

# Client Bulletin

Smart tax, business and planning ideas from your Trusted Business Advisor<sup>SM</sup>

August 2018

## How the new tax law affects 529 plans



For many years, 529 college savings plans have offered a tax-favored way to save for higher education. These plans, officially qualified tuition programs, are named for the IRC section that provides their advantages.

In brief, 529 plans are funded with after-tax dollars. In college savings plans, account owners choose from a menu of investments, and any earnings are untaxed. Distributions are also tax-free if they do not exceed the qualifying educational expenses of the account beneficiary: payments of tuition, fees, supplies, and certain housing expenses for the account beneficiary's study at an eligible educational institution. Before 2018, eligible educational institutions included only post-secondary institutions.

### Youth movement

Under the new tax law, the benefits mentioned previously (tax-free investment

earnings, potentially tax-free distributions) remain as they were. The difference is that for tax years beginning after December 31, 2017, 529 plans are no longer limited to higher education at a post-secondary institution. Now they can be used for elementary and secondary education, as well. That includes learning in public, private, and religious schools.

There is one key caveat: Tax-free distributions for elementary and secondary education are capped at \$10,000 per student per year. As before, there is no annual limit on qualified distributions from 529 plans for higher education.

**Example 1:** Bill and Claire Dawson open a 529 account for their newborn son Noah. Over the years, they invest thousands of dollars there. When Noah is age 10, in the fifth grade, he goes to a private school where the tuition is \$15,000. The Dawsons take \$10,000 from Noah's 529 account to pay part of his tuition with a tax-free distribution. A larger distribution could lead to an income tax obligation and possibly an additional 10% tax on the amount of the taxable distribution.

### Sooner than later

For families like the Dawsons, using 529 money for pre-college costs might not be an ideal strategy. The earlier money is withdrawn, the less time there will be for compounding earnings. Extending untaxed investment buildup, which eventually may come out as a tax-free distribution, is a prime benefit of 529 plans.

## In this issue

- 1 How the new tax law affects 529 plans
- 2 Now the G.I. Bill is forever
- 3 Education as a small-business fringe benefit
- 4 Tax calendar

## Higher education

Measured by market share, total accounts, and assets under management (over \$66 billion), Virginia529 is the largest 529 plan in the nation.

## Trusted advice

### Eligible schools

- For qualified tuition program tax benefits, an eligible educational institution now can be either an elementary, a secondary, or a post-secondary school.
- Among post-secondary schools, eligible schools are generally any accredited public, nonprofit, or privately owned profit-making college, university, vocational school, or other post-secondary educational institution.
- A post-secondary school also must be eligible to participate in a student aid program administered by the U.S. Department of Education.
- Eligible elementary and secondary schools include any public, private, or religious school that provides elementary or secondary education (Kindergarten through grade 12 classes).

Even so, the new law can prove beneficial in some situations. When cash is short and private school costs are high, a \$10,000 tax-free distribution from a 529 plan may be welcome. If students are now attending an expensive high school but are expected to attend an inexpensive college, it may make sense to use the \$10,000 529 distribution each year.

Moreover, even though the new 529 provision applies to federal tax, substantial benefits might come from state taxes. Nearly every state offers a 529 plan, and most of them provide state income tax credits or state tax deductions to residents who invest in the home state's plan. (Some states have tax benefits for investing in *any* 529 plan.)

So far, states have differed on how they'll treat 529 plan distributions

for K-12 distributions. Assuming your state goes along with the new federal law, using \$10,000 a year for pre-college costs may become especially attractive.

**Example 2:** Suppose Ted and Sarah Raymond live in a state that offers a 10% tax credit for 529 contributions. They invest \$10,000 in their state's plan this year, getting a \$1,000 credit against state tax. Then, they use that \$10,000 to pay part of their daughter Gina's private high school tuition. With the \$1,000 state tax saving, the Raymonds effectively reduce Gina's school cost by \$1,000 by streaming their cash through their state's 529 plan.

Our office can inform you of your state's tax treatment of 529 contributions and how the state is dealing with the new rules on 529 distributions.

