

The pros and cons of college savings plans

If you want your child or children to get a college education, brace yourself for costs that have long ago gone through the roof.

Private colleges can cost \$40,000 a year (or more) for tuition, fees, books, room and board. State college annual costs run anywhere from \$11,000 to \$20,000.

Where is that money going to come from? You can take out a second mortgage, dip into retirement savings, ask your child to apply for scholarships and loans and put your child to work in a part-time job. Still these options taken together may not be enough.

There is another popular alternative called a “529 plan,” based on Section 529 of the Internal Revenue Code, that allows you to save over time for your child’s education, and enjoy certain federal tax advantages as the fund grows (gains are tax-free), as long as the money goes toward your child’s education and meets the plan’s requirements.

The sooner you start saving in a 529 plan, the better, because you want the money to grow over several years. Starting one when Sally is 16 won’t do you much good.

Each state (and the District of Columbia) offers a plan. You can buy it directly from your state without a broker, who would charge a fee. The money can be used at any accredited institution. It doesn’t have to be used only for a school in the state where you have the plan.

Should you start a 529 plan? What are the pros and cons?

PROS

- Your investments grow **federal tax free** if the money is used for higher education.
- **Costs are low** for state-sponsored plans.
- **You control the money.** Billy can’t withdraw it and buy a nice new red sports car and ride off into the sunset. It’s your money. However, if you don’t use it for higher education, you may have to pay federal taxes on the investment gain.
- **Saving is easy.** Once you set up a plan, you can contribute by automatic withdrawal, and the plan will manage your investments for you, often at a very reasonable annual fee.

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- **Impact on financial aid is lower.** Only 5.6 percent of the plan assets counts as assets when you apply for financial aid. Normally, 35 percent of other assets count.
- **Almost anyone can afford to participate.** You can start a 529 for as little as \$25 a month and anyone, regardless of income, can participate.

CONS

- **These 529 plans sunset in 2010**, unless Congress extends them. Even so, investment growth after 2010 would be taxed at the beneficiary's tax rate, which likely is lower than yours.
- **The state income tax break** is confusing. If you own a plan from a state other than where you file your taxes, you can't get a state tax deduction. Even then, only 26 states offer a state tax deduction.
- **You don't control investment decisions** in state plans. The state plan administrator makes those decisions.

As you can see, the pros outweigh the cons. These 529 plans might be the best option for college saving to come along.

Useful 529 web sites

www.savingforcollege.com This is a great starting point for information on the plans and state-by-state comparisons of rules, requirements, fees and costs. There's a look-up tool to see if a school qualifies for payment under the plan.

www.collegesavings.org Sponsored by The College Savings Plan Network, this site has guidelines for parents, grandparents and employers on how to set up a plan.

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