

April 10, 2023 – Wealth Planning Commentary

How late is too late to fund a 529 plan?

April is Financial Literacy Month. In this spirit, we are addressing a question that we often receive about education accounts: Are there any benefits to funding a 529 plan if my child is already in high school?

The short answer is likely yes. Assets within a 529 grow tax-free, allowing for tax-advantaged investment returns. Withdrawals from the 529 are tax-free if they are used for qualified education expenses. Also, a state tax deduction may be available for contributions made to a 529, and each state has different rules.

If the child is in high school, the timeframe for investing is about 1-4 years, this is a medium-term horizon. The funds are needed in a relatively short period of time and avoiding losses on the contributed amount is a key objective. The funds should be invested in liquid investments earning interest, such as a money-market fund. If \$10,000 is invested and earns 4-5% over a year, that adds \$400-\$500 of assets that may be dedicated to education. The amount could be greater if a state deduction is available on the contribution to the 529. Money that was previously budgeted for tax payments may be redirected toward education.

A 529 plan that is funded late in the game is very different from a long-term funding plan. A long-term strategy allows the owner to take more risk, potentially earning higher returns that benefit from compounded interest at a tax-advantaged rate. However, the triple tax advantage of a 529 plan, and a higher interest rate environment, may be reason enough to start saving, even if it's late.

If a child is on the fence about whether to attend college, a 529 may encourage them to enroll in higher education. Avoid funding a college savings plan if the child is unlikely to attend college. However, if you do fund a 529 plan and there are unused funds, the assets may be converted to a Roth-IRA in the child's name. Some restrictions apply.

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