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SAVING FOR COLLEGE

# Watch the '529' Deadline Mismatch

Help from financial advisers on college-tuition issues

By CHANA R. SCHOENBERGER

Colleges are back in session, but as parents know, the job of financing the four-year (or more) adventure continues year-round.

The Wall Street Journal fields readers' questions about paying for college, "529" investment plans and more, and we again asked financial-planning experts to help with the answers.

**My daughter's college has a payment deadline in early January for the spring semester. Typical distributions from her 529 take two to three weeks to post directly to her school account. Can I initiate the direct payment in mid-December of the previous calendar year, or will it cause a mismatch of potential qualified expenses?**

**But when a beneficiary takes a distribution from any 529, that amount is disclosed on the following year's Fafsa, which will factor into aid calculations, says Mr. Shrier.**

Try to avoid making a distribution in December and paying the tuition in January, since the mismatch will cause record-keeping problems for your taxes. "The solution is for the parent to pay the tuition directly to the school and then request reimbursement from the tuition plan," says Robert Keebler, a certified public accountant in Green Bay, Wis.

Rules for 529s, the popular state-sponsored plans in which earnings are tax-free if used for college expenses, allow people who pay tuition bills directly to reimburse themselves from the 529. Just be sure to "have good documentation that the expense is at least as much as the distribution," says Zachary Shrier, a financial adviser at Shrier Wealth Management in Los Angeles.

The easiest way to handle this is to establish a direct-payment link between your 529 and your checking account, allowing you to transfer money between the accounts within two to three days, he says: "If that is set up in advance, you can request the money at the beginning of the year, have the money quickly, and write a check to the university."

**How do 529 plans work for stepparents, custodians, cousins, great-aunts or any adult who isn't a child's parent?**

A 529 can be opened for anyone, by anyone. It doesn't matter whether the account-holding adult is related to the beneficiary. Tax rules let you give $14,000 this year to anyone without triggering the gift-tax reporting requirement (a couple can give $28,000). For 529s, you can deposit $70,000 at once ($140,000 for a couple) and have it count as your tax-free gift to the beneficiary for the next five years.

A possible drawback: Only relatives of the original beneficiary can use the account's funds, so if your friend's daughter decides not to go to college, the account you've established for her can be transferred only to her relatives, not yours.

You might want to write the child's parents a check for deposit in a 529 they set up, says Lindsay Bourkoff, also a financial adviser at Shrier Wealth. In many ways, it's easier to make a third-party contribution, she says, although you don't get the tax deduction that a 529 owner would receive. It still helps the child, and you don't assume the responsibility of funding and managing the plan. In a lot of states, for instance in California, there are no state tax benefits to owning your own plan.

Before setting up a 529, check on state requirements. "Some plans might limit participation to state residents," says Mr. Keebler.

Beware of how this could affect financial-aid eligibility. A parent-owned 529 must be disclosed on the Free Application for Federal Student Aid, or Fafsa, form, though it is measured at a preferred rate. An account owned instead by another adult doesn't have to be disclosed. But when a beneficiary takes a distribution from any 529, that amount is disclosed on the following year's Fafsa, which will factor into aid calculations, says Mr. Shrier.

**If a parent receives a direct distribution from a plan by depositing it in his or her checking account and then simultaneously writes a check to the college for tuition, will this create a taxable event to the parent?**

**"The key here is careful record-keeping on the part of the 529 account-holder," Ms. Bourkoff says.**

As long as equivalent funds are used for qualified education expenses, you shouldn't incur tax. Be sure to keep all documents: credit-card statements or checks showing that you paid tuition, or receipts from a university. "The key here is careful record-keeping on the part of the 529 account-holder," Ms. Bourkoff says.

At the end of the year, your 529 provider will issue a 1099-Q, showing the sums distributed from the account. You don't have to itemize those amounts, but if you get audited, you must be able to show where the money went.

The more common way to handle these transfers is to "write the tuition check and then request a distribution from the 529 plan," Mr. Keebler says, which allows you to make sure you are also claiming whatever education tax benefits are due to you on your 1040. Be careful: "You can't double dip—that is, claim an education benefit on your tax return and pay the tuition with a 529 plan distribution," he says.

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