Andrew 0:05
Hello, and welcome to the JGUA Financial Commentary Podcast. I'm your host, Andrew Baron. But let me begin with a short disclaimer. The contents of this podcast are strictly for informational purposes only, and nothing is said to be taken as investment, tax or legal advice. Any strategies discussed may not be suitable for the listener specifically, and JGUA encourages consulting with your advisor before implementing any strategies to ensure they meet your individual objectives. In this episode, I am joined by associate adviser Shirley Nelson to discuss college planning and 529 plans. Welcome to the podcast Shirley, can you share with us some of your background?

Shirley 0:46
Hi, everyone, I'm Shirley Nelson. I'm a licensed patent attorney. I'm a financial planner working with Andrew at JGUA. I'm also a mother to a three year old daughter, thanks for having me here.

Andrew 1:00
Those are some pretty big highlights. So getting into it. I did want to talk about the future of college and graduate school. And even though there has been some changes in attendance and tuition during the COVID era. We do know in the future that some professions will always require a formal academic education, things like: doctors, lawyers, professors, architects, engineers. And Shirley you are quite educated yourself. You are a lawyer, you recently passed the CFP exam, and you are in level two CFA candidate. Can you talk to our listeners about going to college for your daughter, the future and why that's important to you?

Shirley 1:41
My daughter is three and you feel looking into average kids, when they go to college, they're about 17 or 18 years old. So we really have about 14 years left to save for that special moment. College is expensive. And you want it to start planning early. So in my family, my husband, actually, he's the most educated of us all, has a PhD in optic science. And I myself benefited from a Juris Doctor degree. It's a three year law program. So then subsequently, I can take and pass the bar, all these requires education. And so we do have this high expectation for our daughter.
It’s fair to say that in this day and age, if you want to get a higher paying job at some of the tech company like a Google, Facebook, oftentimes they require specific knowledge, in a very tech way. My daughter loves to take care of people. So my mom is a doctor, and through hanging out with my mom, I think my daughter has gained this desire to be a doctor one day. She would be asking us, “Oh, are you okay? Have you bumped your knee? Do you hurt?” and she's really sweet. And then she will be taking temperature of her toys and, and things like that. So I think there's a chance that she may want to be a doctor one day, and then she does have intellectual capacity to be the doctor in this profession.
And so that comes to the question of like how much is gonna cost us as parents, if we wanted to support her in this pursuit? First there’s a four year college, and then there's the medical degree to MD program. And so we're looking at like seven, eight years of education, post-secondary, and you need money to pay for. Except for the rare few that are lucky enough to have a generous scholarship that pays for all, and parents oftentimes have to help out. Otherwise the kids will be drowning in student loans. And you also don't want to see that happen.
I have in front of me a report from the US Census Bureau. As of 2018, we see 13.1% of US adults have an advanced degree like a doctor degree, a law degree or you know, other kind of Master’s, right, your MBAs, all of this is included in advanced degree, you see 13.1% of US adults that has it, and that's like a 5% increase compared to the year 2000. So in 18 years, we already see a 5% increase in these advanced degree so more and more people are going to pursue a higher degree. And that will make the competition more fierce ahead of the next generation. In my household, we support this pursuit by opening a 529 accounts through New York direct so with plenty and we've been doing monthly contribution into this plan. So it's a very automated process that I linked my bank account to this plan. And this plan is going to monthly take money out of my bank account to do the dollar cost averaging on some of the fund investment, you know pretty much hands free.

Andrew 4:54

So when we think of prestigious universities, Columbia University of the Ivy League obviously comes to mind, for the 2020-2021 academic year, the most expensive university in the country at tuition is over $64,000.
Shirley 5:12
Oh, my gosh!

Andrew 5:13
The data I could get, I could go back to 2010-2011 calendar. So 10 years ago, it was only $45,000.

Shirley 5:25
(Laughs), there goes the "only"!

