THE WHITE PAPER

Your Guide to Life Planning

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Using 529 Plans to Save for College

Expecting a bundle of joy and wondering if you will be able to afford sending him or her off to college? Fortunately, you have a number of tax-advantaged federal and state college savings vehicles at your disposal, including the 529 plan, which comes in two varieties: the prepaid tuition plan and the savings plan.

The Prepaid 529 Plan

A prepaid plan allows you to pay now at today's rates for school tomorrow. In return, your account is guaranteed to pay for the tuition and fees at the state's public universities and colleges by the time your child graduates from high school. Note that prepaid plans often do not cover the costs for room and board. Your child also may use the prepaid account to attend a private or out-of-state school, but you might risk forfeiting some of its value depending on how the plan values its contracts. Note, too, that most prepaid plans require that you or your child be a resident of the state in which the plan is offered.

The 529 Savings Plan

The 529 college savings plan is far more flexible than the prepaid tuition schemes. The money accumulated may be used at any school you choose and for all qualified higher education expenses, including room and board.

Each state determines what the lifetime contribution limit or account balance cap will be in its 529 plan, but typically such limits range between $100,000 and $270,000. Investment minimums are low (most plans let you sock away as little as $25 a month as long as a minimum of $500 is accumulated within two years of the initial purchase date), and there is no restriction on how much you may contribute every year unless the account is nearing the lifetime cap.

However, since 529 contributions are treated as gifts subject to gift-tax limitations, if you want to make a tax-free contribution, it shouldn't exceed $14,000 annually ($28,000 if you're contributing with your spouse). There's one exception, however: You may contribute as much as $70,000 tax free in one year ($140,000 with your spouse), but that contribution will be treated as if it were being made in $14,000 installments over the next five years. That means you can't make other tax-free gifts to the beneficiary during that time.

Most 529 savings plans offer a menu of age-based portfolios, and some also offer a small selection of stock and bond funds. In the former case, your annual contributions get invested in a pre-selected portfolio of stocks and bonds. Early on, the portfolio is tilted toward stocks, and as the time for college nears, the weighting shifts toward bonds. You can switch investments up to twice a year.

The quality of 529 college savings plans varies by state, but in most instances you may open an account in any state you'd like. All 529 plans offer generous tax breaks, provided you use the money for qualified expenses. While your contribution is not deductible on your federal taxes, your investment will grow tax-deferred and withdrawals will not be subject to federal tax.

You should always compare the 529 plan of your choice with any 529 college savings plan offered by your home state or your beneficiary's home state and consider, before investing, any state tax or other benefits that are only available for investments in the home state's plan. You should always read the Plan Disclosure Document, which includes investment objectives, risks, fees, charges and expenses, and other information. You should read the Plan Disclosure Document carefully before investing.

Investment Risks

Investing in college savings plans comes with some risk. Unlike prepaid tuition plans, they don't lock in tuition prices. Nor does the state back or guarantee the investments. There also is the risk with most college savings plan investment options that you may lose money or your investment may not grow enough to pay for college.