# 529 Plans—A Smart Way to Save for College

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As the school year wraps up for students across the country, for many families, college is right around the corner. The cost of college is now one of the largest expenses many Americans incur. While the costs of higher education can vary depending on the type of school, location, and financial assistance, early preparation is always a good idea. ***One of the best ways to start saving is in a 529 plan, a tax-advantaged educational savings account***.

***What is a 529 plan?***

529 plans are similar to tax-advantaged retirement accounts, like IRAs and 401(k)s, in that the earnings and growth are not taxable while inside the account. As an additional benefit, you never have to pay taxes on the funds if withdrawn for qualified education expenses. Thanks to a tax law amendment in 2018, you can also use up to $10,000 annually for elementary or secondary public or private school. With these features, it is hard to find a better tax-advantaged savings tool for the cost of college.

Now you may be asking yourself, how do I start? Here are some guidelines for saving in a 529 plan:

***Determine how much to save***

- The future cost of college will vary depending on the school selected as well as the annual college inflation rate, which can range from 2-4%. For help with estimates, check out various online calculators that tell you how much you need to save based on the expected future cost.

- Your ability to save depends on how much money you have after paying your bills and saving for other goals like retirement. Don't underestimate the power of compounded growth; whether you save $10 a week or $10,000 a year, any amount will make a difference!

- The maximum 529 plan contribution is $15,000 a year per donor, but a special 5-year lump sum contribution allows for a one-time $75,000 contribution per donor (or $150,000 per couple, every 5 years). This is an excellent option for those who are able to save a lot. Overfunding is a worry that some individuals may have, but the beneficiary of the plan can be changed at any time if the original beneficiary does not require all of the funds in the account. Original contributions are also free to withdraw, though investment gains are subject to a 10% early withdrawal penalty, in addition to income taxes on the gains.

***Find the right plan provider***

- Start by evaluating your state's designated plan because some states offer tax deductions or credits for contributions into their own state plan. For instance, Massachusetts residences who contribute to the MEFA UFund 529 at Fidelity receive a MA state income tax deduction up to $1,000 for single persons and $2,000 for married persons filing jointly (https://www.mefa.org/products/u-fund-college-investing-plan/).

- When selecting a plan, compare the following features:
  - Enrollment, applications, maintenance, and investment fees
  - Maximum or minimum contributions limits
  - Ease of use of the website, ability for online transfers, and customer service
  - Ease of changing account owners and beneficiaries, and withdrawal restrictions, if any

***Finally, decide how you will invest your savings***

- The following are some of the most common 529 plan investment options to consider:
  - **Target date or age-based funds**: These funds estimate the year your child is expected to start college based on their current age. Funds are allocated according to that date, factoring in time horizon and the risk of loss based on asset allocation strategies. Generally, the longer time period for investment suggests a more heavy weighting in stocks which have higher potential growth along with higher potential losses. As the date the money is needed approaches, allocations to bonds and cash increase. This strategy is best for savers who wish to take a back-seat approach in investing.

  - **Static portfolios**: These portfolios will include a set objective determined by the owner. The objective can be aggressive, moderate, or conservative, or asset class specific to stocks, bonds, or a mixture. This is best for those who have a strategic goal in mind and do not want to frequently update the portfolio.

  - **Customized**: Some of the more robust 529 plan providers offer customized investment options. These include all of the above and more, potentially allowing for selection of specific funds for those who want to actively manage the portfolio.

***When it's time to withdraw***

For those who have successfully navigated the 529 system and saved for college, it will eventually be time to use the account value to pay for the expenses. There are two basic options for withdrawing the money. First, you can have money sent directly from your 529 plan to the college. Virtually all 529 plans have on-line access to request these payments. Consider this option if possible as it makes your recordkeeping much easier and eliminates questions from the IRS. Another option is to pay the college directly and reimburse yourself with proceeds from the 529 plan. Since the IRS will be sent a report of withdrawals out of the 529 plan, it's quite likely they will ask you to justify the withdrawals. Be sure to keep meticulous records of the college expenses should you be requested to produce them.

***Conclusion***

If you plan to help your child or loved one with the cost of college in the future, a 529 plan is an excellent tool to start saving early! If you have any specific questions reach out to your advisor, financial planner, or 529 plan sponsor.

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