Saving For College is Easy With 529 Plans

Saving for college has never been a cinch, but the U.S. Congress has made it a little easier. Congress has made the tax benefits of 529 college savings plans permanent, which is great news for parents saving for their child's college education.

529 plans are tax-advantaged savings accounts for saving for college. A 529 account is opened on behalf of a beneficiary, usually a future college student. You invest money in the account over time and your returns grow tax free. The money is then withdrawn to pay for college or other education expenses and you don't pay income tax on the growth when you withdraw it. If you withdraw the money for an expense other than qualified education expenses, there's a 10% penalty plus you have to pay taxes. However, 529 plans are usually transferrable between beneficiaries. So if you child gets a scholarship, you can move the rest of the money in the 529 plan to a sibling, cousin, etc.

All 50 states and Washington D.C. have 529 plans, and they each have slight differences. For example, some states offer state tax deductions or credits in addition to the federal tax benefits. They also have various minimum investment requirements and maximum amounts you can invest over the life of the account. Most of these minimums are small -- sometimes only $15. Maximums refer to how much you can invest in the 529 savings plan over time. This number is typically enough to cover even the most expensive colleges, and most states increase the maximum as college costs increase. The maximum amount you can invest in a 529 typically does not include your earnings. For example, if the cap is $300,000 and you invest $295,000 but the earnings are $50,000, you will not have hit the maximum even though you have $345,000 in your account.

Although your state offers a 529 plan, it's smart to consider other states' 529 plans as well. Some 529 plans underperform the market and others have high fees. If you decide to invest in another states' fund, keep in mind that you won't get the state tax benefits. Some states, such as Texas don't have income taxes, so residents of these states should shop around for a better deal on a 529 plan. Utah is an example of a state that has low fees for its 529 plans for both in-state and out-of-state residents.

Also, some 529 plans are "direct funds" whereas others are "advisor funds". A direct fund means you can invest directly with the state or the 529 manager. An advisor fund requires you to use a qualified financial advisor to purchase the fund.

Some states also offer a variation on the traditional 529 plan called a pre-paid plan. A pre-paid tuition plan lets you effectively "lock in" the future cost of a college education.

Regardless of which 529 plan you choose, investing in 529 plans is a smart move to invest for college. Between the low minimum investment amounts and the tax-free returns, a 529 is a great way to save for college.

About the Author

Andrew Allemann writes 529s.com, a site about 529 plans.