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**GETTING GOING**

By JONATHAN CLEMENTS



## **Choosing a 529 College-Savings Plan: When It Makes Sense to Go Out of State**

It's time for some adult education.

The allure of 529 college-savings plans is simple enough: They let families save tax-free for college by investing in a menu of mutual funds. Yet many parents are utterly baffled by them -- and understandably so.

There are now 85 savings plans available, with many states offering additional state tax breaks and some sponsoring as many as four or five different 529s. Overwhelmed by the choice? Here's how to cut through the confusion.

- **Staying home.** No matter which 529 plan you buy, your withdrawals should be exempt from federal taxes, provided the money is used for costs at an eligible college in the U.S. or abroad. Unless Congress acts, this tax-free treatment will disappear in 2011.

Uncle Sam isn't the only one handing out tax breaks. The District of Columbia and 27 states now offer a state-tax deduction or credit to residents who fund an in-state 529 plan.

There may also be other benefits for sticking with an in-state 529 plan, such as a matching contribution for low-income households or stronger protection against creditors. Given all that, "my recommendation is always to start with your own state's plan," says Joe Hurley, founder of [www.savingforcollege.com](http://www.savingforcollege.com)<sup>1</sup>, an independent Web site devoted to 529 plans.

Yet that may not turn out to be your best choice. The value of the state-tax break varies widely. For instance, a fistful of states limit the deduction to the first \$2,000 of annual contributions.

In other words, if you pay 5% in state taxes and you invest \$2,000 in an in-state 529, you would save \$100 in taxes. If you itemize your deductions on your federal-tax return, the decrease in your state taxes would be partly offset by an increase in your federal-tax bill.

**Saving for College**  
Looking for a 529 college-savings plan? Here are five top choices.

STATE/PLAN	NUMBER OF FUNDS	ANNUAL EXPENSES
Michigan Education Savings Program	3	0.6%
Nevada/Vanguard 529	20	0.6-0.79
New York 529 Direct	15	0.56
Utah Educational Savings	9	0-0.41
Virginia/CollegeAmerica (F shares)	21	0.78-1.37

Sources: Savingforcollege.com, plan Web sites

Other states are more generous, with Colorado, New Mexico, South Carolina and West Virginia allowing taxpayers to deduct their entire 529 contribution. With these plans, you could invest, say, \$60,000 in one shot and save thousands of dollars in taxes. Even so, you may still be better off investing elsewhere.

"You have to weigh the tax deduction against the plan's investment costs," says

Mark Balasa, a financial planner in Itasca, Ill. "And then, overlaid on all this, is the quality of the investment options. My heart goes out to people. It's just so complicated."

A rough rule of thumb: If your state offers a tax deduction, your state-tax rate is high and your kid is within seven or eight years of college, seriously consider funding your in-state plan.

But if your child is just a toddler and your in-state plan has annual expenses equal to over 0.8% of assets, you may want to pass on the state-tax break and instead go for a low-cost out-of-state plan. The lower costs should translate into years of higher returns, thus compensating for the missed tax savings.

- **Consider West Virginia.** It offers a generous tax deduction and state taxes can run as high as 6.5%. Problem is, if you invest in the state's Smart529 Select, you would pay annual expenses between 0.75% and 1.05%, with the higher costs incurred by those who invest heavily in stocks.

"That's more expensive than a low-cost plan like Utah," notes Jim Winter, a financial planner in St. Albans, W.Va. "If you've got a real long time horizon and depending on the timing of your contributions, it may be worth going out of state."

- **Hitting the road.** Not crazy about your state's plan? If you are a tightwad like me, you will be hard pressed to do better than the Utah Educational Savings Plan, which offers a series of bargain-priced funds run by Vanguard Group of Malvern, Pa.

The plan charges maximum annual expenses of 0.41% and a maximum annual account fee of \$25. Utah's 529 even includes a no-cost money-market account that was recently yielding over 4%.

The downside: The Utah plan has a limited array of investment options, including five portfolios customized to a child's age, two stock funds, a bond fund and the money-market account.

• **Looking for more choice?** If you want a heap of Vanguard investment options, consider either the Nevada-sponsored Vanguard 529 College Savings Plan or New York's 529 College Savings Direct Plan.

The Nevada plan has three age-based portfolios and 17 individual investment options. Expenses range from 0.6% to 0.79%. The New York plan has somewhat less choice, with three age-based portfolios and 12 individual investment options. But costs are also slightly lower, at just 0.56%.

Like Vanguard, New York-based TIAA-CREF has a hand in running a slew of 529s and expenses are typically very reasonable. Among the TIAA-CREF plans, possibly the most appealing is the Michigan Education Savings Program, which charges just 0.6% a year.

• **What if you use a financial adviser?** If there isn't a strong tax reason for sticking with an in-state 529, ask about Virginia's CollegeAmerica plan, which allows college savers to invest in the well-regarded American Funds.

"It's our top choice," says Rich Chambers, a fee-only financial planner in Menlo Park, Calif. The Virginia plan has a variety of share classes, including F shares, which allow advisers to sell the plan without a sales load.

"Most of these plans have these brainless age-based allocations," Mr. Chambers notes. "But we feel it just gets way too conservative." The big draw of the Virginia plan, he says, "is being able to completely control the asset allocation and getting access to these really good American Funds with the load waived."