

Tax Alert

Prepaid Tuition vs. College Savings: Which Type of 529 Plan is Better?

September 29, 2016



Section 529 plans provide a tax-advantaged way to help pay for college expenses. Here are just a few of the benefits:

- Although contributions aren't deductible for federal purposes, plan assets can grow tax-deferred.
- Some states offer tax incentives for contributing in the form of deductions or credits.
- The plans usually offer high contribution limits, and there are no income limits for contributing.

Prepaid Tuition Plans

With this type of 529 plan, if your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. This can provide substantial savings if you invest when the child is still very young.

One downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school. Another is that the plan doesn't cover costs other than tuition, such as room and board.

Savings Plan

This type of 529 plan can be used to pay a student's expenses at most postsecondary educational institutions. Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, supplies, computer equipment, software, Internet service and, generally, room and board) are income-tax-free for federal purposes and typically for state purposes as well, thus making the tax deferral a permanent savings.

The biggest downside may be that you don't have direct control over investment decisions; you're limited to the options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only twice during the year or when you change beneficiaries.

But each time you make a **new** contribution to a 529 savings plan, you can select a different option for that contribution, regardless of how many times you contribute throughout the year. And every 12 months you can make a tax-free rollover to a different 529 plan for the same child.

As you can see, each 529 plan type has its pluses and minuses. Whether a prepaid tuition plan or a savings plan is better depends on your situation and goals. If you'd like help choosing, please contact us.