Saving for education: 529 plans

A 529 plan is a tax advantaged savings plan designed to encourage savings for future education costs. It is named for the section of the Internal Revenue Service code where its unique features and favorable tax treatment are described.

How does it work?

A parent, grandparent, or other interested party contributes to a 529 plan on behalf of the future student who is named as beneficiary of the plan. The contributions grow on a tax-deferred basis, which increases the likelihood that contributions will accumulate faster than they would if placed in other taxable investments.

Distributions, that is, funds taken out of the plan to pay qualified educational expenses, are exempt from federal income taxes. Depending on the account owner's state of residence and the actual plan established, distributions may also be exempt from state income tax. However, the owner may be subject to a 10 percent penalty and will be taxed according to his/her income tax bracket on distributions taken from the plan that are not used for qualified educational expenses.

For a detailed explanation, refer to the plan offering statement.

Two types of plans

Prepayment plan

A few states offer the option of pre-paying the beneficiary's tuition at a qualifying educational institution's current tuition rates.

Pre-paid plans are a way to hedge against the rising cost of tuition; however, not all plans guarantee that the complete cost of future tuition will be covered.

Savings plan

Your other option is to establish an investment plan that can be used to pay the beneficiary's qualified education expenses. This plan allows you to contribute money into a market-based account, where you retain control of the assets accumulated on behalf of the future student.

Section 529 savings plans are established independently by individual states. The state contracts professional management, generally an investment or financial services firm, to administer the plan.

Currently, financial representatives can provide clients with access to 529 savings plans administered by more than 25 different states. Participants need not be residents of the state offering the plan, although there may be tax advantages when a plan is purchased in a resident state.

The information in this brochure is not intended as legal or tax advice.
Consult your attorney or tax advisor for advice that is specific to your situation.

(REV 0823)

92-0136

IS A 529 PLAN THE RIGHT PLAN FOR YOU?

529 plan features and benefits

Federal income tax benefits

Earnings in 529 plans grow federal income tax-free. Distributions taken from a 529 plan are exempt from federal income taxes provided they are qualified withdrawals. Qualified withdrawals include:

- withdrawals used to pay the beneficiary's qualified higher education expenses or;
- up to $10,000 per year for tuition for eligible elementary or secondary schools (K-12)[1] or;
- up to $10,000 may be used to pay principal and interest of a student loan for the beneficiary.[1]

State tax benefits

In addition to state tax-free qualified distributions, some states offer tax-deductible contributions to 529 plans. Your financial representative can provide more information on the state tax benefits offered by your plan.

Investment option flexibility

Section 529 plan account holders are allowed to roll the assets of their account into a different 529 plan once every 12 months. This option offers the flexibility to move your account to a different state's plan, if you feel such a move would be advantageous. Account holders are also able to reallocate the assets in their 529 plan among investment options twice every calendar year or upon a change in beneficiary.

Account control

You retain control of the account assets even when the beneficiary reaches the age of majority. This provides you the ability to change the beneficiary and allows you to determine when distributions are taken from the account.

Financial aid

According to the Federal Financial Aid Student Handbook, 529 plans are considered to be the account owner's asset for federal financial aid purposes. For information relating specifically to your school of choice, check with the college or university's financial aid office.

Estate planning and gifting

Contribution limits for 529 plans vary by state and by plan and may be greater than other types of college savings options. This offers a unique gifting opportunity for relatives, especially grandparents, who may be thinking of estate planning strategies. A special provision of 529 plans makes it possible for individuals to gift up to $85,000, and married couples up to $170,000, at one time to the account and pro-rate the gift for gift-tax purposes over five years.

Flexibility for overfunding

Starting in 2024, the SECURE 2.0 Act provides flexibility for unused funds in some 529 plans. Beneficiaries may transfer unused funds directly to a Roth IRA subject to limits.

Talk with your Northwestern Mutual financial professional today to learn more about the investment opportunity presented by the 529 college savings plan.

[1] Subject to your state's approval of what is allowed as a qualified expense.