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What's the difference between a 529 savings plan and prepaid tuition plan?

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529 savings plans are more popular than 529 prepaid tuition plans because they are broader in scope and more flexible. Most every state offers at least one 529 savings plan, but only a handful of states offer a prepaid tuition plan. Generally, you can join any state's savings plan, but you can only join your own state's prepaid tuition plan. The type of plan you choose will depend primarily on the type of college you think the beneficiary might attend.

A prepaid tuition plan allows you to prepay tuition at in-state public colleges. By purchasing a certain number of credits or units in the plan today, you are essentially guaranteed that your payment today will cover a certain amount of tuition in the future, no matter how much costs go up between now and then. In effect, you are getting a guaranteed minimum rate of return. However, to receive the maximum benefits under a prepaid tuition plan, your child must attend an in-state public college in that plan. If your child chooses a different school, you may pay a penalty. Check the rules of your state's prepaid plan.

By contrast, a savings plan doesn't restrict the beneficiary's choice of college. Funds in a savings plan account can be used for the full cost (tuition, fees, books, and, if the student attends at least half-time, room and board) at any college or graduate school in the country or abroad that is accredited by the U.S. Department of Education. This provides maximum flexibility on choice of college. But there is no guaranteed minimum rate of return. When you contribute to a 529 savings plan, your money goes into one ore more of the plan's investment portfolios, and you either gain or lose money depending on how your investment options perform.

If you're a fairly conservative investor and believe that your child will choose from among a number of public colleges located in your home state, then a prepaid tuition plan may be the appropriate choice (assuming your state offers one). But if you don't want to restrict your child's college options or you believe that you can earn a better rate of return than what is promised by a prepaid tuition plan, then a savings plan that offers a range of investment options may be the right choice.

Note: *Before investing in a 529 plan, please consider the investment objectives, risks, charges, and expenses carefully. The official disclosure statements and applicable prospectuses, which contain this and other information about the investment options, underlying investments, and investment company, can be obtained by contacting your financial professional. You should read these materials carefully before investing. As with other investments, there are generally fees and expenses associated with participation in a 529 plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated. Investment earnings accumulate on a tax-deferred basis, and withdrawals are tax-free as long as they are used for qualified education expenses. For withdrawals not used for qualified education expenses, earnings may be subject to taxation as ordinary income and possibly a 10% federal income tax penalty. The tax implications of a 529 plan should be discussed with your legal and/or tax professionals because they can vary significantly from state to state. Also be aware that most states offer their own 529 plans, which may provide advantages and benefits exclusively for their residents and taxpayers. These other state benefits may include financial aid, scholarship funds, and protection from creditors.*

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