Your College Piggy Bank – The 529 Savings Account

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If you are sending that first child off to college in the next few weeks, you have probably already started to consider how you will pay that first tuition bill. If you diligently saved for your child's college education and used a 529 Plan Account, it will likely be your first source of funds.

So how do you get the money out? Most plans will have a Withdrawal Request Form which can be found on the plan's website. Complete the form, fax or mail it in, and you can receive your funds via 1) a check to the address of record, 2) an EFT to your checking (however, the EFT instructions cannot be set up at the time of the withdrawal request), or 3) you can have a check sent to the eligible college (I would be careful with this one). Many plans also allow you to call in the withdrawal request.

Sounds easy, and it is, however, let's start waving some red flags….

First: Timing is important when it comes to the withdrawals. I would not, for example, take a distribution in August to cover the school year ending in May of the following year (That's one school year but two tax years.). Let's go through the back-end reporting that is going to happen and how this impacts your tax return so you can see the importance of good timing.

When you take a withdrawal from a 529 account, the custodian will record that withdrawal on a Form 1099-Q which will be sent to you and the IRS in late January. The school will also send you and the IRS a Form 1098-T showing how much they billed in tuition and how much your child received in scholarships and other aid. Behind the scenes of your tax return, there is a schedule that calculates if your "qualified expenses" were equal to or exceeded your 529 withdrawal. As long as they did, no tax is owed, and nothing shows up on the tax return. The problem is this tax schedule doesn't go to the IRS so they can't match the 1099-Q to anything (Hmmm… seems like something the IRS should fix.). As a result, many people end up getting an IRS notice saying that they owe tax on the 529 earnings when, in fact, they do not. Matching up the tuition and the withdrawal may help with this, but don't be alarmed if you get an IRS notice anyway.

Second: "He who documents best, wins." If you get a notice from the IRS, you will simply supply a summary of the qualified expenses that you paid, which equals or exceeds the withdrawal amount, and that should resolve it; however, if the agent should come calling, having precise records and receipts will give you the win!

What are qualified expenses? The IRS limits the expenses that "qualify" for payment with 529 accounts. Tuition, fees, books, supplies, and equipment (if required by the institution) are qualified. Computers, printers, and school-related software are qualified if necessary for school-related work. Gaming systems are not qualified. Room and board are a qualified expense but are limited to the lesser of actual cost or what the university allows per its cost of attendance figures (In other words, you can't rent him a $10,000/month apartment rather than putting him in a $2,000/semester dorm room and use 529 money to pay for it.).

Here's how I would handle the process:

1. Set up electronic instructions to send withdrawals from the 529 account to your checking account.

2. Most schools have an online student account that shows how much is owed at the start of the semester. Once you see that number, request a withdrawal for that exact amount and have it sent to your checking account (per the instructions you set in #1 above).

3. Make an electronic check payment through your bank's online system to pay the school bill. Make sure your timing works to pay the fees before the deadline! You'll want to investigate how long it takes to set up the EFT instructions and then process a request.

4. Print out/save a PDF copy of the student account screen showing all of the charges and the payment, copy the withdrawal request form, and the bank statement (or screenshot) showing the money coming in and then, going out to the school.

5. Once you pay for the non-tuition items like books, supplies, and equipment, get all the receipts from your child (scan should be fine), total them up, and request a withdrawal for that exact amount (make sure

there aren't any Snickers bars or t-shirts on that bookstore receipt). Again, attach all of the receipts to the withdrawal request.

6. Keep everything with your other tax return documents. Your accountant will love you!

Yes, I am a geeky accountant and an ex-auditor, so I would totally over-kill the documentation, but if I ever got audited, I would be ready. I would also know that I got reimbursed for everything out of the 529 account. The other benefit is that there is a clear record of what the "hard" college costs are. It can help a lot with planning for other kids.

Whoops! If your timing has gotten a little off, or you didn't perfectly document it, don't worry. You can backtrack and pull together your documentation or show the 2-year history to prove that an overage one year covered the shortage the next. In the worst case of a nonqualified withdrawal, you would only pay tax on the earnings related to that withdrawal.

Plan ahead, document well, save everything, and pat yourself on the back for having saved money to fund college.

If you aren't at that stage with your kids yet, consider a 529 savings plan. The Georgia plan does provide for a tax benefit on top of the tax-free growth of the investments. If you are within five years of your child starting college, it may not be worth it to use a 529 account but talk to your accountant and he/she can run the estimates for you. Any savings is better than none so start stashing away some cash for your kids; the college years come around faster than you think!

To your financial success!

To learn more or get help planning your financial goals, please email me at gildea@homrichberg.com.

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