stanley Wealth Management Investment Solutions and 529 Plans Product Manager.

Though states began creating college savings plans in the 1980s, they didn't gain federal tax relief under Section 529 of the Internal Revenue Code until 1996. As a result, those looking to help extended family members may be unaware of 529 plans.

"Many of our clients are grandparents looking to help their children handle future education expenses," Tierney says. "We encourage them to take a look at 529 plans, which may not have been on their radar the last time they were saving for college."

529 Contribution Limits

In 2023, annual contributions of up to $17,000, or $34,000 for couples filing jointly, are treated as gifts and qualify for the annual per-beneficiary gift tax exclusion. Additionally, 529 plans employ a special rule: an upfront contribution in one year of up to $85,000, or $170,000 for married couples—the equivalent of five years' contributions—may be made without any gift tax consequences.

Investing Early for Future College Costs

When it comes to investing in a 529 plan, typically the earlier you can start putting money away, the better.

Still, it's never too late to start saving for college. Money set aside when a child is 16 will still have several years to grow, assuming you use those funds to pay for the later years of undergraduate expenses, or even graduate school.

A 529 plan is a convenient, flexible and tax-advantaged way to invest for a child's education expenses. Morgan Stanley offers a robust platform of investment 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. If you have questions or need more information about 529 plans available through Morgan Stanley, contact your Financial Advisor or Private Wealth Advisor today.

[1] "Trends in College Pricing and Student Aid 2022", The College Board.

[2] Projected college costs in 2031 include 6% annual tuition inflation rate: https://bigfuture.collegeboard.org/pay-for-college/college-costs/college-costs-calculator

[3] "A Look at the Shocking Student Loan Debt Statistics for 2022", Student Loan Hero, April 2022. Retried from: https://studentloanhero.com/student-loan-debt-statistics/

[4] The filing of IRS form 709 is required to validate the five-year election.

[5] Source: College Savings Plans Network, Feb. 2019: 68% of people surveyed nationally have not heard of 529 College Savings Plans

Disclosures
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Assets can accumulate and be withdrawn federally tax-free only if they are used to pay for qualified education expenses including tuition, fees, room and board, books and supplies. Earnings on non-qualified distributions will be subject to income tax and a 10% federal income tax penalty tax. State taxes may apply.

For more information, please see the applicable Morgan Stanley ADV brochure: www.ms.com/adv.

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. Morgan Stanley Smith Barney LLC does not provide tax and/or legal advice. Investors should review a Program Disclosure Statement, which contains more information on investment options, risk factors, fees and expenses and possible tax consequences.

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 Morgan Stanley National Advisory 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 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.

If an account owner or the beneficiary resides in or pays income taxes to a state that offers its own 529 college savings or pre-paid tuition plan (an "In-State Plan"), that state may offer state or local tax benefits. These tax benefits may include deductible contributions, deferral of taxes on earnings and/or tax-free withdrawals. In addition, some states waive or discount fees or offer other benefits for state residents or taxpayers who participate in the In-State Plan. An account owner may be denied any or all state or local tax benefits or expense reductions by investing in another state's plan (an "Out-of-State Plan"). In addition, an account owner's state or locality may seek to recover the value of tax benefits (by assessing income or penalty taxes) should an account owner rollover or transfer assets from an In-State Plan to an Out-of-State Plan. While state and local tax consequences and plan expenses are not the only factors to consider when investing in a 529 Plan, they are important to an account owner's investment return and should be taken into account when selecting a 529 plan.

Tax laws are complex and are subject to change. This information is based upon current tax rules in effect at the time this was written. Morgan Stanley Smith Barney LLC and its Financial Advisors do not provide tax or legal advice. Individuals should always check with their tax or legal advisor before engaging in any transaction involving 529 Plans, Education Savings Accounts and other tax-advantaged investments.

Investments in a 529 Plan are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so an individual may lose money.

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

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Investments are subject to market risk and may fluctuate in value. Before investing, investors should consider whether tax or other benefits are only available for investments in the investor's home-state 529 college savings plan. Earnings on non-qualified distributions will be subject to income tax and a 10% federal income tax penalty State taxes may be applicable. Before investing, consider whether tax or other benefits or investments are only available in your home state 529 college savings plan.

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