Setting Sail

First Quarter 2024

The 529 Plan Problem Finally Has a Solution

When it comes to college savings solutions, it is hard to beat the 529 Plan. These accounts are administered by the various states and offer investors a tax-advantaged way to invest for their children's or grandchildren's college expenses. Although contributions do not receive a tax deduction, the earnings grow tax-deferred and eventually tax-free if used for qualifying education expenses. Some states, including Idaho, offer a state-tax deduction for contributions to their state's 529 plan.

The biggest downside with these plans is the unknown nature of the actual costs of college for any given child. Sure, we can make reasonable assumptions about how fast college costs will inflate over time, but we are just guessing when it comes to the college cost of your son or daughter. Maybe they will choose a lower-cost school, receive a scholarship, drop out early, or not attend college at all. In any of these or other scenarios, the cost can run out before the funds in the 529 plan do. This dilemma has led to a balancing act by parents who try to fund their children's 529 plans like they are contestants on The Price Is Right by getting close without going over.

The good news is that the Secure Act 2.0, which was passed in 2022, has a provision that became effective in 2024. Starting this year, unused 529 plan assets can be rolled over to Roth IRA accounts to avoid the taxes and penalties associated with a regular withdrawal for unqualified expenses. There are a few limitations to consider before executing this transfer.

First, the beneficiary of the 529 plan must be the owner of the Roth IRA. You can't roll the funds into your own Roth IRA. They must go to the intended beneficiary. Also, the account must have been open and had the same beneficiary for 15 years. Any funds contributed in the last five years and their earnings are not eligible for this rollover.

The amount rolled over in any one year cannot exceed the annual limit on regular Roth IRA contributions. In 2024, the contribution limit is $7,000 for Roth and Traditional IRAs. If the beneficiary contributed to either a Roth or a Traditional IRA, those contributions count toward the $7,000 annual limit. In addition, the individual must have earned income of at least the amount of the rollover and their own contributions. However, rollovers from 529 plans are not subject to income limits like regular contributions. If the Roth IRA owner has income

Setting Sail is written by **Alan S. Campbell, MBA, CFP®** and published quarterly by **Spinnaker Financial Advisors, LLC,** a Registered Investment Adviser. The firm provides ***fee-only*** wealth management services, including investment advisory and management services and comprehensive financial planning and consulting.

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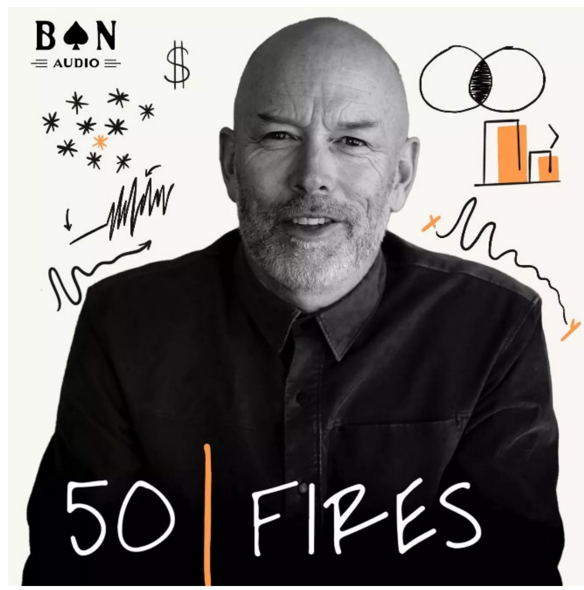
over $161,000 for single tax filers or $240,000 for married filers, they may not be eligible to make their own Roth IRA contributions, but 529 to Roth IRA rollovers are still allowed.

These rollovers must be direct rollovers from the 529 plan to the Roth IRA custodian. They cannot be paid to an individual and later contributed to a Roth IRA. Lastly, there is a lifetime limit of $35,000 per person for this rollover.

Lawmakers have carefully crafted these rules to address a common issue with 529 plans without creating a loophole. These new rules don't incentivize intentionally overfunding 529 plans. Instead, they allow for reasonable amounts of funds to be repurposed for other financial goals if the original education plans change. This provides a safety net for those in the accumulation phase, allowing them to confidently continue funding these accounts, knowing that there is a flexible option if plans change along the way.

Conversations About Money: A Resource



Part of being in polite society means not talking openly about politics, religion, and money. I suppose this norm is based on the idea of not being disagreeable about character-defining attitudes and traits. Money, in particular, can be a difficult topic because we all have different views on income, spending, debt, and other money-related topics. Often, we feel attached to the strategies that have worked for us or for our family and may judge others who take a different approach or who value different things. Some people define their value by their income or net worth and revealing too much may open them up to judgement or stereotyping from others.

I find this social norm challenging because I love talking about money and what makes people tick. Deep down, we all have feelings and beliefs about money that dictate our financial behavior. One of the most satisfying aspects of my job is hearing and understanding my client's feelings about money. For a topic that we don't talk about much, it surrounds us all the time. How we earn, save, invest, spend, donate, and share our money says a lot about us.