Andrew 5:26
You see those big sticker prices for Columbia, but I did want to at least talk about has a major endowment, which is well over $11 billion dollars. Which allows them to provide over half their students with a financial aid package. And while there is a portion of the financial aid package that will come from student loans, 84% of that is grant and scholarship based from the university itself, which obviously helps quite a bit. So you see those high numbers, but not everyone's gonna pay the full sticker price, obviously. You mentioned 529 plans Shirley, can you talk to us a little about the different types of those?

Shirley 6:04
Basically, every state will have some form of a 529 plan. I'm a resident of New York. New York State direct paid 529 plan for my daughter, I've had this account for three years. And then I just do what I can, you know, I contribute every month, and I'll deposit into this account. The most common type 529 plan is college savings plan. So this is the basic kind of 529, where it doesn't limit where your kids will go. And then it's affected by the investment options to the performance of this plan. So it works just like a Roth IRA account. So you invest your money after tax, and then the money grows, tax deferred. So over the years, while it's growing in there, you don't need to pay any tax on the growth until the time you take it out. And so when you take it out, if it's a qualified distribution, you don't have to pay tax or penalty on this withdrawal. However, if it's non-qualified, it's possible they will be subject to penalty to income tax for both the federal and the state and potentially even recapture of the former tax benefit you received when you do the contribution. So that's the first type of 529.
And there's another type of that's called a prepaid tuition plans. So within the prepaid tuition plans, you have two types. One is actually sponsored by your state. And then it covers the cost of in-state public college education. So you're basically pre-paying for a future expense per today's dollar value. So when you do so, it will be guaranteed that by the time your kids go to school, and then the tuition fee of that in-state public college will be paid for. So there will be a takeaway the risk of underlying performance or the market downturn just a year right before your kids go to college. So that take the risk away.
But that also kind of limit where your kids will go for college, what if he decides to go to some private college for profit out of state, and that's, you know, that's a consideration when you were choosing these prepaid tuition plans. The other one is a private college 529. These are separate prepaid plan for each private college, so sponsored by those colleges. And so if your kids that they have their dream university already picked at a young age, then you can look into that specific college 529 plan and plan accordingly.
For most of the college saving plans becoming managed in two ways. So one is direct sold, and the other one is advisor sold. So as the name suggests, if you go with advisor sold, so you are buying these plans through an advisor, so there is a fee charged on top of the underlying management. So usually the advisor sold plan will be more expensive than the direct sold plan. But sometimes, you know, like that the performance can be different. So that's another thing to take into account, even though an advisor sold fund can be more expensive, but if it does provide a better performance than it or if that's the only plan your state offer. And you may not have an option but to choose these advisor sold plans.

Andrew 9:31
I did want to talk about how do you evaluate the best 529 plan for you? Lots of times people only look at their state, but you were mentioning fees and performance. Could you talk to us a little about how does someone make those kinds of evaluations?

Shirley 9:45
Sure. So many states offer these tax benefit when you do your contribution into the plan. For example, I live in the state of New York. My plan is in-state plan, so I bought it through a New York direct sold 529. And so for every dollar, I contribute into this plan up to a $10,000 limit for a tax year, for this year, I will have a tax deduction for these amounts I contributed. However, this tax benefit will be recaptured, if 18 years down the road, I decided to withdraw the money to pay off my mortgage instead of pay for my kids' education for whatever reason. And then when it's not a qualified expense, I'm potentially subject to a tax benefit recapture. So for some of those audience out there in other states, you know, they may now have a state tax benefit. If that's the case, then that they're actually free to choose from a plan that's offered by any other state, they're not really limited, because there's really no incentive for them to choose your in-plan.
If there is no tax benefit associated with the contribution, if that's the case, they should look into the underlying management, the available funds that's within these plans that they are going to choose from, what's their return? And then what's your management fee? If there are additional fees based on how much they have to contribute? If there is a limit, sometimes they have a cut off that you have to contribute a certain amount per year out of life, you'll be subject to this fee or that fee, you know, those are all features to look into.
And then also, some states conformed to the federal definition of qualified distribution. So what the federal considered as a qualified will be college expense. And then $10,000 per year, education for elementary and secondary. But many states such as New York, does not conform to the federal definition. So for New York, they only recognize the college expense as qualified. So if I were to use this money, five years down the road for my kids private, elementary school tuition, it will not be considered as a qualified expense, I will have to pay for tax on earnings question. And I'll also need to be subject to recapture of all those tax benefit I received to this day on those contributions for those amounts.

