Acorn Financial Advisory Services

Dispelling Myths About 529 Plans

Myth 1: You have to contribute to a 529 in your home state. That statement is false with regard to 529 college-savings plans, in which money is invested in a portfolio of securities on behalf of a beneficiary. Any U.S. resident can contribute to a 529 college-savings plan in any state. Contributing to a plan offered by your home state might offer an added bonus in the form of a state income tax deduction, but that shouldn't be your sole consideration. If your state's plan is poor (with high fees and poor investment options, for example) looking at plans outside your state might be worth forgoing the tax break.

Myth 2: You have to send your child to a school in the state where his 529 plan is offered. Also false. A 529 college-savings plan is fully portable, meaning that assets can be used for college expenses in any state and at some institutions abroad regardless of which state's plan holds the account.

Myth 3: You can only get a tax deduction if you contribute to your state's plan. Usually true, but not always. In fact, residents of Arizona, Kansas, Maine, Missouri, and Pennsylvania get a state income tax break on 529 contributions made to any state's plan. Elsewhere the benefit is restricted to contributions to in-state plans, with deduction limits varying from state to state and some states offering tax credits.

Myth 4: If you save in a 529 account for your child, it will hurt his financial aid prospects. Possibly, but not as much as you might think. Yes, financial aid calculations generally do take into consideration 529 assets, but money in a 529 account owned by the parents or a dependent student counts far less than assets owned by the student outside a 529. In fact, non-529 student-owned assets carry more than 3 times more weight in financial aid calculations than do assets held in the parents' names. So no, 529 accounts aren't completely impact-free when it comes to financial aid, but the impact is relatively minor.

Myth 5: If your child doesn't go to college, you'll lose the money. Unused 529 money does not have to go to waste, or to the tax collector. It can be used to help pay another family member's college costs simply by changing beneficiaries or transferring funds to the family member's existing 529 account. And the list of potential recipients is rather long, including siblings, first cousins, parents, grandchildren, aunts and uncles, and even in-laws. If you do decide to cash out the plan, you'll have to pay federal and state income taxes on earnings, plus a 10% penalty (waived if the beneficiary dies, becomes disabled, or gets a scholarship).

Myth 6: All 529 plans are the same. This is a potentially costly mistake some investors make. Like many investment products, 529 plans may look similar from the outside, but once you get under the hood you'll find major differences that determine how effective they can be at helping you meet your college-savings goals. Fees, fund offerings, glide path (the rate at which the asset allocation switches from equities to fixed-income in age-based portfolios), and even ease of use vary from plan to plan. Fees, in particular, can have a corrosive effect on 529 assets, and can vary not only from state to state but also within the same plan.