Saving for College - 529 Plans

As the air chills and kids head back to school, thoughts turn to college plans - and for the parents, college costs. Last year, the average cost of a four-year public college increased 6.6% to $12,127, and 5.7% to $29,026 for a private four-year college. Congress, attempting to help parents save for their children's education, enacted tax code section 529 creating the 529 plan.

529 plans can be excellent estate planning components to provide for your child or grandchild while removing taxable estate assets. Every year, you can transfer up to $12,000 per person or $24,000 per couple for each recipient without any federal tax consequences. Additionally, 529 gifting shifts future asset appreciation from taxable to tax-free status.

There are two types of 529 plans – prepaid and investment. Prepaid plans allow the owner to pay tuition years in advance and lock in tomorrow's tuition at today's prices. Issued either by the state or educational institution, plan performance is based on educational costs – rising tuition results in a better deal. State-issued savings plans invest the money in specific investment portfolios, similar to many retirement accounts. Some plans even allow the investment mix to become more conservative as the student nears college age. Contributions are Maryland income tax deductible up to $2,500 per account or beneficiary, and withdrawals are free from both federal and Maryland income taxes so long as used for qualified educational expenses, allowing for tax-free growth.

Low initial payments and automatic deductions (as low as $25 per month) make these plans a convenient vehicle for college savings. Owner-retained control and the ability to change beneficiaries ensure maximum flexibility, as does the ability to use savings plan proceeds at nearly any educational institution (over 8,000 at present). Up to $250,000 can be placed into these accounts and will be protected from bankruptcy. Additionally, a special exemption allows up to five years of payments to be made up-front for increased tax-free growth.

The plans, however, are not without drawbacks. The owner can't manage the assets directly and can only change the investment mix once a year. In addition to the fees and charges the plans incur, the savings-based plan is subject to market fluctuations. And tax advantages are minimized for those who need the benefits the most – those in lower tax brackets. The accounts may also be counted as an asset and thus affect some financial aid, in addition to government benefits such as TANF, SSI, food stamps, etc. Finally, withdrawals may be subject to a 10% penalty and income tax if not used for qualified educational purposes.

Still, 529's should be seriously considered not just for income and estate tax advantages, but as a way to provide for the future of your family's education. More information about these plans is available at www.CollegeSavingsMD.org.

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