WealthRx
wealth and wellness tips to help you live better
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Wm WEALTH MANAGEMENT

529 Plan Withdrawals

After years spent investing and saving for your child's or grandchild's education, the moment it all pays off is when you can finally withdraw some of that money to cover the tuition bill. However, if you're using a 529 Plan to pay for your child's education, it's important to understand the potential tax implications and the best strategies to avoid tax penalties on withdrawals.

One of the biggest benefits of a 529 Plan is that it allows for tax-free growth of money used for education expenses—make sure you get the full use of this benefit by learning how to properly take withdrawals.

Qualified withdrawals

The biggest determinant of the tax treatment of money withdrawn from a 529 Plan is whether the money is used for a "qualified education expense." Qualified education expenses must go toward education at an eligible institution; you can tell if an institution is eligible by looking to see whether it has been assigned a federal school code by the Department of Education. If it has, it is considered eligible. Qualified education expenses include:

- Tuition and fees
- Room and board (only if the student is enrolled at least half time)
- Books and supplies
- Any school-related special needs services

Qualified education expenses **do not** include:

- Sports or club activity fees
- A computer, unless it is required by the institution
- Transportation costs
- Student loan repayment
- Room and board costs in excess of the amount the school includes in its quoted cost of attendance

In addition, total withdrawals for the year can't exceed the account beneficiary's "adjusted qualified education expenses" for that year. Adjusted qualified education expenses equal the total of all qualified education expenses minus any costs covered by Pell Grants, tax-free scholarships, fellowships, tuition discounts, veteran's education assistance, tax-free employer educational assistance programs and the American Opportunity Credit or Lifetime Learning Credit. If withdrawals fail to meet these requirements, they will be subject to income tax and, in some cases, a 10 percent federal tax penalty.

If you make use of the American Opportunity and Lifetime Learning Credits, you must reduce qualified education expenses by the amount of expenses taken into account when determining the credit, not the amount of the credit itself. For example, you must incur $4,000 worth of expenses to get the maximum $2,500 of the American Opportunity Credit, so you would have to reduce qualified education expenses by $4,000 and not $2,500.

Keep in mind that account owners should be able to provide proof that funds were actually used for qualified education expenses, so it's a good idea to save tuition bills, invoices from the school and receipts that cover all eligible qualified education expenses. If your student received any scholarships or tax credits that may reduce his or her adjusted qualified education expenses, you should also keep record of those.

Tax treatment of withdrawals

Designating a recipient

Generally, you can request withdrawals either online, by phone or by submitting a paper request form. Each year in which you take withdrawals, the account

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manager is required to submit Form 1099-Q to the IRS showing how much was withdrawn and who received the withdrawal. The recipient is determined by how you choose to receive the money when you request a withdrawal and will be an important factor in how taxes are assessed.

You have three choices for how to receive withdrawals: a check can be made out to the account owner (you), a check can be made out to the beneficiary (your child), or a check can be sent directly to the higher education institution that your child attends. Before you make this choice, be sure to consider the possible implications of each option.

Whoever receives the withdrawal (you or the beneficiary) will have to report the taxable income on his or her tax return, and that person will be subject to income tax and any tax penalties the distribution incurs (provided it is a non-qualified distribution).

The beneficiary is designated as the recipient if the check is sent directly to him or her or to his or her school. Since the introduction of the "kiddie tax," which causes children's investment income to be taxed at their parents' rate if it exceeds $2,000, most of the advantages of a beneficiary's lower tax bracket have been wiped out. If you foresee having a large amount of non-qualified withdrawals, which will generate high income taxes and penalties, you should likely make yourself the recipient to avoid saddling the beneficiary with high tax bills.

One instance in which naming the beneficiary as the recipient might reduce taxes is if he or she is able to claim the American Opportunity Credit or Lifetime Learning Credit to reduce taxes and you are not. Keep in mind that in order to claim the credits, the beneficiary must have paid some of his or her own educational expenses. If taxes are fairly low and can be covered by one of the credits, designating the beneficiary as the recipient would help to reduce overall taxes.

Keep in mind that some schools will adjust students' financial aid packages if they receive a check directly from a 529 Plan, which can reduce the amount of aid your child is eligible for. You should contact the school's financial aid office before choosing this option to see how they handle distributions from a 529 Plan. Your financial advisor can help you determine the best way to designate a recipient to reduce taxes overall.