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## Now the G.I. Bill is forever

When you think of the G.I. Bill, you probably recall reading about a program designed to help military veterans receive college educations after they left the armed forces following World War II. Somewhat less known is that the G.I. Bill has endured, in various forms, until present times.

Last year, the Harry W. Colmery Veterans Education Assistance Act of 2017 became law, named for the American Legion member who wrote the initial G.I. Bill. The latest version is known as the "Forever G.I. Bill" because there is no time limit on receiving benefits for military personnel. Furthermore, education benefits may be transferred to spouses and children.

### Who qualifies

The new G.I. Bill applies to service members with at least 90 days of aggregate active duty service after

September 10, 2001. In addition, at least one other condition must be met. A person must be

- still on active duty,
- honorably discharged, or
- discharged with a service-connected disability after at least 30 days of service.

Thus, the new G.I. Bill can be used for college classes, including post-graduate study, or for various types of career training. An extensive approved list ranges from entrepreneurship training to flight training to vocational or technical training.

The current program provides up to 36 months of education benefits, equivalent to four years at a standard college. (A 45-month limit for educational benefits may apply for individuals who first enrolled before August 1, 2018.) For the 2018–2019 academic year, the

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## Did you know?

The Servicemen's Readjustment Act of 1944 (G.I. Bill) paid almost \$4 billion to nearly 9 million veterans from 1944–1949 in unemployment compensation. The education and training provisions existed until 1956, and the Veterans' Administration offered insured loans until 1962. The Readjustment Benefits Act of 1966 extended these benefits to all veterans of the armed forces, including those who served during peacetime.

Source: History.com

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benefits cover all tuition and fee payments for an in-state student at a public college or university; for private (or even some foreign) institutions, benefits cover costs up to \$23,671.94. Many schools across the country participate in a Yellow Ribbon program that provides even greater benefits. The U.S. Department of Veterans Affairs matches contributions from the educational institutions.

In addition to those amounts, G.I. Bill recipients also may receive a housing allowance plus a stipend for books and supplies. Benefit amounts may differ for education that does not occur at an institution for higher learning, such as online learning.

Generally, someone must have served at least 36 months to get full benefits; those with less time in service may receive partial benefits. The time that a reservist was ordered to active duty counts towards eligibility. All post-9/11 Purple Heart recipients are fully eligible, regardless of length of service.

Previously, there was a 15-year time limit for use of these benefits. Under the new law, as long as someone's release from active duty was after 2012, the time limit has been removed.

### Transferring benefits

One of the most interesting aspects of today's G.I. Bill is the ability to transfer benefits to a spouse or a child.

**Example:** Tanya Walker has a college degree and no interest in further education after she leaves the military. She can transfer her unused G.I. Bill benefits to her husband Dave, but Dave also has no interest in continuing any classwork. Therefore, Tanya transfers her benefits to their son Ernie and their daughter Fiona.

Tanya must transfer her benefits before she leaves the military. Once she has been discharged, a transfer isn't possible. If Tanya has used any benefits under the G.I. Bill, only the unused amount can be transferred.

A few more hurdles must be cleared. Applicants must have been in the military for at least 6 years when requesting the transfer and agree to serve another 4 years on active duty or in selected reserves. Alternatively, an individual must have been in the military for at least 10 years and agree to serve as long as allowed, by policy or by law. Special rules apply to anyone who was eligible for retirement on August 1, 2012.

When a transfer of benefits goes to the spouse, the recipient must use them in full within 15 years after the veteran leaves active duty. When a transfer goes to children, they can't use the G.I. Bill benefits until they graduate from high school, get an equivalency certificate, or reach age 18. Once a child reaches age 26, he or she can no longer use the transferred benefits.

In this example, Ernie and Fiona may divide the transferred G.I. Bill benefits after they graduate high school. The benefits must be fully used before both children reach age 26.