Andrew 12:20
So 529 plans are tax savings accounts, specifically for higher education. Although there are those private school carve outs depending on each state's plan. I also want to mention on the prepaid tuition for in-state universities, if you were or maybe your child decided to attend an out of state university, because there's a risk people need to consider that oftentimes, they may only get their principal refunded, and they may even owe a penalty. So that is something to consider before just deciding that's the surefire method.

Shirley 12:52
Right, right.

Andrew 12:54
The other thing I also want to talk about in 529 plans is similar to what you see in retirement plans are target date funds, but instead of trying to match retirement, these funds are trying to match college.

Shirley 13:10
Yeah, you see, there's a lot of investment options in many of these 529 plans that the common ones you see is target date. So you choose based on the age of your kids, they assume that your kid will go to college when he or she turns 18. And so that will be the target date. Then they are going to automatically adjust how much percentage goes to bond, and how much goes to equity. So as the kids approach at 18 years old, and then you will see a higher percentage goes to a bond fund within these 529 target date plans. Whereas the other type, you probably have to manually adjust, you're just choosing some equity as an investment option within your direct 29 plan. And then you have to manually adjust per the risk preference and per the age of the kid, how much risk you'd like to take. And do you have concerns about this,

always feel free to reach out to us. Because that's our job, Andrew and I have help people with their investment, and then 529 is one thing that we will help our clients to look into.

Andrew 14:12
For listeners, there is some difference between grandparents and parent owned 529 plans. What are the benefits of each owning that? How can that be a strategy for some of our listeners?

Shirley 14:24
The advantage of the grandparents open or be the owner of a 529 plan. We're naming the grandkid as the beneficiary. When a kid goes to college and fill out the federal financial aid form, what we also call as FAFSA. So those assets will not be counted on that FAFSA form. And unless it is withdrawn, if it was withdrawn too early. And given how to FAFSA look back two years, that could hurt the kids' eligibility to qualify for the financial aid. The advantage would be having a grandparents open a 529 account and hold off on withdrawing any money from it until the kid is in their third or fourth year of college and when they want to do the two year look back. When they look at their first and second year of school, they didn't have these income, the income comes later. So another thing about qualified distribution for federal is up to $10,000 per beneficiary can be used for student loan payback. So there's also that choice available if you manage to take a student loan of less than $10,000. And you pay it off with just 529 amount after the student graduates, or if they're doing the last two years of college that will not hurt their FAFSA application, also. The other day, you were telling me this example of this special cutoff date for sophomore year?

Andrew 16:03
Yes, so due to the two year look back window effect, starting the January 1 of the sophomore year, you could use the grandparents' distributions if a grandparent owned 529 plan, the distributions from that 529 plan wouldn't count negatively against the student. If it was the years previous, it would--it would be counted as unearned income.
So it is careful to plan for that kind of funding the first years of college versus the second years. If you have the ability, if you if it's a shared family goal to get a child through college, you can flip the responsibility and remain eligible for as much financial aid as possible. I also wanted to mention that if you had, let's say too much in a 529 plan after the student graduates, from a four year university, maybe they decide they don't need graduate school, you can rename the beneficiary as long as it stays within the family. So that is a consideration I did want to make.

Shirley 17:04
Right. And for some states may not allow you to change the name, that you can open a separate account for a different beneficiary within the family and just roll it. Many states allow you to roll it for however many times within the in-state plans. If you have two kids and the first kid is really lucky and got a scholarship. And then now you want to roll that amount to the second kid's 529. And then some states will allow you to do that at no additional charge.

