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00:03

JIM: Probably one of the most confusing subjects for a lot of Americans is the college savings arena and student loans and all these different things. What I find is a lot of people start looking into this when it’s too late for their own kids but I work with a lot of grandparents that are interested in helping out grandkids and I can’t think of a better gift than education and our federal government encourages it with 529 plans. Today, we have a 529 expert, Jeff Roach. He has worked with many different mutual fund companies. He’s had a diverse background in many different types of investments, insurance, real estate but over the last several years, he has been training other advisors on the intricacies of a 529. I thought it’d be a great opportunity for us to educate people on what’s available with 529s and why people should be considering them to help with the college savings burn and I know when we look at student loans right now, they’re reaching a trillion dollars. We’re reaching record levels that we’ve never seen before. Maybe a little bit of pre-planning can help alleviate some of that debt for our kids. Jeff, welcome to the program.

01:11

JEFF ROACH: Thanks for having me.

01:12

JIM: Why don’t we just start out with just the simple basic what is a 529 college savings plan?

01:17

JEFF ROACH: Absolutely. Now a 529 college savings plan is actually named after Section 529 in the Internal Revenue Code. It’s designed to help individuals and families help pay for college. Traditionally what you’ll find is it is an agreement between a specific state and an investment manager. They offer the product. Each individual state or I believe 48 of the 50 offer their own version of the 529. What you’re going to find are some similar characteristics that are going to be the same across the board and then each state has made some minor tweaks to their specific plan to make it their own.

01:54

JIM: Now I know each state, as you mentioned, has a different program and I know some states even have more than one. I know here where I am in Wisconsin, they have a state-sponsored plan that you can do direct and one through an advisor. Now I’m biased. I’m an advisor but it’s come from experience. I know working with an advisor probably is real helpful in this area because as we go through some of these details, I think people are going to find there’re a lot of questions and today we’re giving you a general overview. Obviously every state is a little bit different and you have the ability to pick any state’s program. Let’s talk about what are some of the advantages of opening a 529 plan?

02:30

JEFF ROACH: Absolutely. Regardless of which plan you use, you’re going to find your three major advantages. The first is the tax advantages, the second is flexibility, and the third is the control. Let’s start with the tax advantages because that’s the advantage that most people tend to gravitate toward. When you contribute to a 529, the money goes in post-tax. You’re going to find it’s going to have tax-deferred growth and if you use the money to pay for college or vocational school, the money is going to come out tax-free. Right off the bat, you get your tax advantages. In addition, there is going to be some flexibility. Anybody can contribute. There are no income requirements in terms of being able to make a contribution. There is some flexibility in terms of the amount of money you can gift. Also, you can use this at any school nationwide and you can use it at some schools internationally as well. Finally the level of control, you control the assets. When you put the money in, it gets put down as a completed gift. You do have the ability to change the beneficiary and you do control how much money the individual would get at any given time. Those are the three major advantages, the tax advantages, the flexibility, and the control.

03:34

JIM: Yeah and that’s the same no matter what type of program you pick. You talk about the tax advantages. That’s on the federal level. Now there may also be some state tax advantages but then you have to use the state program. They vary from state to state and that’s something that we could spend three hours talking about all the differences of those but no matter what plan you pick, you get those federal tax advantages. Let’s talk about who can open a 529 college savings plan?

03:58

JEFF ROACH: Certainly. Now anybody can open an account but the control of the account relies on the person who is the account owner. That account owner has the ability to name the beneficiary. The account owner gets to pick the investments, how much money is going in. They determine if they’re going to make up to two investment changes per year. They’re going to initiate any distributions. They have the ability to change the beneficiary at any time if that first beneficiary gets a scholarship or decides not to go to school for any reason for that matter. Anybody can open it but the person that does is in control of the plan.

04:33

JIM: Now I must emphasize unlike a custodial plan where you might open an account for a child, once that’s open, you really don’t technically have a lot of flexibility with it. Being able to change beneficiaries, again, depending on the plan, there may be some restrictions as far as who you can change the beneficiary for but basically any family member it can be changed to and there might be some restrictions outside the family but that’s something you need to check with your advisor on. Let’s talk about who can contribute to a 529 college savings plan.

05:02

JEFF ROACH: Absolutely. Anybody can contribute to the plan. As I mentioned before, it’s the account owner that has control but in fact the 529s, they act like magnets for the extended family because if you express your intentions at birthday parties and events like that that you’re not looking for gifts but you’re looking for contributions into the existing 529 plan, well then anybody has the ability to make those contributions into those 529s.

05:28

JIM: Yeah I tell you that’s probably the most awesome thing. I’ve been in practice for a long time and I don’t know. When did those 529s come out? Probably 10 or 12 years ago?

