Saving for College: 5 Costly Mistakes to Avoid

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Just because you've researched the right 529 college savings plans for your children—and funded them appropriately—doesn't mean your job is done. Not quite yet. Saving for a child's college education is never easy. But 529 college savings plans offer an excellent option: These investment vehicles were expressly designed to cover higher-education expenses with tax-deferred growth and the potential for tax-free qualified distributions.

The Tax Cuts and Jobs Act of 2017 expands the qualified use of 529 savings accounts by allowing withdrawals for K–12 tuition expenses, with a limit of $10,000 per year, per child.* While individual states are developing their own policies on how this may impact their particular programs, many states continue to offer tax benefits for contributions to their plans. Although you're not restricted to your own state's plan, you should always consider the tax benefits provided by your state before investing in another's.

But 529 plans don't guarantee that you'll save enough to pay for tuition by the time the first bill comes due. They still require careful management between the time you set them up and when you begin to pay tuition. You'll need to determine your contribution rate (if you haven't calculated the monthly figure yet, use our college savings calculator) and how to invest your contributions.

You can improve the benefits you receive from investing in a 529 plan by avoiding these five common mistakes.

Mistake #1: Assuming your money will grow

A 529 plan might be called a college savings account, but don't let the word "savings" fool you. Like a 401(k), your money isn't guaranteed to grow, and your plan's performance depends on your investment selection, as well as market conditions. Your investments can fluctuate and you can lose money that you invest in a 529 plan. Your purchasing power can also decrease due to inflation, which means your investments won't keep up with the cost of college. You can mitigate the risks by starting a 529 plan early so that you have more time to try to recover from market losses, choosing a diversified portfolio of investments based on your risk tolerance and time horizon, and taking advantage of potential compounding growth over time.

Mistake #2: Forgetting to adjust your asset allocation and savings rate

When you shop for a 529 plan, you typically have the option of choosing an age-based strategy or a static one. An age-based portfolio holds more stocks than bonds initially, when the child is younger, and grows more conservative the closer the child gets to college age (similar to a target-date fund).

The static option sticks to the mix of assets you pick. If you go with this option, bear in mind that you're responsible for periodic rebalancing, and for adjusting the asset allocation over time. As with many investment goals, the standard advice here is to reduce your equity stake as the time for college enrollment approaches.

Setting up 529 contributions automatically is a great way to get things rolling without having to think about it. Also, it's not a bad idea to increase your annual contribution as your earnings grow, particularly if you're starting off with a modest amount. Many parents supplement regular automatic contributions with periodic contributions from birthday or other holiday gifts from friends and family.

Mistake #3: Getting the timing of your contributions wrong

Contributions to 529 plans must be made by December 31 to have them count toward the current year for gift tax purposes. This differs from tax-advantaged retirement savings accounts like IRAs, where you typically have until mid-April of the following year to contribute for income tax purposes. However, if your 529 plan offers a state income tax deduction, the April deadline might apply in that case.

Mistake #4: Getting the timing of your withdrawals wrong

Once your child has begun college and the bills start rolling in, be careful to take out only the money you will use for qualified college expenses within that calendar year. Keep this in mind for the end of the year with tuition bills that arrive in December and aren't payable until January.

Also, make sure the expenses you intend to claim are on the IRS-approved list of qualified expenses for 529 plans, and aren't already covered by other tax-advantaged sources like scholarships.

Mistake #5: Emptying an account when your child doesn't need the money

Speaking of scholarships, what if your child ends up winning a full or partial free ride to college? In that case, you can withdraw the *exact* amount of the scholarship, and the usual 10% penalty on nonqualified distributions of earnings would be waived. Ordinary income taxes will still apply, however. The remainder in the account can be used for other qualified expenses that aren't covered by the scholarship.

If some of your child's college expenses don't qualify, you have other options before you resign yourself to taxes and penalties. If your child intends to pursue an advanced degree, you could leave the money in the plan where it will continue to have tax-deferred growth potential and can later be used to help pay for graduate school.

Or, if you have other children, you could make them the beneficiaries of the funds without paying any penalty or tax. Just be sure to make the switch before the next child begins college.

A third option is to designate yourself the beneficiary, and apply the funds to your own continuing education courses. You can also wait and designate the funds for your grandchildren.

*You should consult with your specific 529 provider and tax advisor before using a 529 plan to pay for any K–12 tuition expenses.

What you can do next

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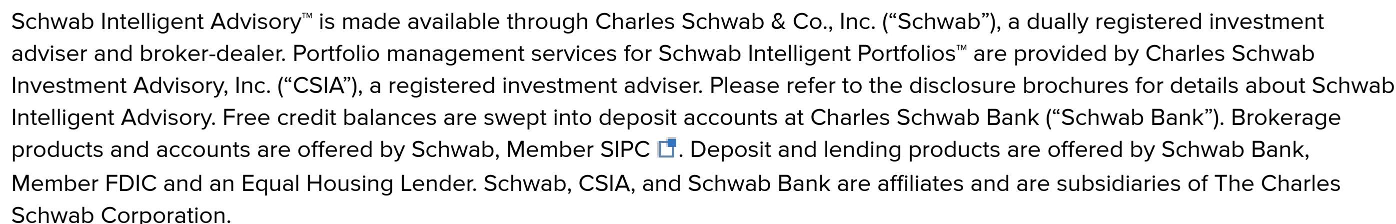

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