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## Improved state, federal laws offer more tax benefits for 529 plans

The recent passage of the Pension Protection Act of 2006, along with a separate Pennsylvania bill, adds significant help to Keystone State families using Section 529 plans to save for their children's college educations. Here's a summary of the "triple tax break" now working in our favor:

**Break 1 — Tax-Deductible Contributions:** For Pennsylvania residents, effective for 2006, any contribution made to any 529 plan sponsored by any state is now Pennsylvania state income tax deductible! The upper limit on deductible contributions is \$12,000 per investor (\$24,000 if married) per beneficiary. This is tied to the annual federal gift tax exclusion amount. A \$12,000 contribution would result in a tax break of \$386 based on Pennsylvania's 3.07 percent state income tax rate. Pennsylvania investors need to dust off their abaci and tally up contributions already made this year, the law being retroactive to Jan. 1.

**Break 2— Tax-Deferred Growth:** This provision remains unchanged in that 529 plan assets grow without federal or state taxation. Investment options vary greatly, including static or set allocations into investments ranging from high-risk stock funds, bond funds, money market and/or combinations of all. Most 529 plans also offer age-based investments whereby allocations automatically become more conservative as the beneficiary gets closer to college.

**Break 3— Tax-Free Withdrawals:** An enhanced new provision for Section 529 plans is the permanent extension of favorable tax treatment on qualified withdrawals. This provision was previously scheduled to expire on Dec. 31, 2010, but now extends into perpetuity. Qualified educational expenses are payments made to accredited post-secondary institutions for tuition, room and board, books, fees, supplies and equipment.

An additional kicker for Pennsylvania residents owning plans from other states is the elimination of Pennsylvania income taxes on gains from out-of-state plan withdrawals. In other words, you may live in Pittsburgh, own a Rhode Island 529 plan, take withdrawals to pay for eligible expenses, and Pennsylvania will not tax you.

**Estate Planning Play:** Contributions to 529s are considered a gift from the investor (usually a parent or grandparent) to the beneficiary. Present laws permit annual gifts from any individual to another of up to \$12,000 in 2006 (\$24,000 if married) without incurring gift taxes. Motivated and financially secure relatives or friends may further make five-year lump-sum contributions in advance. The maximum is \$60,000 per child per investor (\$120,000 if married). This accelerated gifting strategy will reduce

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the estate size and thus, potential estate taxation. Note that if an investor dies within five years of making an accelerated gift, a prorated portion of the accelerated gift will be included in the estate. Participant Control: A key benefit with 529s is that the investor maintains control over investment and withdrawal decisions. The investor also retains the right to change beneficiaries from one child to another, which could come in handy if the named beneficiary obtains a scholarship, if grades do not match expectations, or if the student decides to forgo sophomore year in order to spend the "college money" on a Harley.

**Financial Aid:** Parents investing in 529 plans also should know that these assets are considered "parental assets." Predecessors to 529s, namely UGMA and UTMA accounts, are considered "child-owned." For the purposes of qualifying for financial aid, parent-owned assets are normally preferable. Moreover, a grandparent controlling an account intended for college is even better from a financial aid perspective, since their accounts are completely off of the financial aid radar screen!

**Summary:** Based on research from the College Board, 2005 college costs for a newborn are now expected to exceed \$138,000 for a four-year public education and more than \$300,000 for a private school! Section 529 plans, especially in light of recent favorable tax enhancements, now contain even more compelling tax benefits. Certainly there are expense factors to consider, which can vary greatly, even among plans offered within the same state. There is also the risk that plan investments may lose value or not perform well enough to cover college costs as anticipated. Before investing, request disclosure documents containing more complete information regarding underlying investment options and performance, a complete fee description and possible risks.

*NFP Securities, Inc. does not provide legal or tax advice. Any decisions whether to implement these ideas should be made by the client in consultation with professional financial, tax and legal counsel.*



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