05:36

JEFF ROACH: I believe it was 2001 is when they first started coming out.

05:39

JIM: Okay so that’s 14 years ago and the thing that I see, a lot of families when they start out and they start having kids and the young kids are at home, most of those families are really strapped when it comes to cash, not always but a lot of times that seems to be the case. What I’ve found is a terrific tool, grandparents love their grandkids and what sickens a lot of them is they’ll give them a toy and they don’t even remember who they got it from and it’s broken or whatever and it’s not as meaningful to them. A lot of grandparents feel there’s no greater gift to give than that of education and being able to have that control and being able to move assets to someone else gives them the peace of mind. Even though you might be making that decision early on in someone’s lifetime to set up a college fund and college isn’t for everybody, having that ability to have those funds available for other grandkids is something that’s really attractive but one thing I’ve found, a lot of these accounts in today’s world with all the compliance and paperwork and everything else, the minimums to open an account aren’t necessarily as easy for a younger family starting out to get into. I know a lot of accounts now have $500 or $1000 minimum to start out or a $50 a month commitment. Let’s face it. For some younger families, that’s difficult but for grandparents a lot of times even just to plant the seed money to open that account to make it available for all the friends and family to contribute because most of them don’t know what to get these kids these days but why not make a gift to their education at Christmas or the holidays or birthdays. It’s just a great tool. Have you found that to be the case, Jeff? Do you see a lot of that where families are working together to contribute for one child’s education or many kids’ education?

07:17

JEFF ROACH: Absolutely. I mean I can use myself as an example. I have a 9-month-old daughter named Mia and at Christmastime this year she was flooded with all kinds of toys and what I found is the toy usually ended up in the trash. She fell in love with the box. We had multiple doubles of the same toy and she was no closer to having any money saved for her education. In a perfect world, what I would have done is identified this ahead of time, let everybody know that we would appreciate a contribution to her 529 savings account as a primary gift and if they want to get her a little toy as a secondary, that would be fine. This way here, our house wouldn’t be flooded with a bunch of broken toys but her 529 account would be flooded.

7:56

JIM: That’s funny. You talk about the lawyer that has no will or the cobbler’s kids that have no shoes. We all make the same mistakes. No matter how much expertise we have, sometimes we forget to take care of those details in our own households. I appreciate you sharing that. Anybody can set this up. Anybody can contribute to it. I’ve got to implore people, it’s such a fantastic thing to do and if you start out with a newborn and everybody’s just putting in $50 at a time at different special occasions, man if those kids go to college, they have a great jumpstart. In some cases, they might even have enough to cover all the schooling and the fact that the parents or the grandparents can stay in control of those funds, if the kids decide to go off the deep end a little bit and don’t apply it toward their studies, there’s no rights for those children to demand payment. You make sure that that money goes to what it’s intended for and I think that’s one of the most awesome things is that control thing.

08:48

JEFF ROACH: You’re absolutely right. We used to joke back in Boston that if you’re thinking Yale and they end up in jail, you’re not locked into that money. You can always try to give it to another family member who may be more on the course.

08:59

JIM: Absolutely. That’s awesome. I love that saying. We can learn from the people in Boston. Let’s talk about what can you use the 529 college savings account for? I know that’s probably one of the biggest questions I get from clients. Can we use it for their airfare to be an exchange student?

09:14

JEFF ROACH: Right off the bat, unfortunately, I learned the hard way that you can’t use it for your education transportation because if you could have, I certainly would have gone to the University of Hawaii as opposed to a small school in Connecticut but in all seriousness, what you can use a 529 plan for is your traditional route, your colleges and your universities, but one of the lesser known avenues you can use the 529 for is for vocational schools, extended training, trade schools because the majority of people, they say well what happens if my kid doesn’t go to college because college isn’t for everybody but there are very few opportunities out there in today’s world that you can go right from high school into a job with zero training. Even your electricians or plumbers or mechanics, they need to go to that trade school to build up that craft and get that type of training before they’re up and running. A 529 can also be used for that. Just because your child is not thinking the traditional liberal arts education doesn’t mean they’re not going to need some sort of specialized training and the 529 can cover it either way.

10:14

JIM: Hey we’re going to take a short break and let’s get into some more details on what’s qualified to be paid for and what we’ve got to stick away from. Please stay tuned.

[BREAK]

11:28

JIM: Welcome back as we continue to visit with the father of a 9-month-old, Jeff Roach, who over the last several years has made it his passion to be an expert and helps train financial advisors on how to do a better job for their clients when it comes to talking about college savings 529 plans. Before the break, we were talking about one of the big misconceptions out there. People think that kids have to go to a four-year formal college. One of the things we’re hearing a lot of is these kids are coming out of college without the skills to get a job and yet at the same time, I know I’ve had a guest with Manpower on several times and he talks about the need for plumbers and electricians and welders and there’s nobody available that’s getting trained in these skilled jobs and you were saying before the break those vocational schools also can qualify. What are some of the other qualified educational expenses? What about books or computers or other things like that? Can that be used, the money from the 529, to pay for those kinds of things?

