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COLLEGE-SAVINGS PLANS HOTTER AFTER TAX OVERHAUL

By Laura Saunders
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So-called 529 education-savings accounts, and Americans who can benefit from using them, are big winners in the recent tax overhaul.

New curbs on state and local tax deductions will make these tax-sheltered accounts more attractive. Many people will also benefit from a change that now allows assets in these plans to be used to pay elementary and high school tuition.

In addition, 529 account assets can now be transferred to so-called 529 ABLE accounts. These accounts offer tax-favored savings for people with disabilities without affecting eligibility for benefits such as Medicaid.

"The recent tax changes expanded the benefits for 529 plans, which are already highly popular with middle - and upper-income families," said Mark Kantrowitz, a college-savings analyst in Chicago who tracks 529-account features.

529 accounts, which are named after a section of the tax code enacted two decades ago, allow savers to contribute dollars after federal taxes have been paid on them. The assets are then invested and can grow free of federal and state taxes. Withdrawals are tax-free if they are used to pay eligible education expenses such as college tuition, books, and often room and board.

According to the latest data from the College Savings Plans Network, assets in 529 plans grew to $275 billion in 2016 from $106 billion a decade earlier.

Most 529 plans are offered by states, and almost all states have them. Typically they are open to all savers, not just their own residents. So savers dissatisfied with their own state's offerings or fees can go elsewhere – although investment options are limited in most states.

About three dozen states allow an income-tax deduction or credit for savers who contribute to them, and the amount varies widely. Seven allow deductions for 529 contributions to any state plan; others only allow a tax break for contributions to in-state plans.

So far, no states have changed their 529 features since the tax overhaul. According to Mr. Kantrowitz, Colorado and New Mexico allow a full deduction for contributions to 529 accounts, while New York and Connecticut limit them to $5,000 per single taxpayer and $10,000 per couple. California, New Jersey, North Carolina, Tennessee, and Kentucky don't offer any deduction.

Many taxpayers will find 529 contributions even more attractive following the tax overhaul, said David Taylor, a certified public accountant with Anton Collins Mitchell LLP in Denver. The overhaul limits deductions for state income or sales and property taxes to $10,000 per return. So a write-off for a 529 contribution can help lower state income taxes that may no longer be deductible on a federal return.

Another landmark change of the overhaul allows 529 plan assets to be used for up to $10,000 a year, per student, for private-school tuition for K-12.

This change is a mixed blessing. It provides savers who have 529 plans with more flexibility, but private schools will want to know about families' 529 savings and may take that information into account when making financial-aid decisions.

The change "will likely affect some financial aid calculations" for the year 2019-20, according to a spokeswoman for the National Association of Independent Schools, which has 1,600 member schools in the U.S.

Taking 529 withdrawals for private-school fees also shrinks the time that assets can compound tax-free – a principal benefit.

The overhaul also enabled savers to transfer funds from 529 plans to 529 ABLE accounts. 529 ABLE accounts benefit those who become blind or disabled before age 26 without limiting their access to Medicaid and Supplemental Security Income, or SSI, benefits.

Like 529 plans, 529 ABLE plans allow assets to compound tax-free. Annual contributions are currently capped at $15,000, and withdrawals can be tax-free if used to pay expenses such as housing, legal fees, and employment training. The total assets in an account can reach $100,000 without affecting SSI benefits.

The recent change allows transfers of up to $15,000 a year from a regular 529 plan to a 529 ABLE account. Such rollovers will help expand ABLE accounts because they help deal with a drawback: after the beneficiary's death, remaining funds in an ABLE account typically go to the state to repay benefits if the person was receiving Medicaid – as many are.

The assets of regular 529 plans, however, needn't go to the state at death. Under the new rules, said Mr. Kantrowitz, someone could fund a 529 account for a disabled person and transfer money as needed to a 529 ABLE account. This arrangement offers tax-free growth and perhaps a state-tax deduction, without giving up ownership of assets.