College Keystones

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The 529 Explained

Of all the options a family has for setting money aside for college, the companies offering 529 plans have, by far, done the best job of marketing their option as the best option available for families interested in getting an early start on preparing for the daunting cost of college. This Keystone will explore the merits and drawbacks of a 529 plan.

It is important in this evaluation to understand the key benefit(s) of a 529 plan. For most it is the idea of being able to take out investment earnings for qualified educational expenses without incurring any income tax on the growth. With time and substantial earnings this most certainly can result in some significant savings. An additional benefit may be that state taxes can be avoided as well when using the 529 plan from the state in which you reside. Furthermore, investing in your state's 529 plan will provide those assets protection from bankruptcy and lawsuits.

In today's uncertain market and economy, I believe families need to determine their risk tolerance and decide if they want to SAVE or INVEST for college as there is a significant difference. Investing for college means that you are willing to take risk with your money. When you invest it is possible that you will lose some or all of your money. The only reason someone should choose to invest for college is if they believe that they have sufficient time to recover any losses before they will use the money, and they should also believe that the rate of return will be substantially higher for taking this risk.

Saving for college is more about protecting your principal first and your rate of return is secondary. Because you are not taking much, if any, risk the rate of return is going to be predictable but with less upside potential that comes with investing. Given the turbulence in the market this past decade, many people are simply less willing to take significant risk.

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529 plans are investment plans. Each plan, sponsored by a state, is managed by an investment firm or firms. You have a variety of mutual funds and mutual fund portfolios to choose from, however the overwhelming majority of choices involve risk. Furthermore, there are costs associated with each plan that must be overcome before you earn anything on your investment. These costs are incurred each year, even if your 529 investment doesn't earn anything.

While the tax free benefit is very enticing, a 529 plan without any growth really has no benefit. Consequently, a family with little time before college may have little opportunity to earn any money, therefore there may be little or even no benefit to them to invest in a 529 plan.

While most expenses such as tuition, room, board, and books qualify as qualified education expenses, you can't use expenses paid with a 529 distribution as a basis for calculating the American Opportunity Tax Credit. Since the IRS ordering rules say that credits are calculated first, you may lose some of the tax-free benefit that the 529 account provides because you can't use the same expenses for more than one education tax benefit. Furthermore, paying back student loans with 529 money is not considered a qualified expense.

A handful of states still offer prepaid tuition plans under their 529 umbrella, which provides you the opportunity to purchase future college credits at today's cost. It is important to read the fine print on these plans as you may be limiting the choices that your kids may have in their college selection with such plans.

Each state's 529 plan offers slightly different features and each has its own nuances. It is very important that you understand what you are getting into as well as the risks that you are taking. Only after you know these things are you able to determine if the risk is worth the reward.

We are in the business of helping families through the major life transition of sending their children to college. For many, it will be the most expensive time of their lives and, if not handled properly, could cost them their retirement. If you or someone you know needs the help and guidance of a trained financial professional, don't hesitate to contact your local College Planning Relief® Licensee. Remember, you shouldn't have to choose between your child's college and your retirement.

Scott Moffitt is one of the nation's leading experts in paying for college without jeopardizing retirement. He is the author of the book, "College and Retirement You Can Do Both!" He is the founder of College Planning Relief, a national training and certification program for financial advisors in short-term college planning, For more information about Scott or to find one of his certified licensees in your area, please visit www.collegeplanningrelief.com

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