

Advantages and Disadvantages of 529 Plans

Advantages

- ▶ People of all income levels are eligible to contribute to a 529 plan
- ▶ 529 plans have high contribution limits (many plans have contribution limits of \$300,000 and up)
- ▶ College savings plans are open to residents of any state
- ▶ Plan contributions grow income tax deferred
- ▶ Withdrawals that are used to pay the beneficiary's qualified education expenses are completely income tax free at the federal level
- ▶ States may offer their own income tax incentives for residents of their state, such as a tax deduction for contributions or a tax exemption for withdrawals used to pay the beneficiary's qualified education expenses. Before investing in a 529 plan outside your state of residency, find out what state tax benefits, if any, you might lose if you do so.
- ▶ Plan contributions qualify in 2009 for the \$13,000 (\$26,000 for joint gifts) annual gift tax exclusion, and a special election lets you contribute up to \$65,000 (\$130,000 for joint gifts) in a single year and avoid gift tax by treating the amount as a gift in equal installments over five years (no additional gifts can be made to the beneficiary during the five-year period without incurring a gift tax)
- ▶ Plan contributions generally aren't considered part of your estate for federal tax purposes, yet you still retain control of the account during your lifetime as the account owner
- ▶ You can change the beneficiary without penalty if certain conditions are met
- ▶ You can contribute to a 529 plan and a Coverdell education savings account (ESA) in the same year for the same beneficiary without triggering a penalty
- ▶ Once every 12 months you can roll over the beneficiary's 529 account to a different 529 plan for the same beneficiary without tax or penalty implications
- ▶ Some 529 college savings plans let you change your investment portfolio once each calendar year and/or anytime you change the beneficiary (for 2009 only, states may permit 529 college savings plan investors to change the investment options for their existing contributions twice per year instead of once per year)
- ▶ A 529 account is treated as a parental asset for federal financial aid purposes (if parent is the account owner) and assessed at a rate of 5.6% (distributions aren't counted as parent or student income)
- ▶ A 529 account owned by someone other than the parent (like a grandparent) is not considered an asset for financial aid purposes

Disadvantages

- ▶ 529 plans charge various fees and expenses to cover investment expenses and the administration of your account
- ▶ Withdrawals from a 529 plan that are not used for the beneficiary's qualified education expenses are taxed and penalized (the earnings portion of the withdrawal is subject to a 10 percent federal penalty and is taxed at the income tax rate of the person who receives the withdrawal)
- ▶ For college savings plans, your investment choices are limited to the pre-established investment portfolios offered by the plan; prepaid tuition plans give you no opportunity to choose your investments
- ▶ You are generally limited to the prepaid tuition plan offered by your state of residence
- ▶ Prepaid tuition plans are generally designed to pay the undergraduate tuition (but not room and board) costs at in-state public colleges, so the beneficiary won't get the maximum benefits under the plan if he or she attends a private or out-of-state college
- ▶ Prepaid tuition plans generally require that all tuition credits be used before the beneficiary reaches age 30, and all withdrawals completed within 10 years of the time the beneficiary

starts college

- ▶ College savings plans don't guarantee your return and are subject to risk--you could lose some or all of the money you've contributed
- ▶ College savings plans aren't legally required to let you change the investment option on your existing contributions once per calendar year or allow you to choose a new investment option for any future contributions (though most plans do give you this flexibility)

Investors should consider the investment objectives, risks, charges and expenses associated with 529 plans carefully before investing. More information about 529 plans is available in the issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

The availability of the tax or other benefits mentioned above may be conditioned on meeting certain requirements.