

BY **Joshua C. Young, CFP®**
V.P., Wealth Advisor

How to Select a 529 Plan

Created by the IRS in 1996, 529 plans were designed to help families set aside funds to cover future college costs. We've discussed before how beneficial these plans can be (*see our Winter 2016 INVESTED article, "Managing the Climbing Costs of College"*), but even if you are well aware of these benefits, choosing the plan that's right for you can be overwhelming. There are a wide variety of plans out there, with many variations and important nuances—from different investment options to fee structures and administrative functionality. In this article, we outline some key factors to consider when weighing various plans.¹

Additionally, we've included a brief addendum regarding changes to 529 plans as a result of the 2017 Tax Cuts & Jobs Act. While most of the 529 plan landscape remains unchanged, there is one important exception we wanted to highlight.

State Income Tax Deductions

The primary benefits of 529 plans are tax-deferred investment growth and tax-free account distributions (for qualified educational expenses). In fact, these alone could lead to \$36,000 of total savings for a family looking to fund four years of private college for one child.² But another significant bonus for many is the ability to deduct state income taxes. More than 30 states offer full or partial state income tax deductions to residents who use the 529 plan sponsored by their home state.³ And seven states (Arizona, Arkansas, Kansas, Minnesota, Missouri, Montana, and Pennsylvania) offer this deduction to their residents for contributions to any state's 529 plan.⁴

All states' plans are available to everyone, so you are not limited to your home state's plan. In other words, you could be an Illinois resident, invest in a Utah plan, and send your student to college in Washington, D.C. Obviously, though,

if you don't live in one of the seven states listed above, you would be giving up the state income tax incentive you'd receive for contributing to your home state's plan. To determine whether this sacrifice is worth it, weigh the state income tax savings available from your home state's plan against the potential for higher quality investment offerings and/or lower costs in other states' plans.

Investment Options

One of the biggest differentiators between plans can be the investment options they offer. Some plans offer actively managed strategies while others offer passively managed ones. Some plans offer investments in the form of mutual funds, others as ETFs. Additionally, if you are interested in a more hands-off approach, there are "target-date" or "target-risk" funds. Much like a target-date 401(k) plan, these 529 plans will automatically adjust the underlying investments to decrease risk as the date of your first projected distribution gets closer. In all cases, you'll want to confirm the investment options offered have long-term, established track records.

Fees

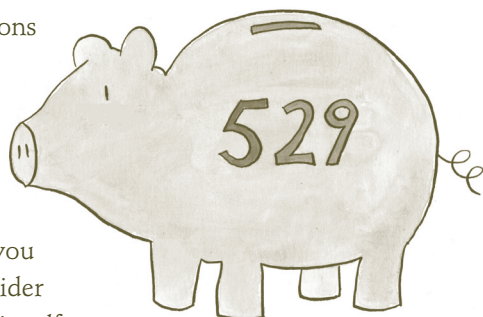
Most plans charge an annual fee, sometimes called an "administrative," "maintenance," or "program management" fee. Check to make sure this cost is reasonable; it can range from 0% to 0.25% of the account value, and some plans may offer fee waivers for accounts of a certain size. Also be aware that there will likely be an asset-based cost related to the plan's underlying investments. This cost will vary from one investment option to another, as it is based on the cost of the specific investments you choose. On average, 529 fees have decreased dramatically since these plans were launched back in 1996, but they can still have a meaningful impact on account performance over time.⁵ »

Flexibility

Evaluate the plan's flexibility related to where the funds can be used and by whom. Most plans' funds can be used at nearly all U.S. universities, not just those in your state, as well as several hundred international schools.⁶ For many plans, the beneficiary is also flexible. In those cases, 529 plan beneficiaries can be changed to another child in the family or even to the parents or account owner if needed, for post-graduate or other qualified coursework. This can be very helpful if you happen to have remaining funds in an account after a beneficiary has completed school, or if you have multiple 529 accounts and want to prioritize which to use first.

