

# How to Use Your 529 Plan

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QUESTION: What do you think is the best way to save for my children's college expenses?

Podnos: Hands down, a 529 plan is the best way to save for a child's college education. There

are hundreds of these plans nationwide, and they allow tax free earnings to be used for educational expenses.

The first thing to know is that there are broker sold plans with high expenses. Avoid them and do it yourself. Many states have their own plans with online enrollment and low expenses. The large no load brokerages (such as Fidelity, Vanguard and Schwab) all have low cost good plans that are useful nationwide.

With these plans, you deposit after tax funds with a parent or grandparent as “owner” and a child as beneficiary. The beneficiary can change later on. The “owner” can pull back funds anytime (with taxes and a penalty on the earnings only), but if the money is used for educational costs for the beneficiary, any earnings come out tax free. The funds can usually be invested in a customized portfolio (all stocks, etc) or defaulted to an “age based” schedule of decreasing stock and increasing bond investments as the date of college approaches. In most states (including Florida), these funds are protected from creditors.

Some states also have a variant of 529 plans that involve “prepaid” tuition. These are fine investments as well, as they are guaranteed to keep up with the rate of educational inflation, which has been more than general inflation for the last few decades. If you don’t use the prepaid tuition at a State School, you can get a refund adjusted for inflation to use elsewhere. There is even a “private college” 529 prepaid tuition plan that allows funding of tuition by paying for today’s costs. It covers about 300 private universities. Note that the general 529 plans (not prepaid tuition) allow use of the money wherever one goes to school.

Note that distributions should be taken within three months of the calendar year in which they are incurred, and that distributions to pay for room and board should conform to the cost of doing so through the university housing/food system. Beginning in 2018, 529 money can also be used for private school before college. But doing so removes some of the additional long-term tax free gains from waiting till the child is older.

The one mistake I’ve seen with these plans is having too much money in them. If this happens, the owner can take out the funds and pay the taxes/penalties on the earnings, or leave the funds for the next generation and their educational expenses. We find that these vehicles are nice for grandparents, in that they retain control of the funds if needed, but have the benefit of asset protection and tax free growth if used by children or grandchildren.

I can’t recommend any better way to save for your child’s or grandchild’s educational costs. Trusts and Life insurance are touted by some, but are almost always bad choices.

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