12:29

JEFF ROACH: Absolutely. I mean traditionally what you’ll find is it’s going to cover your tuition, your room and board, your books, equipment, and any fees. Now you mentioned computers. That’s actually an interesting one. Right now, it will allow to pay for the computer but only if the school requires you to have a computer but there’s actually a motion going on in Congress right now to have it so that the 529 always is able to pay for computers across the board. That’s something that they’re working to change right now because they’ve identified that a computer is very critical to the education process and you shouldn’t be limited by whether the school requires it. You should be able to have one at any given point.

13:07

JIM: I know my kids just graduated from college and I know all their assignments for most of their teachers, even though they weren’t required to have a computer, they had to email their assignments in by a certain time.

13:17

JEFF ROACH: Right. Yeah that’s just the way of the future and it looks like they’re taking the necessary steps to make sure the 529s are going to be relevant in today’s world.

13:25

JIM: Now what are some of the things you come across that people think should be covered but are not.

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JEFF ROACH: The transportation is something that you hear all the time that it should be covered but it doesn’t seem like that’s something that they’re going to do right now. Right now, it’s designed to have the things that are necessary in order to be part of the school. Like I said, it’s the tuition, the room, the board, the books, a couple of extracurriculars. I had somebody ask me what if their child was going to go to Ireland on a tour of the city to practice the recorder because they were a music major. That didn’t fly either but there are your traditional ways to use it and there are some people that try to think outside the box but as a safe bet, stick to the format, tuition, room, board, books, education, and fees.

14:09

JIM: I do know in the past exchange students, some of that stuff could be covered but it had to be some type of formal exchange program for it to work. The big thing is you want to stay on top of this. Don’t assume from this program something is or isn’t covered because the rules can change. As you get closer to school time, it’s important before you make that withdrawal to make sure that it’s going to be a covered expense so you don’t have a surprise. Let’s talk about what if the beneficiary does not go to college.

14:36

JEFF ROACH: Certainly and this is something that comes up a lot because like we talked about earlier, people are concerned that some people just aren’t built for college. If the vocational route doesn’t work, you have a couple of different options. The first is you can change the beneficiary to another member of the family and this way here, it allows you to keep the tax advantages in check. It allows them to continue or if you’ve exhausted all the existing family members, you’re able to take a distribution, pay a 10% penalty and income taxes on the earnings only. In essence, if you put $50,000 in a 529 and it grows to $100,000, 50% of that is principal, 50% of that is earnings so you’d only be taxed and penalized on the earnings portion of that.

15:16

JIM: One thing is and we’re not here to spend a lot of time on it but if you do the math, having the ability to grow money in a tax-deferred basis really gives money a chance. Don’t let just the penalty stop you. Do the math on it if you’re concerned about it but the biggest thing is you can change beneficiary. One question, I know I’ve got a lot of clients who are schoolteachers and other professions where they have to take continuing education and I’ve got a lot of schoolteachers taking advantage of the 529 plan and they might even be in their 40s or 50s. It is something that can be held for a long time and used at a later date when the kids might be at a position where maybe they’re thinking maybe I’ve got to go back to school. You can hold that money there and you’re still not paying taxes on it until you draw it out. Right?

16:15

JEFF ROACH: Absolutely. That’s right.

16:16

JIM: Let’s talk about how much you can invest in a 529 college savings plan.

16:20

JEFF ROACH: In regards to how much you can invest, it actually varies on a plan by plan level. All the plans have their idea of approximately how much money you potentially could need to pay for college. What you’re going to find is the range is going to be approximately $250,000 and $450,000. Like I said, it varies from plan to plan.

16:51

JIM: The cool thing about that is most families obviously are probably putting those contributions in of $50 here and $1000 there and things like that but there are families that are in a position to do something sometimes much more significantly and when you look at the benefits of the income tax deferral, tax-free if used for education, the ability to change beneficiaries, you really can set up an educational legacy for future family members by setting it up properly. I know in my own case when I set it up for my kids, I was the owner of the plan but I had a family trust set up as the contingent owner so then all my successor trustees could step in and take care of management of that if something happened to me. With some planning, you can accommodate some pretty significant money to help future generations. It’s just a great tool but again talk to your advisors about that. It’s not as simple as just boom, you do it and it’s done. You really want to think it out and use some professionals to help guide you in that area. Let’s talk about that because we are gifting money. If you’re going to $400,000 or something like that, obviously there might be some gift tax consequences. Can you talk about how the gift tax laws factor in?

