



### Case of the Week: Underwater 529

Even 529 college savings plans were not immune to the historic market losses of 2008. Our ERISA consultants on the Columbia Management Learning Center Resource Desk regularly receive calls from financial advisors who have questions about 529 plan contributions and rollovers. Through our relationship with the Columbia Management Learning Center, we regularly guide Columbia Management's financial advisor partners through the rules and regulations that govern 529 plans.

A recent call with an advisor in Michigan is representative of an unfortunate, and more commonly occurring, 529 plan scenario. The advisor's client had a 529 plan in Alaska that, as a result of investment losses, was now worth less than the amount of the original contributions. Because the Alaska 529 plan was "underwater," the client was wondering the following:

- 1) Are the 529 plan losses tax deductible; and
- 2) Could he/she make a cash contribution to another 529 plan (e.g., the Michigan 529)?

#### Highlights of Recommendations

- Because claiming a loss can be a complicated tax matter, it is always a best practice to suggest a client discuss the issue with a tax advisor.
- Generally, a taxpayer can deduct a loss in a 529 plan as a miscellaneous itemized deduction on Schedule A of IRS Form 1040, provided the following criteria are met:
  - ✓ The individual itemizes deductions;
  - ✓ The total value of the 529 plan is distributed, and the amount distributed is less than the unrecovered basis in the plan; and
  - ✓ The loss exceeds two percent of the taxpayer's adjusted gross income.
- As previously mentioned, in order to be able to deduct the loss, the client must fully distribute the account, *and cannot roll over the amount to another 529 plan*. If a cash contribution of an equivalent amount is made to another 529 plan within 60 days of the distribution from the Alaska 529 plan, the IRS would treat the contribution as a rollover, and the individual would not be allowed to deduct the loss.
- The client would be able make a cash contribution to the Michigan 529 plan after the 60 days had elapsed, and the amount would be treated as a new contribution to that plan.
- Note also that large miscellaneous deductions can trigger alternative minimum tax rules.

#### Conclusion

Losses in a 529 plan can be tax deductible under certain circumstances. When faced with this situation, financial advisors should suggest their clients meet with a tax advisor to discuss the specific requirements. For more helpful information on 529 plan issues, financial advisors can rely on the expert guidance of the Columbia Management Learning Center consultants.