The Wide World of 529 Plans - Transcript

Tom Mullooly: In episode 124 we're going to talk about the wide, wide world of 529 Plans. Stick around.

Welcome to the Mullooly Asset Show, I'm your host, Tom Mullooly, and this is episode number 124, where we're going to talk about 529 accounts, 529 plans.

Why do people shy away from using these 529 accounts? I read a stat recently, and we'll link to it in the show notes, that only 16% of parents with college age kids have actually put money into these 529 accounts. Why? They were first rolled out about 20 years, I think 1997 or 1998.

And I have to chalk it up to the fact that there's probably a lot of misinformation, or folks simply don't know what's going on. So, the four top things that we hear from folks about 529s are. "I'm not putting money in it, because my money's locked up." The second thing is, "I'm not sure if Junior is really going to be college material." The third thing that we hear, or get asked about is, "Hey, what if they get a scholarship? Then I put that money away for nothing." And the fourth thing is, "Hey, we've heard about the costs and the fees of 529s. They can be excessive. What's up with that? Maybe there's a cheaper way to do this."

So, let's take these one at a time. First, the money is locked up. Is it really? Is it really? What if you don't use 529 money for college? What if you're in a pinch and you really need the money? Understand, first thing I'll tell you is under the new tax law, you can use up to $10,000 per person per year for education costs for private school from K through 12. So, you don't necessarily have to use it for college, you can apply some of this toward high school and grammar school, private school costs.

The other thing, more importantly to think about with 529 contributions is that all of the money that's put into this plan goes in on an after tax basis, so you've already paid tax on it. What does get taxed, the earnings. And earnings plus 10% are what's going to be taxed on the way out if you're really in a jam and you've got to take the money out, and it's not related to an educational expense. What this also means is that your principle can be withdrawn without a penalty. Please understand that.

So, if you don't have an education related expense, the earnings will be taxable to you, plus a 10% penalty on the earnings, not the principle. It's very important to understand that.

So, the second thing. "We don't know if Junior is college material." How could you know? He's an infant, or she's an infant. You're not going to know that. Why don't you really let Junior decide that. You're partially making the decision for them by announcing you're not going to put any money away for college. And you haven't saved anything. One other thing that I will point out, when we're talking about, "I don't know if Junior is college material," understand that you can use 529 money for vocational schools and for trade schools. So, if you have a family member that's going to be an electrician, they can use this money for something like that.

So, the third point, "What if my kid gets a full ride? What if they get a feel scholarship to college?" One of the things we then hear is, "We saved, and saved, and saved. And then we can't use it." Or, "We don't need to." Well the first thing I'll tell you is you can shift the money in a 529 to another beneficiary. Another child in your family. You can shift it to a sibling. A sibling of yours. You can use it to pay for college for a first cousin, for a grandchild. You can use it for yourself if you're going to go back to school. You can change the beneficiary usually once a year.

Incidentally, you should know that if your child does get a full scholarship to college, the penalty on the withdrawal of the earnings is waived. Good tip.
The fourth thing I want to cover is the cost, or the fees that are associated with 529s. I'll be the first one to tell you, we think that sometimes these plans can be expensive. The other thing we'll tell you is that they often limit the number of transactions that you can make in your account. So, don't think you're going to be date trading your kids 529 account. First of all, that's just reckless. And secondly, it's not what they're designed for. They want to limit how many times you can make portfolio changes. We think that's a good idea.

But understand that many plans ... the plans are sold by the state, and there's usually a broker sold version in the state, and there's the state, or direct to consumer plan that's out there. The direct to consumer plan is the way that we would tell you to go. You can usually open an account right on the state website, or the state 529 website. You can open the account online, and it's super simple to set up. You can give us a call, we can talk about what kind of allocation choices you may have. But there's a lot of misunderstanding that still goes on with these 529s 20 years later.

Talk with a financial planner, talk with your investment advisor. Talk with someone before you make the decision, "Meh, we're not going to money away for Junior." See you next time.