

COLLEGE FUNDING

LIFE INSURANCE AND 529 PLANS



AVERAGE ANNUAL COLLEGE COSTS

PUBLIC **\$28,840**

PRIVATE **\$60,420**

Includes: Tuition and fees, room and board, and allowances for books, supplies and transportation. Source: CollegeData.com. 2023. "How Much Does College Cost?" <https://www.collegedata.com/resources/pay-your-way/whats-the-price-tag-for-a-college-education>. Accessed Oct. 7, 2024.



Many people want to help fund education costs for their children or grandchildren. The sooner you begin to develop a strategy for education savings, the more time your money will have to accumulate.

The costs of a higher education can be daunting.

So can the myriad of options available to help you save. There are many different vehicles to consider when creating a strategy for higher education costs, including savings accounts, 529 plans, Coverdell Education Savings Accounts (ESA), Roth IRAs and cash value life insurance. For many people, a combination of these products can help ensure the money is there to pay the tuition bills.

Let's look at some of the pros and cons and what you should consider for two of those options: cash value life insurance and 529 plans. While either one can help you potentially fund a college education, which one makes sense for you is a unique decision to make.



CASH VALUE LIFE INSURANCE

When people hear “life insurance,” the first thing they often think of is the death benefit protection. Certainly, the main purpose of life insurance is to help ease the financial burden for your loved ones if you were to pass away prematurely. However, cash value life insurance (also known as permanent life insurance) can provide meaningful benefits while you’re still living, including helping you realize your college savings goals.

Pros

- Income tax-free death benefit that could fund an education should you die unexpectedly.
- Tax-deferred cash value growth potential.
- College costs can be paid for through tax-free policy loans and/or cash value withdrawals.*
- No requirement that the withdrawals must be spent on qualified education expenses.
- Certain permanent life insurance policies offer protection from market downturns.
- Life insurance is not currently considered under FAFSA® federal aid guidelines.¹

Cons

- Life insurance policies are subject to medical underwriting and, in some cases, financial underwriting. Individuals who suffer from certain health conditions may be denied coverage.
- Life insurance products contain fees, such as mortality and expense charges, and may contain restrictions, such as surrender charges.
- It takes time – often several years – to build up the cash value of a life insurance policy.
- Premium payments for a life insurance policy are not tax-deductible.
- The policy can lapse due to excessive loans and withdrawals, insufficient premium payments or lower-than-expected policy performance.
- Because the insurance is fixed in nature, policy growth is limited.

Things to consider

- If the policy is classified as a modified endowment contract (MEC) under IRC Section 7702A, loans and withdrawals may be subject to tax at the time that the loan or withdrawal is taken and, if taken prior to age 59½, a 10% federal tax penalty may apply.
- Tax-free distributions will not increase tax expenses, Social Security taxation or Medicare premiums.
- There are no annual income limits or IRS-imposed contribution limits; however, contributions are subject to both federal guideline rules and death benefit amount issued by the insurance carrier.
- While cash value life insurance can provide many possible benefits, exercising one or more of them will likely mean reducing or eliminating other benefits.

**Policy loans and withdrawals will reduce available cash values and death benefits and may cause the policy to lapse. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. Tax laws are subject to change; consult a tax professional about your personal situation.*

529 PLANS

A 529 plan is a tax-advantaged investment account that can be used to pay for qualified education expenses from kindergarten through graduate school. 529 plans were established as a way to encourage families to start saving for college early, while their children were still young.

Pros

- Many states offer an income tax deduction or tax credit for 529 plan contributions.²
- Withdrawals spent on qualified education expenses (and up to \$10,000 per year in K-12 tuition) are income tax-free.
- 529 plans have no annual contribution limits and high maximum aggregate contribution limits.
- Accounts can be opened online or through a licensed financial professional and funded via direct deposits from a bank account or employer payroll deduction.
- No income taxes will be due on the investment earnings while the money is in the account.
- Because the funds are market-based, there is the potential for greater growth.

Cons


- Earnings are subject to income tax and a 10% penalty if the withdrawal is not spent on qualified education expenses.
- You are limited by the investment options offered by the program and those investment options are subject to market risk, including the potential loss of principal.
- 529 plans charge fees and expenses that could impact the amount you are able to save for college.
- No death benefit. Check the rules in your state for what happens when the account owner or the beneficiary dies.

Things to consider

- 529 plans are reported as a parental asset on the FAFSA[®] and have a minimal impact on financial aid eligibility.
- The 529 plan account owner, not the beneficiary, has legal control of the money in the account.
- The beneficiary can be changed at any time to another family member (subject to IRS guidelines).
- Beginning in the 2024-2025 school year, grandparent-owned 529 accounts will no longer impact a student's eligibility to receive needs-based financial aid.³
- You can convert unused 529 funds tax- and penalty-free, up to a lifetime limit of \$35,000, to a Roth IRA for the 529 beneficiary. The 529 plan must have been open for at least 15 years and Roth IRA annual contribution limits apply.⁴



Regardless of the method you choose to save for future education costs, the most important takeaway is to start saving early. Speak to a financial professional to help you determine what makes sense for your family.



¹ Kathryn Flynn. *Saving for College*. Aug. 17, 2023. "How 7 Different Assets can Affect your FAFSA and Financial Aid Eligibility." <https://www.savingforcollege.com/article/how-7-different-assets-can-affect-your-financial-aid-eligibility>. Accessed Oct. 7, 2024.

² Matthew Toner. *Saving for College*. Sept. 26, 2024. "How much is your state's 529 plan tax deduction really worth?" <https://www.savingforcollege.com/article/how-much-is-your-state-s-529-plan-tax-deduction-really-worth>. Accessed Oct. 7, 2024.

³ Kathryn Flynn. *Saving for College*. Feb. 19, 2024. "What to Know About 529 Accounts Owned by Grandparents & the New FAFSA." <https://www.savingforcollege.com/article/new-fafsa-removes-roadblocks-for-grandparent-529-plans>. Accessed Oct. 7, 2024.

⁴ Fidelity. "How unused 529 assets can help with retirement planning." <https://www.fidelity.com/learning-center/personal-finance/529-rollover-to-roth>. Accessed Oct. 7, 2024.

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