The Basics of 529 Plans

A 529 plan, also called a qualified tuition plan, is a **tax-deferred savings and investment account that is designed to help provide funds for qualified educational expenses.** The money put into such an account may be used to help fund the postsecondary education of a designated beneficiary. The beneficiary can be anyone the account owner selects; it does not have to be a family member.

While each 529 plan account has a designated beneficiary, that person can be changed by the account owner once a year to one of the beneficiary's eligible family members. Account owners hoping to help pay for education for multiple children or grandchildren concurrently may want to open multiple accounts to avoid the administrative hassle of changing the beneficiary so as to pull funds out for a different student each year. Qualified withdrawals are federally tax-exempt, and many states also offer a tax deduction to people who contribute to their state-sponsored 529 plan.

There are two types of 529 plans: prepaid tuition plans and education savings plans. Each state and Washington, D.C., sponsor one or both types of 529 plans. A group of private postsecondary institutions sponsor a **prepaid tuition plan**. Many banks and brokerage firms also offer 529 education savings plans. Each plan has its own investment options and associated fees, as well as potential specific state income tax advantages, so it is important to compare your options and find the right plan to fit your family's unique needs and risk tolerance.

> **Note:** Specific rules vary, but you are *not* required to purchase a 529 in the state where you reside. This is good news for military families who have frequent moves. However, if you pay state income taxes in your home state, there could be an income tax deduction for residents who participate in their own state's plan – making it a more appealing option.

What is a 529 education savings plan?

An education savings plan allows the owner of the account to save money for the beneficiary's future education at any qualified institution, including colleges, universities, vocational schools, community colleges, and other postsecondary institutions that are accredited and participate in a federal student aid program. Many foreign institutions are also included. This money can be applied to tuition, room and board, books, mandatory fees, and more. Use of 529 plans is not limited to postsecondary schools—parents wishing to send their child to a primary or secondary school that charges tuition may withdraw up to $10,000 per year from the plan to pay those tuition expenses.

Money deposited into a savings plan is usually invested in a selection of mutual funds. Typically, savings plans offer target-date funds, meaning that investments become more conservative as the beneficiary's college attendance date approaches. The target date is generally the year you expect the beneficiary to need education funds, i.e., when your child or grandchild will start college.

The owner of the account maintains control of all funds, regardless of the age of the beneficiary. Money can be added to the account at the account holder's discretion, and there is typically no minimum amount that must be deposited. The money in the account grows tax-free, and as long as the funds are used for qualified education expenses, the withdrawals are not subject to state or federal taxes. Friends and family are usually also able to contribute funds to this plan.

How much money can be deposited into a 529 education savings plan?

The IRS does not specify annual contributions, but many plans do have total contribution limits. The total amount of money that can be deposit into a 529 savings plan depends on the state. Typically, these limits are between $235,000 and 529,000. Under federal law, a 529 plan balance cannot exceed the expected cost of the beneficiary's qualified higher education expenses. In some cases, once the limit for a single beneficiary is reached in a state, regardless of who is contributing money (for example, if a parent and a grandparent open multiple 529 savings plans in the same state for the same beneficiary), the savings plan will not accept additional contributions. Accounts in different states are not aggregated, meaning you could have multiple 529 accounts in various states each with their own limit.

> **Note:** As with any financial account, you may be charged account management fees. Because a 529 savings plan is an investment account, you may be charged an application fee, an advisor fee, a maintenance fee, and/or an asset management fee. When comparing different plans, ask for a schedule of these fees – small annual percentages can add up to a lot of money over 15–20 years.

It's also important to note that 529 plans do count as an asset for parents who open them for their children. When applying for financial aid, 529 plan balances must be reported as a parental asset, even if the beneficiary is another sibling.

What is a 529 prepaid tuition plan?

Less common than education savings plans, prepaid tuition plans allow the owner of the account to purchase "credits" at participating institutions that will help pay for tuition for the beneficiary when the time comes for them to attend college. Credits are purchased at the current price of tuition, allowing account owners to lock in cheaper rates than will be available by the time the beneficiary starts school.

Once you enroll in this type of plan, you will make payments that convert to tuition credits at a predetermined rate. Like the savings plan, any prepaid tuition credits used to pay tuition expenses can be withdrawn from the account tax-free. However, prepaid tuition plans will not cover room and board expenses. The beneficiary must also attend a school that is eligible for the plan (typically within the state university system), which limits education options. There may be other restrictions depending on where the plan was purchased, such as which graduate programs are included, even within the state system.

When should I start saving?

While anyone over the age of 18 can open a 529 account, it typically makes the most sense for parents or grandparents to open an account shortly after the birth of each (grand)child, specifying that child as the beneficiary of the account. They can then contribute to the account each year of their (grand)child's life, giving the investments 18 years to grow before money needs be taken out.

If you did not open an account when your child or grandchild was young, the next best time to start saving for college expenses is now. 529 plans are a simple and easy way for anyone to begin investing and grow their funds for ever-increasing higher education expenses.

To find out which plan may be best for your family, the National Association of State Treasurers offers a state and feature plan comparison **here**, or you can visit **CollegeSavings.org** to complete their 529 questionnaire.

What happens if my (grand)child gets a scholarship?

If the plan's beneficiary gets a tax-free scholarship or grant, funds can be withdrawn up to the amount of the scholarship to be used outside of qualified educational expenses without any penalty. However, any earnings on the withdrawal will still be subject to taxation. This also applies to any funds received by the beneficiary as part of the GI Bill.

What happens if my (grand)child decides not to go to college?

Should the beneficiary of a 529 plan no longer need the money for education, the owner of the account can change the beneficiary to another of the beneficiary's relatives without any penalty. If the account owner were to pass away, the account ownership will transfer to a successor as designated by the plan's original owner and any applicable state laws. While there are typically no penalties for this transfer, there are penalties if any money is withdrawn from the account and not applied toward qualifying educational expenses. Account withdrawals in this case will be subject to both state and federal taxes, and a 10% penalty will be applied to all earnings. For more information, see IRS Publication 970, Chapter 8: Qualified Tuition Program **here**.

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