Andrew 17:33
You want to be careful if you're changing from state to state though, because some states are going to pull back that tax deduction they provided they might claw that back.

Shirley 17:46
I mean, that's a great point. So when we see some of our clients moved to a separate state, let's say they're originally live in North Carolina, now they moved to New York, and then instead of roll that amount out of their original 529 into a new 529, you might as well just open another one in the next state that you move to. You can have however many 529 accounts open the same owner, the same beneficiary, it doesn't matter. Like you can open multiple accounts with different owners or same beneficiary or same owner different beneficiaries. It doesn't matter. It's not like exclusive. You can have multiple 529 accounts just keep track of them. So you know what you're investing.

Andrew 18:30
A similar related topic is the 529 ABLE account that I also wanted to discuss, since its name is so similar to the 529 plans, but it does work a little bit differently and kind of has a different intention.
What are the difference between the 529 and the 529 ABLEs?

Shirley 18:47
For the ABLE account, it's very specific about who can open it. A 529, anyone can open it, whereas 529 ABLE, it is created to allow individuals with disabilities and their families, a tax advantage way to save money for disability related expense as well as college expense. So even though its 529A, but it's more related to this disability, then specific created for education. It's more like owner specific than an account specific, if that makes sense.

Andrew 19:27
So the 529 plan has a goal to fund education, while the 529 ABLE is really more of an asset shield. So the beneficiary, if they're disabled, can shield up to $100,000 and still receive those Social Security disability benefits. The other key thing to remember for 529 ABLEs is the beneficiary does need to be diagnosed before age 26. So it needs to come early in life, similar to thought process to the 529, where it's a preparation for the beneficiary in their future, whether or not they're disabled, or whether or not they can go on to higher education.
There are two main education tax credits, there's the American Opportunity Tax Credit and the Lifetime Learning Credit. The main differences are the American Opportunity Credit is really for the first four years a student attends post-secondary education. So it's a federal tax credit, and the maximum amounts worth is $2,500 total. But it's pretty generous because it's the first $2,000, 100%. And then on the next $2,000, it's 25%.

Shirley 20:42
Okay, and this for the Lifetime Learner Credit, there is an income cut off. So for single filers that's $59,000, as of this year, and then for married filing jointly, you double that amount, you have $118,000. So if you make more than this amount, then you will likely unable to take such a Lifetime Learner Credit.

Andrew 21:04
There are income restrictions on both of these credits. So if you, you are, if you skew in the higher income, this might not be available to you. But it is something that maybe your child would qualify for, something to consider. Maybe your child has their own tax returns instead of being claimed, depending on what makes the most sense,

Shirley 21:21
Right? Yeah, if you have a kids that emancipated or if the kids got married, or they no longer claim as a dependent on your tax return, and they may be able to be eligible for these kind of credits on their own merits.

Andrew 21:36
Well, for you to talk about the tax credits did you want to talk about direct to institution payments?

Shirley 21:42
So if this is not done ahead of time, this is when your kid is already admitted to a school, and then you just gifting the money instead of to the student you give the money to the student's school and paying for the student's tuition. And this way, it doesn't count towards your annual gift exclusion or your lifetime gift exclusion.

Andrew 22:03
It also means that you don't just give a child who's 18, $15,000. You can control where the money goes.

Shirley 22:13
I love that! That’s similar to pay your kid’s tuition directly to school instead of handing them the check or hand them the cash.

Andrew 22:21
Shirley, I know we've went through a lot of information. Did you have any closing thoughts?

Shirley 22:28
Oh no. Thank you for having me here. I mean, it's this has been a great opportunity that I get to speak to your audience on 529 and then saving for college.

Andrew 22:37
Thank you so much for being part of this Shirley!

Shirley 22:39
Thank you for having me, Andrew.

Andrew 22:42
For our listeners. If you have any questions and how they pertain to your specific situation, please don't hesitate to email info@jgua.com or visit our website for additional content. Until next time, stay smart.