

Should You Superfund Your 529 College Savings Plan?

With college costs already astronomical and rising, saving for them isn't just a year-end thing. But if those prices—averaging \$40,917 a year for a private four-year college or \$18,391 for a state school, according to the College Board—have got you down, there are some ways to max out your savings before 2013 ends.

You can stuff a lot of money into a 529 college savings plan now and then do the same thing at the beginning of 2014—a strategy that advisers say they are seeing many wealthy clients adopt this year.

Because of the interplay of gift tax rules and generous contribution limits on these plans, affluent grandparents (or parents, but it's usually grandparents) can set aside as much as \$84,000 per grandchild over the next month or so.

Contributions to 529 plans are made with after-tax money, but earnings that build up in the account are free of federal and state income taxes when funds are withdrawn for qualified education expenses. Some states sweeten the pot by offering tax deductions or credits against those contributions. In Illinois, for example, contributions of up to \$10,000 a year for an individual or \$20,000 for a couple filing jointly are deductible for state income tax purposes.

Federal tax rules allow annual gifts excluded from gift taxes of \$14,000 per grandchild or other recipient per year, and there is a special rule for 529s that allows contributors to front-load five years worth of savings in one year. That means you can set aside \$14,000 now and another \$70,000 in January—for each budding scholar you've got.

Two grandparents with enough money could double that—with each

putting away \$84,000 per grandchild. Depending on where the child goes to school and how much the money earns within the 529 plan, you might be done with one sizable contribution.

“Think of this as superfunding,” says Michael Conrath, executive director and 529 program director at JPMorgan Asset Management, a unit of JPMorgan Chase & Co. “You are getting six years compressed into a small window. That is a strategy that more affluent families will look at” as a way to aggressively cover those college costs and save on taxes.

The Super Strategy

There’s no timetable by which you have to spend down 529 funds and no required withdrawals, and that’s what makes these plans a good place to do some estate planning while you’re saving for college.

The superfunding strategy allows wealthy grandparents to get substantial amounts of money out of their estates, notes Mike Campbell, a tax partner in the private client services practice at tax and accounting firm BDO USA. He says he has clients taking advantage of the five-year front-loading for their kids and their grandkids. “They are thinking about it in terms of estate planning,” he says.

If your child or grandchild ends up not needing all of the money you’ve set aside, you can change the beneficiary on the plan to another child, a cousin or yourself. Even if you needed to withdraw the funds for some other purpose, you would get most of your money and earnings back—owing a 10 percent penalty and taxes on the earnings.

There are some ramifications for financial aid. For federal, need-based aid calculations, the 529 plans owned by college students (who are dependents for tax purposes) or their parents count as assets and reduce need-based aid by a maximum of percent of the asset’s value. But money withdrawn to pay for college does not get factored into aid calculations.

The reverse is true for 529 plans held by grandma, grandpa or anyone else. Those assets won't appear on the federal financial aid application so have no impact on aid at first—but withdrawals do count against aid needs and can ding you pretty hard.

The result, generally, is that it's better to have the plans in the name of the parents or students (assuming they are dependents), than the grandparents. Grandparents can contribute to those plans, however.

Benefits of Compounding

Of course, there are a limited number of people who can afford to set aside such astronomical sums. But even smaller savers can benefit by plowing money into a 529 plan now.

You could, for example, use bonus money or cash received for the holidays to fund a 529 plan before year-end, and then do a second funding in January or from a tax refund next spring.

To really see the value of 529 contributions, consider the way that earnings on those savings compound, and then compare that to the interest you might be paying on college loans if you don't save enough, suggests mutual fund giant (and 529 plan provider) T. Rowe Price Group Inc.

Covering \$40,000 in college costs, for example, would require \$32,000 in 529 plan contributions over that child's first 18 years or \$61,000 in total payments on student loans, according to T. Rowe Price calculations.

Calculating the optimal contribution is less important than making a contribution, says Conrath: "Don't get caught up in the numbers, but do something."