How taxes are assessed

All taxes for 529 Plans are assessed only on earnings withdrawn, not on the principal. However, unlike in a Roth IRA, you cannot simply withdraw the entire principal amount from the account; instead, each withdrawal contains a pro-rata portion of earnings and principal.

Although there is no specific guidance from the IRS on timing of withdrawals, best practice is to withdraw money in the same tax year that you need to pay the qualified education expense to avoid tax penalties. For example, if you withdraw money in December to pay a tuition bill in January, you may not have enough qualified education expenses in the year of withdrawal to avoid taxes.

If a withdrawal is classified as "non-qualified" solely due to the American Opportunity or Lifetime Learning Credit or due to a scholarship that the student has received, the 10 percent penalty tax is waived, and only regular income tax will be assessed on the earnings from these withdrawals.

If you take too large of a withdrawal

If you realize that you've taken too large of a withdrawal from a 529 Plan, you can roll the excess amount withdrawn into another 529 Plan so that it is no longer treated as a distribution; however, you must do this within 60 days of withdrawal, and you won't be able to if you have already rolled that beneficiary's 529 Plan account over within the past year.

If you miss the 60-day rollover window, you can use the excess to prepay next year's expenses instead of this year's, provided you are still in the same calendar year as when you took the withdrawal.

Avoiding taxes on excess 529 funds

If you find that you have money left over in your 529 Plan after your child graduates, you will need to come up with a withdrawal strategy to avoid being taxed on the remainder. You can roll it over into a different account if you have younger children or save the money for grandchildren's college expenses or even your own, should you choose to go back to school at some point. Withdrawing non-qualified funds is a last resort, but it may be necessary if it is the only way for you to access the money.

the August market

at a glance

U.S. Large Cap (S&P 500)	U.S. Mid/Small (Russell 2000 Index)	Foreign Large (NYSE International 100)	U.S. Treasuries (Barclays US Aggregate)
2,471.65	1,405.28	5,519.04	2,048.21
0.05%	1.39%	0.83%	0.90%

August 2017 market data

in action

- Venezuela is continuing to battle economic and political turmoil. The country's GDP has shrunk by about 35 percent since 2013. In comparison, in the four years spanning the duration of the Great Depression, the United States' GDP decreased by 28 percent.
- Boxing legend Floyd Mayweather faced off against MMA superstar Conor McGregor on August 26 in Las Vegas in what was declared "The Fight of the Century." Though the exact numbers have not yet been released, pay-per-view purchases are expected to surpass 4.6 million, resulting in an estimated $500 million in revenue. Live gate for the monumental event could be as much as $90 million.
- Walmart recently filed for a patent for a "floating warehouse" that would be used as a way for drones to more easily deliver to homes. This move is said to help Walmart bring down costs for consumers and to remain competitive in the increasingly crowded online shopping space.
- The second-largest Powerball in history, worth over $700 million if the annuity option was exercised, was won in August. The odds of winning were roughly one in 292 million.
- Disney announced that it would be removing its movies from Netflix at the end of 2018. Disney then announced that it is planning on launching its own exclusive streaming platform, tentatively scheduled for 2019.

September

is National Childhood Obesity Month

It is vital for our youth to maintain a healthy lifestyle, which is becoming more challenging today with the increasing use of computers and cell phones. Sedentary lifestyles are causing children to have health problems that were once only seen in adults, such as type 2 diabetes, high blood pressure and heart disease.

Today, one in 3 children in the U.S. are overweight or obese. Making small lifestyle changes can help kids to avoid this trend. For example, keeping fresh fruit in the house as an alternative to unhealthy snacks. Going for a walk after dinner as a family can be a great way to get some exercise and discuss the day's events.

Please see the toolkit and other resources available at **healthfinder.gov** for ideas to help you take action today.

The "PLANADVISER Top 100 Retirement Plan Advisers" list is compiled from responses to the PLANADVISER Retirement Plan Adviser Survey. The list is drawn solely from a set of quantitative variables and information in the survey supplied by the advisers themselves. H&H qualified under the small team category, which is an advisor with 10 or fewer team members, in 2016 and 2017. Go to **planadviser.com/Top100** for more information.

About Hooker & Holcombe Wealth Management

Contact:

Jonathan Gruber, RICP®, AAMS®
Director, Wealth Management
860.856.2128
JGruber@hhconsultants.com

Katerina Nikolaou, CFP®
Financial Advisor
860.856.2067
KNikolaou@hhconsultants.com