Administrative Considerations

Does the account have online access, so that you can easily track contributions, distributions, and growth? Are you able to make contributions electronically and/or set up automatic contributions? These considerations may seem trivial but can significantly impact how happy you will be with the plan you choose. Also consider whether the plan is self-directed or advisor-guided. Having an advisor-guided plan can simplify the logistics for you, and can allow your advisor to better coordinate your 529 plan's allocation with your broader portfolio. Finally, see if the plan has a minimum initial contribution. This can vary widely from \$0 to \$3,000 but is generally under \$100.⁷



Addendum | Changes for 2018: K-12 Education Funding

The 2017 Tax Cuts & Jobs Act added a provision to expand the benefits of 529 savings plans in 2018 and beyond. The GOP tax bill allows for as much as \$10,000 of 529 funds per year for private school K-12 tuition expenses.⁸ While the new federal legislation permits this expanded use of 529 plan funds, it is important to keep in mind that the plans are ultimately sponsored at the state level, and not all states necessarily follow the new federal guidelines.

As a result, there is still uncertainty around this expanded benefit, and it differs from state to state. In Colorado, for example, state lawmakers are currently reviewing whether 529 plan distributions for K-12 expenses will qualify for state income tax deductions or whether these withdrawals could be subject to state tax recapture and/or face state tax on investment gains.⁹ As a result, owners of Colorado-sponsored 529 plans are urged to be cautious and consult with a tax advisor before using these funds for K-12 expenses. Conversely, many states have already confirmed their conformance with the new federal provision. While we wait for clarity from all states, those who would like to fund a 529 plan or use an existing 529 plan for K-12 expenses should:

- » Consult with a tax advisor and your RMB wealth advisor before making any withdrawals or new contributions for K-12 expenses;
- » Call the administrators of the 529 plan and inquire about the potential consequences of a withdrawal for K-12 expenses;
- » If your home state has not yet confirmed its position, consider opening a new account to keep these funds separate from other 529 plan college savings balances. ■

1 There are a variety of tools out there to help you compare plan features. Savingforcollege.com and collegesavings.org both offer helpful calculators and allow you to compare plans from various states.

2 When calculating the initial lump sum needed to fully fund private college, the amount that a 529 plan required was \$36,289 less than a standard savings vehicle. Calculation assumes child of age two at time of initial funding and age 18 when starting college; private college cost of \$49,320 per year for four years, in today's dollars; college inflation rate of 5%; and average annual investment return of 5.65%. Source: MoneyGuidePro Financial Planning Software, "College Calculator" tool, April 2018.

3 "State Tax Deductions for 529 Contributions," FinAid, accessed on May 18, 2018, <http://www.finaid.org/savings/state529deductions.plhtml>.

4 Matthew Toner, "How much is your state's 529 plan tax deduction really worth?," Savingforcollege.com, March 13, 2018, <https://www.savingforcollege.com/article/how-much-is-your-state-s-529-plan-tax-deduction-really-worth>.

5 Joseph Hurley, "Understanding 529 Expenses," Savingforcollege.com, July 18, 2016, <https://www.savingforcollege.com/articles/understanding-529-expenses>.

6 "2018-2019 Federal School Code List," U.S. Department of Education: Office of Federal Student Aid, accessed on May 18, 2018, <https://ifap.ed.gov/ifap/fedSchoolCodeList.jsp>.

7 "Compare by Features," Savingforcollege.com, accessed on May 18, 2018, [https://www.savingforcollege.com/compare_529_plans/?plan_question_ids\[\]=387&page=compare_plan_questions](https://www.savingforcollege.com/compare_529_plans/?plan_question_ids[]=387&page=compare_plan_questions).

8 Dan Caplinger, "What Tax Reform Did for 529 Plans," The Motley Fool, March 23, 2018, <https://www.fool.com/taxes/2018/03/23/what-tax-reform-did-for-529-plans.aspx>.

9 "An Important Update on the New Federal Tax Law Changes," CollegeInvest, accessed on April 18, 2018, <https://www.collegeinvest.org/register/>.

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