College knowledge: Debunking 529 plan myths

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Even in the best of times, many investors aren't up to speed on 529 savings plans. But with the recent uncertainty related to COVID-19, it's even more important now to debunk common myths that can cause parents, grandparents, aunts and uncles to miss out on the potential tax savings and college planning benefits.

What is a 529 plan?

Let's quickly debrief before we debunk. Named after Section 529 of the U.S. tax code, 529 plans are sponsored by individual states but are generally open to everyone. In most cases, you can invest in any state's plan and use the money at any accredited college throughout the country as well as many institutions overseas.

Here's how it works: You open an account and name any child or adult as beneficiary. Contributions are made with after-tax dollars. Investment earnings aren't taxed while in your account, and withdrawals are tax free when used to pay qualified education expenses. Because your earnings grow tax-deferred, your account has the potential to grow faster for a loved one's future. That's a huge benefit.

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Myth: "I don't need a 529 plan. Financial aid will pay for college."

One of the biggest misconceptions around saving for college is that all financial aid is "free money." The reality is, only 0.3%—or three out of every 1,000 students—receive enough grant and scholarship money for a free ride to college.[1]

A 529 plan can help fill funding gaps while easing the heavy burden of college debt. One of every three dollars in financial aid currently comes from loans that must be paid back with interest in the critical years after students graduate and before parents retire.[2] The more you save in a 529 plan now, the less you may have to borrow later, especially if you contribute regularly and stay invested for the long run.

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[1]Finaid.org. Based on full-time students at four-year colleges.
[2]College Board, Trends in Student Aid, 2019

Myth: "I'll lose my money if a student doesn't go to college or gets a scholarship."

The money is still yours, no matter what happens. If a student doesn't attend college or didn't spend the whole account, you have the flexibility to transfer it to another family member. Other options include:

- **Use funds for private elementary or high school:** Up to $10,000 toward tuition can be withdrawn per student each year without federal taxes; state tax rules vary by 529 plan.
- **Keep the account in the original beneficiary's name:** Money can go toward college or graduate school later in life, or it could be transferred to the next generation when the beneficiary has a child.
- **Make a non-qualified withdrawal:** If you want the money back, you would owe taxes and a 10% penalty only on any investment gains. The dollars you put in are never taxed or penalized when taken out.

What about scholarships? You could use a 529 plan to pay qualified expenses not covered by the scholarship. You can also make non-qualified withdrawals equal to the scholarship amount without penalties, though income taxes would still apply to any earnings you withdraw.

Myth: "I can only use a 529 plan to pay for college tuition."

Not true. Qualified higher education expenses include tuition, fees, room and board, books, supplies, computers, internet access and services for special-needs students. And it's not just at four-year universities, but also community colleges, graduate schools and vocational/trade schools.

More good news: The recently enacted SECURE Act expanded tax-free withdrawals to cover qualifying apprenticeship programs and student loan payments, up to a lifetime maximum of $10,000 for each account beneficiary and sibling. Some states have yet to adopt these new enhancements so be sure to check your state's rules.

Next steps: Create your college plan

Don't let myths stand between you and college. Use our resources to make informed decisions and a positive impact on a student's life. Reach out and speak to a J.P. Morgan Advisor to help you navigate the current market volatility and request a personalized goals-based strategy to help you achieve your education goals. Your Advisor can help you with your investment selections.

What's most important is to have a plan. Start by looking at how college fits in with your other financial goals and your family's overall budget. How much will college cost? How much are you comfortable paying? How much do you need to invest each month to get there? If you don't think you can cover all the costs, your plan should also include other funding options like financial aid, loans or family gifts.

The Goals-Based Analysis referenced is a tool that provides an additional resource in the evaluation of the potential risks and returns of investment choices. The projections or other information generated by the goals-based analysis regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results.

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