Contributing to a 529 Plan

A "***529 Plan***" (also known as a *Qualified Tuition Plan*) is a savings account for college. The IRS has a provision that if you contribute money a 529 Plan, there will no tax on the **earnings** in that account, **if** the money is used for qualified college expenses.

While that is nice, the interest on those accounts is sometimes minor, in which case not paying tax on it is often not a big deal. However, Minnesota just passed a new law that makes 529 Plans much more valuable.

The simplified explanation: **If you contribute $1000** to a 529 plan, **you can save up to $500 on your Minnesota tax return.** You can do this **every** year. Effectively it is only costing you $500 to put away $1000 for college.

Sounds fantastic, right? Well here are a few things to consider before making the decision to contribute to a 529 Plan. However, these are only generalized points, so please ask me if you have any questions about your specific situation.

First, a few potential negatives:

- If your income is under $75,000, you qualify for the full $500 credit. It slowly phases out, so once your income reaches $160,000 ($100,000 if not filing Jointly), the credit is eliminated.
- If your family income is below $80,000, Minnesota has a new plan (North Star Promise) that may pay for all tuition if the student goes to a Minnesota Public state college or university. But the 529 plan might be able to be used for other things, such as housing.
- If your income is very low so that your total Minnesota tax is less than $500, this credit can not be 'refunded' to you. It is limited to the total amount of Minnesota tax.
- If you withdraw the money and use it for something **other** than qualified college tuition (non-qualified expenses), you must repay this credit (plus any interest that it earned will be subject to tax and a 10% penalty).
- Like other savings accounts, your money in a 529 will be taken into account when you apply for financial aid, so the 529 Plan could slightly lower your financial assistance.
- The student must be at least a half-time student. So just taking a class or two would not qualify to use a 529 Plan.
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A few other points to consider:

- If the total annual qualified college expenses (**after** scholarships) are less than $2000, the American Opportunity Credit would be better than a 529 Plan, so a 529 plan would not be useful for tuition. However, see the next point below for why it still could be useful.
- A 529 plan can also be used for student housing. Student housing includes (a) on-campus housing, (b) off-campus housing, and in some cases even (c) living at home with the parents. The amounts vary from college-to-college, and vary between the three situations. Contact the financial aid office of the college to ask for details about their "*Allowance for Room &Board*" as part of their "*Cost of Attendance*" (COA).
- If the total annual qualified college expenses (**after** scholarships) are between $2000 and $4000, the American Opportunity Credit will reduce the benefit of the 529 Plan credit. However, in most cases you would still save money by using the 529 Plan.
- If the total qualified college expenses (**after** scholarships) are over $4000, this is a **really** good deal.
- You can open your 529 Plan with any State; it does not need to be Minnesota. Some State's 529 Plans have better earnings than others, and some States also make it easier for non-Residents of that State to open an account. One article that I read suggested that California and New York are particularly accommodating to non-Residents of those States, and historically have above-average earnings on the contributions. However, I recommend you do your own research before deciding which State to open you 529 Plan.
- If the beneficiary (student) of the 529 Plan decides not to go to college (or not use the 529 Plan), you can always re-designate the beneficiary. It can be transferred to other children, grandchildren, or anybody else. If you want to set up a 529 plan for somebody outside of your immediate family, please talk to me first.
- You only qualify for the credit for your 'net' contributions for the year. For example, if you were to contribute $1000, but then you also were to withdraw $800 for college expenses, you would only get a tax credit based on the $200 contribution. If you withdraw more than you contribute for the year, you would not qualify for a tax credit that year.
- Although Federal law now allows money from a 529 Plan to pay for K-12 tuition (for example, "private" schools or some online schools), Minnesota does NOT conform to that part of the law. So you can NOT use money from your 529 Plan for K-12 purposes without *significant* consequences from Minnesota (see prior comments about repaying the credit for non-qualified expenses).