

Capital Ideas

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Dec. 20 issue - If you're saving for college in a state-run 529 plan, are you using it to best advantage? Your bottom line depends on what you pay for the account. Sometimes, annual fees can cost more than the taxes you save. If you buy a 529 through a broker or planner, instead of directly from your state, your tax savings may never catch up with the commissions you pay, says Susan Dynarski, an economist and public-policy professor at Harvard's Kennedy School.

- **The tax appeal.** A 529 plan provides a mix of stock and bond mutual funds that you can use for higher education. The earnings on your investments—interest, dividends, capital gains—pass tax-free, when used for school. Many states also let you deduct some part of your contribution on your state-tax return.
- **The investment appeal.** All things being equal, a 529 yields a better return than a taxable account. But the fees can be time bombs. You pay a small portion of your account every year, in management and administration expenses. A 1.5 percent charge on \$5,000 comes to \$75. If you earn 5 percent on that account, in the 25 percent bracket, you save \$62.50 in tax. So your costs exceed tax savings by \$12.50. If you switched to a similar 529 fund that costs only 1 percent, you'd pay \$50—leaving you \$12.50 ahead.
- **The great fee hunt.** It's not always easy to figure out what percentage of your 529 investment you pay in fees. Your plan should disclose it, but there may also be annual, flat-dollar fees. A \$15 fee would erase the \$12.50 gain in the account mentioned above. A deduction on your state-tax return helps this calculation a little, but not a lot.

"People get stars in their eyes when they think they're hiding from taxes," Dynarski says. You assume that a tax exemption always pays. But not if you're charged too much for it. Look for low-fee funds in your own state's 529. If there aren't any, check out the plans in another state. You can compare plans at savingforcollege.com, to find one that makes sense.

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