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Ten Minute Professor

More Questions About 529 Plans

Is investing in a 529 plan right for you?

By SAGE Scholars | Updated Summer 2020

Learning the financial landscape of 529 plans is important, as each college saving option may have a different impact on your eligibility for financial aid. If you need help determining which options work best for your circumstances, you should consult with your financial professional or tax advisor before you start saving. If you are interested in learning more about 529 plans, the following questions will provide a helpful overview.

How will a 529 impact financial aid?

Financial aid treatment depends on whether the owner of the assets is the parent, the student, or the grandparent. According to the federal financial aid formula, 5.64% of parental assets are expected to be contributed toward the student's college expenses for each academic year. However, if the investment is student-owned, the expectation rises to 20%.

529 plan assets are considered owned by the investor—typically, the parent(s) or the grandparent(s). So, if the 529 plan is parent-owned and the end-of-year balance is $10,000, a student's eligibility for need-based financial aid would typically be reduced by 5.64% ($564) for the subsequent year.

However, if the 529 plan is grandparent-owned, there would be no reduction in the student's financial aid eligibility—if no withdrawals are made. However, a withdrawal is typically treated by a financial aid office as student income on the FAFSA in the following year. Therefore, the standard advice for grandparent owned 529 plans is to make withdrawals to pay for the junior and/or senior year of college, eliminating any financial aid reduction for the student. Or the grandparent can make the parent the owner of the asset.

If the student becomes legally independent (no longer claimed by a parent as a dependent on the income tax return), it is possible that a 529 plan can reduce aid eligibility. Students frequently become independent and change their state of residence when attending an out-of-state public college; this enables students to claim residency and eligibility for in-state tuition. Withdrawals from parent-owned 529 plans may then be considered student income by the college. Likewise, if account ownership passes to the student, there are financial aid implications. Each college sets its own financial aid policy for independent students.

What questions should I ask before I invest in a 529 plan?

Is the plan available directly from the state or plan sponsor?

What fees are charged by the plan? How much of my investment goes to compensating my broker? Under what circumstances does the plan waive or reduce certain fees?

What are the plan's withdrawal restrictions? Are there limitations on the colleges and universities where withdrawals can be used?

What types of investment options are offered by the plan? How long are contributions held before being invested?

Does the plan offer special benefits for state residents? Would I be better off investing in my state's plan or another plan? Does my state's plan offer tax advantages or other benefits for its plan? If my state's plan charges higher fees than another state's plan, do the tax advantages or other benefits offered by my state outweigh the benefit of investing in another state's less expensive plan?

What limitations apply to the plan? When can an account-holder change investment options, switch beneficiaries, or transfer ownership of the account to another account holder?

Who is the program manager? When does the program manager's current management contract expire? How has the plan performed in the past?

What restrictions apply to 529 investments?

Investments: participants in 529 college savings plans usually have limited number of investment options which range from conservative to aggressive. Under current tax law, an account holder is only permitted to change their investment option twice per year if there is no change in beneficiary. However, you can change the investment options for your future contributions anytime you want.

Withdrawals: Withdrawals used for qualified educational expenses are tax free and can be used at any accredited college or university for full-time undergraduate and graduate students.

In 2017 the law was changed and now withdrawals used for qualified educational expenses include up to $10,000 annually of 529 savings that can be used for private school K-12 tuition.

Below is a chart of common educational expenses with their qualification status. Please note that although parents can withdraw money from a 529 plan at any

Expense	Is It a Qualified Expense?
Tuition and fees	Yes, up to the full amount of college tuition & required fees. As of 2017 you can withdraw up to $10,000 per year for K-12.
Books and supplies	For college expenses only
Computers and internet access	For college expenses only
Room and board	For college expenses only, if the student is enrolled at least part-time
Special needs equipment	For college expenses only
Transportation and travel costs	No, costs associated with transportation to and from campus (airfare or gas) are not qualified education expenses
Health insurance	No, even health insurance policies offered by a school are not considered qualified expenses
College application and testing fees	No
Extracurricular activity fees	No
Student Loans	Yes, the Secure Act created a lifetime limit of $10,000 in qualified student loan repayments per 529 plan beneficiary and $10,000 per each of the beneficiary's siblings

time for any reason, the earnings portion of a non-qualified distribution will incur income tax and a 10% penalty.

Losses: although profits on a 529 plan investment are not taxable at the federal level (and frequently not taxable on the state level), losses are not fully deductible. If the account is worth less than the investment, you can claim a loss only if:

1. You close the account
2. You liquidate all owned 529 accounts for the same beneficiary

If it is then determined that a loss has occurred, the liquidation amount cannot be paid towards educational expenses. This is called a non-qualified liquidation. The investor must claim it as a miscellaneous itemized deduction (not as a capital loss on the Schedule D). Miscellaneous deductions can be taken only to the extent that they exceed 2% of adjusted gross income.

Why can a 529 plan be essential in a divorce?

Natalie Pace, the author of "You vs. Wall Street" and the founder and CEO of the Women's Investment Network, LLC, wrote in the Huffington Post in 2011, "I've spoken to many divorcées who had divorce settlements that mandated money [be set] aside for college—only to discover, when it came time to pay tuition, that no funds had actually been saved. Or, the college fund had been drained to pay other bills. It's difficult, expensive, time-consuming, and simply too late to try and go back to court for a judgment in time to keep your kid in college. That is why setting up a 529 college fund that both parents are able to monitor annually (at a minimum) is a safeguard against this disaster."

Where can I find more information?

Offering circulars for 529 plans: you can find out more about a particular 529 plan by reading its offering circular. Often called a disclosure statement, disclosure document, or program description, the offering circular will have detailed information about investment options, tax benefits and consequences, fees and expenses, financial aid, limitations, risks, and other specific information relating to the 529 plan. The National Association of State Treasurers created the College Savings Plan Network, which provides links to most 529 plan websites.

Additional information about underlying mutual funds: you may want to find more about a mutual fund included in a college savings plan investment option. Offering circulars for college savings plans often indicate how you can obtain these documents from the plan manager for no charge. You can also review these documents on the SEC's EDGAR database.

Investment adviser public disclosure website: many program managers of college savings plans are registered investment advisers. You can find more about investment advisers through the Investment Adviser Public Disclosure website. On the website, you can search for an investment adviser and view the Form ADV of the adviser. Form ADV contains information about an investment adviser and its business operations, as well as disclosure about certain disciplinary events involving the adviser and its key personnel.

Broker-dealer public disclosure website: you can find more about a broker through the FINRA's National Association of Securities Dealers' BrokerCheck website. On the website, you can search for any disciplinary sanctions against your broker, as well as information about their professional background, registration, and licensing status.

Also check out:

- The College Savings Plan Network -
- https://www.collegesavings.org/
- The Internal Revenue Service's comprehensive Publication 970 - https://www.irs.gov/forms-pubs/about-publication-970
- Saving for College -
- https://www.savingforcollege.com/
- Morningstar - https://www.morningstar.com/

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