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Pros and Cons of 529 Accounts for College.

A beginner's guide to the popular account for saving for college

When saving for college, it's often parents who need to educate themselves about the financial options they have in front of them. As with any major expense, understanding the impact your decisions will have on your future is the first step of the process.

One popular college-saving vehicle parents can evaluate is the decades-old "529" savings account. These accounts offer tax advantages but can also have limited utility since the purpose is so specific.

These are some of the pros and cons of 529s:

The Pros:

- Money in 529 accounts grows tax-free and remains that way until you withdraw it for qualified educational expenses.
- Depending on where you live, you could be eligible for tax deductions or credits if you invest in a 529. More than 30 states offer some kind of tax break.
- The account's beneficiary can usually be changed later on to a different direct relative if your child doesn't end up using all the money in the 529. That provides flexibility and can allow the account to survive for generations.
- Anyone can contribute, though it's best to have a parent own the account for tax reasons.
- 529s can offer financial-aid advantages. While the Fafsa, the federal application that determines financial-aid eligibility, typically counts 20% of student-held assets as available funds to pay for college, 529s owned by students or parents are only considered at 5.64%.

The Drawbacks:

- 529s can be restrictive. Once you invest into the account, the money is earmarked for higher education. Withdrawing the money for any other purpose will impose penalties and fees on the money you've saved.
- What counts as qualified educational expenses can be confusing. Many community colleges, for example, don't include room and board in their total cost of attendance, meaning funds in a 529 can't be used to cover that part of the college experience.
- The plans are subject to changing tax regulation conditions. What the funds can be used for has expanded, but since they're tax-advantaged, the uses can change in varying political conditions.
- There isn't a one-size-fits-all approach to 529s, which means how you open and maintain the account could subject you to higher fees.
- Noncustodial guardians or grandparents who open 529s will face a tougher road with financial aid. As soon as a student withdraws money, it can be counted as untaxed income, which can be counted toward the expected family contribution calculation at a rate of up to 50% of the amount.
- The funds in a 529 cannot help for precollege expenses, such as campus visits or application fees.

Your Resources

Depending on your personal situation, some advantages could work against you and some of the disadvantages could work in your favor. For example, if you don't have a direct relative to whom you can transfer the account, you'd need to get creative about spending down the money in that account if there is any left over.

As with any major decision, you need to consider the future to determine how your actions now could affect your financial reality. If you are unclear, a financial professional can help you sort through the nuances. But there are resources available to you before you seek out professional advice.

The SEC has a 529 account guide for investors as they weigh their options. It dives deeper into the specifics around the tax code. Using the information here in conjunction with the government's guide can be a good way to begin evaluating your options.

Additionally, Chana Schoenberger writes a regular column about saving for college and recently answered the top six questions she has received about the often-confusing plans. She has answered several years of questions that range from common to unique, which may prove helpful to your decision.

However you approach the decision, it's important to consider all the information in front of you. There may be further considerations beyond the pros and cons listed that apply to your particular situation.

But as tuition prices continue to rise, your savings options now could affect your child's college choice in the future. Being financially smart can mean that your money isn't the one making the final decision for them.

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By Kevin McAllister

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