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A Quick Review of 529 College Savings Plans

As fall comes to the Village, it is the logical time for families to start wondering about funding future college expenses for children in their lives. Here is a summary of 529 savings plans.

The 529 college savings plans are operated by a state or school to help families save money for future college costs.

There are two types of 529 plans. The first is a prepaid plan, where you pay tuition for a designated school at the current tuition rate. This locks in the rate and saves you the assumed inflationary costs of paying later. These are usually for in-state public institutions, but they may be converted for some other uses. There is a single prepaid plan for private colleges, The Private College 529 Plan.

The much more commonly used type of 529 plan is a savings plan. Here, the saver invests after-tax dollars and the funds grow, hopefully, without any capital gains taxation. This is similar to an individual retirement account (IRA).

When you withdraw the funds, there are no taxes paid on the amount you contributed or on any of the earnings if the money is used for qualified education expenses. Over long periods

of time, this can be a significant amount and is a major tax incentive.

Qualified education expenses include tuition, fees, required equipment (i.e. computers), books, and portions of room and board. Of note, you can use the money from your New Mexico 529 savings plan to pay for school anywhere – it is not restricted to use in New Mexico.

Now, we all think our kids are amazing and hope they will get that coveted scholarship for college. Good news. If a student receives a scholarship, the amount of the scholarship can be withdrawn without the 10 percent penalty. So, that should not be a disincentive for saving in a 529 account. In addition, money in a 529 plan can be transferred, within standard guidelines, to siblings, parents, cousins, and other family members if it is not used for the original beneficiary.

Luckily, New Mexico is also one of the states that allows for an above-the-line (code for awesome) deduction of any contributions to a New Mexico 529 plan on your state income taxes. Contribution amounts and the tax benefits do have some limitations and should be reviewed with a tax

professional.

New Mexico has two 529 plans. The Scholar's Edge is only sold through financial advisors and is, frankly, much more expensive. The Education Plan is sold directly to consumers and is much more affordable. Both are run by Oppenheimer funds and have very similar portfolios. The portfolios all include age-based options where the investments automatically adjust as the child gets closer to college.

Now, the downside can be that the money has a penalty if not used in a restricted fashion. What if your kiddo does not go to college or you do not need the funds? If you do not use the funds withdrawn for a qualified educational expense, you will pay income tax and a 10 percent penalty on the earnings portion that you withdrew. Ouch.

For this reason, I often like to counsel clients to do strategic planning with the 529 being one important piece of the college funding puzzle.

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