A new podcast called 50 Fires dives into this forbidden topic of money and meaning. The podcast is hosted by Carl Richards, a former financial advisor and artist of the financial-themed sketches seen around our office and produced by Chip and Joanna Gaines. Carl has deep, frank, funny, and often difficult conversations about money with guests from all walks of life. Rather than talk about specific numbers or investing strategies, the conversations include questions like "What is your first memory of money?" and "What Socio-economic group were you in during Jr. High School, and how did you know it?" Guests share what it is like to be a class migrant, what attitudes about money were shaped by their religious or faith tradition, and what money customs they learned from their family. Carl often speaks about how we use our capital, which he defines as our time, attention, money, and talents, to pursue our goals and to align our capital with our values and goals.

Even though we all have different financial lives, we all share the universal struggle to make sense of money. You may find that these conversations are a great way to learn more about yourself, your spouse, or your friends and discover what we value most as individuals. If you would like to tune in, "50 Fires" can be found on Apple Podcasts, Spotify, and most other podcast-hosting platforms.

2024 Tax Update

Every year, the formula for personal income taxes changes at least a little bit. Some of these changes are made by Congress, and others are simply cost-of-living adjustments that the IRS calculates according to the tax code. The historically high inflation of 2022 led to some significant changes for the 2023 tax year. However, with lower inflation in 2023, the charges are not as significant.

The standard deduction for married couples filing jointly for tax year 2024 rises to $29,200, up $1,500 from the prior year. For single taxpayers and married individuals filing separately, the standard deduction increases to $14,600 for 2024, up $750, and for heads of households, the standard deduction will be $21,900 for tax year 2024, up $1,100 from the amount for tax year 2023. In addition, taxpayers aged 65 and over get a bonus of $1,950 to their standard deduction for singles and $1,550 each for married filers.

The tax rates remain the same as 2023, but the level of income needed to be included in these brackets has increased. The tax bracket income levels have all increased by just over 5%. For example, for married filers to stay in the 12% bracket, they will need to keep their income under $94,300 in 2024 compared to $89,450 in 2023. The tax rates for ordinary income are 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

Contribution limits to Health Savings Accounts and retirement accounts have also been increased for 2024. HSA limits have been increased from $3,850 to $4,150 for single taxpayers and up to $8,300 from $7,750 for families. In addition, taxpayers 55 or older can contribute an extra $1,000 to their HSA accounts.

Traditional and Roth IRA contribution limits are also increasing in 2023. The new limit is $7,000 per person in 2024, up from $6,500 in 2023. Those who are aged 50 and over can contribute $8,000 this year. Taxpayers can contribute to either Traditional or Roth IRAs, or both, if the total contribution does not exceed these limits. However, you or your spouse must have earned income equal to or greater than the amounts contributed.

The income limit needed to make Roth IRA contributions has also been adjusted. In 2024, married taxpayers can make full Roth IRA contributions up to $230,000 of income with a phaseout amount available up to $240,000. Single filers reach the phaseout of the Roth contribution ability from $146,000 to $161,000.

The limit on employee contributions to a 401(k) is now $23,000 instead of $22,500 last year. Those aged 50 and older can now defer an additional $7,500 to increase the total to $30,500. Simple IRA contribution limits are up from $15,500 to $16,000, with a $3,500 catch-up bonus for those 50 and over. SEP IRA contribution limits are increased from $66,000 to $69,000.

For those interested in making gifts to family or friends, the annual gift tax exclusion has jumped from $17,000 to $18,000 in 2024. This is the amount any individual can gift to another individual without triggering a gift tax or even requiring a gift tax return.

On the flip side, the Social Security wage base has also been indexed to inflation. This is the amount of earned income that is subject to Social Security taxes before the tax doesn't apply. The wage base has increased to $168,600, up from $160,200 in 2023. If you have already started Social Security benefits but have not reached your full retirement age, the amount of earned income that you may receive before triggering any penalties is now $22,320 for the calendar year 2023. Above that threshold, one dollar in benefits will be penalized for every $2 earned.

Currently, Congress is working on a tax bill that has gained bi-partisan support at the committee levels of both the House and Senate. Tax bills are generally uncommon in election years, although this one is relatively small. The most important part for individual taxpayers is setting the refundable amount of the child tax credit to a higher level. Currently, the child tax credit for children under 17 is $2,000 per child. However, only $1,600 is refundable, meaning taxpayers can only use the full credit to reduce their taxes. If their tax bill is already at zero, they will only receive up to $1,600 per child. The new bill changes this refundable amount to $1,800 for 2023, $1,900 in 2024, and $2,000 in 2025. After that, the amount of the credit would be adjusted for inflation.

In 2021, Congress expanded the child tax credit to $3,600 per child and paid these credits in advance monthly. As a result, child poverty rates declined drastically as parents used the funds to cover rent, food, and other necessities. That higher amount expired at the end of that year, and child poverty rates came back up. This bill still has a long journey to President Biden's desk, but it looks to be on its way.

As always, we will provide our clients with annual tax planning updates based on their specific situations. If you would like to see the impact of these changes, please let us know, and we will prepare a customized tax projection for you.

If you don't do it this year, you will be one year older when you do.

-- Warren Miller (1924-2018)
American skier, film producer, and director