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## Education as a small-business fringe benefit

As reported in previous issues of the *CPA Client Bulletin* this year, the Tax Cuts and Jobs Act of 2017 dramatically reduced taxpayers' ability to itemize deductions. Among the tax deduction opportunities that have vanished, from 2018–2025, are miscellaneous itemized deductions that exceed 2% of the taxpayer's gross income. Such deductions included unreimbursed employee business expenses.

Drilling down, those no-longer-deductible employee expenses included education outlays that were related to someone's work at your company.

**Example 1:** Heidi Larson is a supervisor at ABC Corp., where she is responsible for a small group of

workers. Heidi is paying for online courses that will ultimately lead to an MBA and help her in her current job. Under prior law, Heidi may have been able to deduct her costs for the MBA program, but that's not the case now.

### Filling the gap

Many people will be in Heidi's situation, unable to offset the cost of paying for education that will bolster their careers. In this environment, your small business can provide valuable education-related assistance. Offering help in this area may allow your company to attract and retain high-quality workers, in addition to improving your employees' on-the-job performance.

In 2018, the IRS released an updated Employer's Tax Guide to Fringe Benefits, which reflects the new tax law. This guide mentions some ways that employers can offer education benefits that receive favorable tax treatment.

### Educational assistance programs

An educational assistance program (EAP) must be a written plan created specifically to benefit your company's employees. Under such a plan, you can exclude from taxable compensation up to \$5,250 of educational assistance provided to each covered employee per year.

**Example 2:** Suppose that DEF Corp. has an EAP. Ken Matthews, a supervisor there, is taking courses in

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a local MBA program. DEF provides \$5,000 to help Ken pay for his courses this year. DEF can deduct its \$5,000 outlay, whereas Ken does not report that \$5,000 as taxable income. It makes no difference whether DEF pays the bills directly or reimburses Ken for his outlay.

Some formality is required when setting up an EAP and certain requirements must be met. The plan can't favor highly compensated employees or company owners, for example, and it can't offer cash to employees instead of educational assistance. Our office can help you create an EAP that complies with IRS requirements.

### Working-condition fringe benefit

The benefits in this category don't require a formal plan, there is no

limit on the amount of educational assistance involved, and no explicit limit on highly compensated employees or owners. However, there are rules that must be followed to earn tax breaks.

The education must be required, by the company or by law, in order for the employee to maintain his or her present position, salary, or status at the firm, and the learning must have a valid business purpose for the employer. If those conditions can't be met, tax breaks still may be available if the education helps to maintain or improves job-related skills.

Regardless of the previous paragraph, tax benefits will be denied if the education is needed to meet the minimum educational requirements of the employee's current job or if the

course will qualify the employee for a new trade or business.

**Example 3:** Nora Pearson, a supervisor at GHI Corp., is going to law school at night. Even if learning the law will help Nora do her job better, company funding for her courses won't qualify for favorable taxation because the education could enable Nora to become an attorney, a new trade for her. Any assistance from GHI will be treated as taxable compensation.

Note that it is possible to have an EAP and provide over \$5,250 to an eligible employee. Assuming that all conditions are met, assistance over \$5,250 might be deductible for the employer and excluded from the employee's taxable compensation as a working-condition fringe benefit.

## Tax calendar

### AUGUST 2018

#### August 10

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2018. This due date applies only if you deposited the tax for the quarter in full and on time.

#### August 15

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in July if the monthly rule applies.

### SEPTEMBER 2018

#### September 17

**Individuals.** If you are not paying your 2018 income tax through withholding (or will not pay in enough tax during the year that way), pay the third installment of your 2018 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in August if the monthly rule applies.

**Corporations.** Deposit the third installment of estimated income tax for 2018. Use the worksheet Form 1120-W to help estimate tax for the year.

**Partnerships.** File a 2017 calendar-year return (Form 1065). This due date applies only if you timely requested an automatic six-month extension. Provide each partner with a copy of his or her final or amended Schedule K-1 (Form 1065) or substitute Schedule K-1.

**S corporations.** File a 2017 calendar-year income tax return (Form 1120S) and pay any tax, interest, and penalties due. This due date applies only if you timely requested an automatic six-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) or a substitute Schedule K-1.



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