6 Questions About 529 Plans

What parents need to know about saving for college

If you're saving for your child's higher education, you probably have a lot of questions besides "When did college get so incredibly expensive?" One popular savings tool that might puzzle you the most is the 529 Plan.

Started in the late 1980s and operated by states and financial institutions, the 529 College Savings Plan offers tax-advantaged ways to save for various costs of higher education. What else should you know? Here's a list of commonly asked questions:

What can my child use 529 money for? The money can pay for qualified expenses such as tuition, fees, books, supplies, computer-related costs and room and board for someone who is at least a half-time student. Pizza, burritos and beer don't qualify, unfortunately.

How much can I contribute? The answer is not as straightforward as with an individual retirement account or 401(k) retirement plan. Generally, contributions to a 529 Plan max out at $350,000 per beneficiary.

You also need to remember federal gifting tax laws. A gift of more than $14,000 to a single person in one year incurs gift tax. A 529 allows an individual to potentially contribute up to $70,000 (married couples up to $140,000) tax-free in one year to an account for a beneficiary.

There are no age or income restrictions to contribute.

What if our relatives want to contribute? Family members can either open a 529 account and name your child as the beneficiary or kick into an existing 529 that they don't own.

If your family members contribute to a 529 account that they do own, they receive a state tax benefit if their state offers such a deduction. Opening just one account for the beneficiary and letting your family help fund it is usually simpler.

Why use a 529 over a regular taxable account? These accounts defer taxes and your contributions grow tax-free as long as you use the funds on the qualified expenses mentioned earlier.

This beats paying the government for an after-tax account – but the latter does offer complete flexibility on where and how you can spend the money. A 529 doesn't.

What if my child gets a full scholarship? You will not lose money.

You can withdraw from the 529 without penalty, though you do pay taxes on the earnings at the scholarship recipient's tax rate. You can also use your 529 to pay for expenses that the scholarship doesn't cover, such as room and board, books and other required supplies.

In addition, you can keep the 529 open with your child as beneficiary if he or she plans on graduate school, or you can also change the beneficiary and name another college-bound child.

What if my child does not want to go to college?
You can change the beneficiary to another family member (a sibling, first cousin, grandparent, aunt, uncle or yourself, for example), and the money goes toward that person's education. Most plans allow you to change your beneficiary only once a year, but if your child has a change of heart and does decide to attend college, you can rename that child the beneficiary.

Remember too that these funds can help pay for two-year associate degrees, as well as for trade and vocational schools.

A final option: Withdraw the money, or cash out the plan. You pay income tax and a 10% penalty on the earnings, but not on your contributions.

If unsure that your child is in fact headed to college, sit tight on cashing out. One thing you learn fast about young adults: life can always change.

Call me to discuss your options. I look forward to helping you better understand 529 plans.