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Section 529 Plans Are Now Better Than Ever

For the past several years, college costs have risen rapidly, and they're still going up fast. That's why you need to look at all possible college-funding sources – one of which is the Section 529 plan. And now, thanks to the recent tax reform legislation, this plan is better than ever.

Section 529 plans (named after the portion of the IRS code authorizing these accounts) have been offered in two different versions: a prepaid tuition program and a tax-deferred savings plan.

In the pre-paid tuition plan, you bought future tuition credit at an in-state, public school at today's prices. Under the tax deferred savings plan, your earnings grew tax-deferred until you withdrew the money to pay for qualified higher education costs. Withdrawals were then taxed at the student's tax rate. The new tax laws have changed both of these options. If you're interested in the prepaid tuition arrangement, you may be able to expand your choice of schools, because private institutions can now develop their own prepaid plans.

But the biggest change affects the tax-deferred savings plan. Starting in 2002, qualified withdrawals for college costs will be exempt from federal income tax*. No matter how much your account increases in value, you'll be able to take qualified withdrawals free of federal income tax. The new tax laws will also make Section 529 plans more flexible. You will be able to roll over your account tax-free and penalty-free to a different state's 529 plan, as frequently as once every 12 months. Previously, you had to change your beneficiary if you wanted to roll over your plan. In addition, you may now also change your investment options without changing your beneficiary once every 12 months – without hassles, taxes, or penalties.

This provision allows you to take greater control over how your 529 plan investment dollars are being allocated. Because different states choose different investment managers, there's a great deal of variability among plans in terms of investment philosophy, strategy, etc. Now, if you don't like the direction your 529 plan is taking, you can move your account or make a change in the investment options once every 12 months – without hassles, taxes or penalties.

Of course, Section 529 plans continue to offer the same significant benefits as always. For example, you've got great freedom in naming your beneficiary – you can choose anyone (typically a child or a grandchild). Plus, you can contribute large amounts to your plan. (Contribution limits typically vary by state.) And now, you can add tax-free qualified withdrawals and investment mobility to the list of Section 529 advantages. Put them all together and you've got a great college-savings vehicle – one that can help you cope with the high cost of higher education.

*Under a "sunset provision", these changes are scheduled to expire on December 31, 2010, in the absence of re-enactment.

If you have any questions regarding Section 529 plans, please feel free to call our office to discuss it at 847-486-9000.