18:03

JEFF ROACH: Absolutely. Now when it comes to the contributions to the 529, anybody can give anybody up to $14,000 per year and not report it. That’s not exclusive to the 529. That’s just across the board but they allow you to make a special five-year forward gift for the 529 so that you can actually frontload that $14,000 per person. That means that you could contribute $70,000 for one person. A husband and wife can do up to $140,000. Now the reason that’s important is because there are no other options that allow you to frontload your annual federal gift except a 529. You’re not able to give a secondary gift if you max out that amount but getting the money working for you as early as possible in a tax-deferred way is significantly going to improve your chances to have as much money to pay for college as you possibly can. Once again, $14,000; you can take advantage of a five-year forward gift, which is $70,000; husband and wife is up to $140,000; and then you can even gift more than that. It just has to go against your lifetime gift exemption. A single person that’s $5.3 million; husband and wife would be $10.6 million but if those are the types of contributions that are going to be a possibility, I would definitely encourage you to work with a financial advisor because now this is factoring in to your total financial plan. There are other things at play here. Are you going to be able to impact financial aid? Are you going to have estate planning aspects of gifts like that? Those types of significantly larger gifts are probably going to be helped along the way by working with a financial advisor as opposed to doing it yourself.

19:36

JIM: Yeah and you want to look at even talking to your tax advisor, your legal counsel. When you get into those issues, it’s really a collaborative team approach. I will say one of my biggest clients that we did 529 planning for, we had some significant estate planning issues that we were able to accomplish and we also made a big difference in the overall income tax situation. There were many different fronts we were able to take advantage of while at the same time really setting up an educational legacy for that family. These tools go far reaching depending on the family circumstances. One last thing I want to ask you today, I know there are some significant benefits to a 529 compared to the traditional UTMA and UGMA accounts, which is the Unified Transfer and Unified Gift to Minors Act where you can set up accounts for kids. Those I know if a kid has some money in one of those accounts, that goes right on the financial aid application and will count against them for getting financial aid. Tell the audience what the difference would be then having a 529 plan as opposed to one of those more traditional-type accounts.

20:41

JEFF ROACH: Absolutely. Now when you’re thinking in terms of financial aid on the FAFSA form, there are two types of contributions. You have the parental contribution and the student contribution. The parental contribution in terms of assets, they can count up to 5.6%. The 529 would be considered a parental asset but just to put that in perspective, if you had $100,000 in the 529, that means approximately $5600 would be factored into the equation to determine your expected family contribution and that means approximately $93,000 and change is able to be used to pay for school that’s not factoring in and that can be used to pay for school tax free. Now in terms of the student contribution, that can count up to 50% if it’s counted as income. One of the biggest misnomers is should the parent own the account or should the grandparent own the account? If the parent owns the account, it counts as 5.6% toward the equation. If the grandparent owns the account, it does not but this is where people get tripped up all the time. If the grandparent owns the 529 and you take a distribution from that to pay for school, that amount of money counts as student income for the calculation the following year. It may seem like it’s the right thing to do but ultimately you could be costing yourself more financial aid because if the amount of that distribution is significant, it counts 50% toward that student asset the following year. That amount could be higher in that calculation than that 5.6% as the parental asset.

22:12

JIM: If the parent owns it and there’s a distribution, it does not count?

22:16

JEFF ROACH: No, it doesn’t.

22:17

JIM: Okay so that’s a significant difference. That’s why it’s so important to not do this stuff alone. The other thing too is let’s say the grandparents do have that account and maybe you have enough money to pay for two years of college education. Well there’s a little strategy planning because maybe you’re better off borrowing the money or taking whatever opportunities there are to get outside help for the first two years and then have Grandma and Grandpa’s 529 plan that they set up for the grandchild, use that for the second two years. A lot of times, I see people that go it alone, they just draw the money out and they don’t know any of the consequences and that’s why it’s important to plan ahead and get the most benefit out of this. Jeff, I really appreciate you taking the time. You shed a lot of light and hopefully our listeners gained a lot from your knowledge. Hopefully, if they don’t have a 529 plan now, they’ll set one up. If they do, maybe they’ll make another contribution. Thanks, Jeff.

23:08

JEFF ROACH: You’re welcome. Thanks for having me. I really appreciate it.

23:11

JIM: Thanks for joining us this week and tune in again next week as we explore another phase of the Real Wealth process and remember if anything you heard in today’s show you’d like to get more information about, contact your Real Wealth advisor. Also, if you feel that any of this information would be helpful to a friend or family member, just click the Forward to a Friend button.

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