MASTERCLASS: Breaking down 529 plan myths

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Rising college costs pose a significant challenge for many Americans. That's why it's important to know the facts about 529 college savings plans.

Planning for higher education expenses has become an important part of many investors' overall wealth managment strategy, and 529 plans are powerful, tax-advantaged investment vehicles built specifically for this purpose. Unfortunately, poeple may hold back from investing in a college savings plan because of some persistant myths:

Financial advisors

Watch [MASTERCLASS: 529 College Savings Plans on Asset TV] on Asset TV (free registration required). Learn more about 529 plans, and earn one hour of CE credit.

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"If I invest in a 529 plan, I won't qualify for as much financial aid."

Many people assume that financial aid will provide free money. But in reality, a significant part of financial aid packages could consist of loans that have to be repaid. Additionally, most financial aid is given based on an individual's need — and schools weigh parental and student income more heavily than assets. The formula used by the Free Application for Federal Student Aid (FAFSA) counts 22% to 47% of parents' income and 20% of student-owned assets such as UGMA and UTMA accounts toward the expected family contribution. But the formula only considers 5.64% of assets in a 529 plan owned by a parent.

"Investing in a 529 plan limits my options."

A lot of people assume that they can only invest in the 529 plan offered in their state. Others believe investing in a particular state's 529 plan means they must attend a school in that state. And many fear that if they don't end up needing their 529 assets for college, they will lose the money. None of these are true. You can invest in any 529 plan that fits your needs. You can use the assets for qualified expenses at any eligible educational institution in any state, including colleges, graduate schools, vocational schools, trade schools and, as of 2018, kindergarten through twelfth grade. If the withdrawal is not used for qualified educational expenses, taxes and a 10% penalty apply, but only to the earnings portion of the withdrawal. And the penalty is waived in cases of disability, death or if the beneficiary earns a scholarship.

"Investing in a 529 plan means the child or beneficiary always gets the money."

While the child is named as the beneficiary of the 529 plan, the owner of the account still owns and controls the assets. The owner can decide to name a new beneficiary or withdraw the assets and use them for a purpose other than education, although taxes and penalties may apply. The account owner is always in control.

Bottom line

Given the high cost of a college education, it's critical to look past the myths and make the most of 529 plans.

Investors should carefully consider the investment objectives, risks, charges, and expenses associated with a 529 Plan before investing. More information regarding a particular 529 Plan is available in the issuer's official statement, which may be obtained from the program sponsor or your financial advisor. Investors should read the 529 Plan's official statement carefully before investing. Clients should also consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other state benefits such as financial aid, scholarship funds or protection from creditors that are only available for investments in such state's qualified tuition program.

Withdrawal of earnings not used for qualified higher education expenses will be subject to federal and possibly state and local income tax and may be subject to an additional 10% federal penalty tax.

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