

529 PLAN GUIDE



MUTUAL FUND RESEARCH & MARKETING

Where Preparation and Talent Yield Powerful Results.

Welcome. We hope this guide to Section 529 plans (529s) will aid you in making the right decision regarding your education funding needs.

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Investors should carefully consider the investment objectives, risks, charges and expenses associated with 529 plans before investing. This and other information about 529 plans is available in the issuer's official statement and should be read carefully before investing.

Investors should consult a tax advisor about any state tax consequences of an investment in a 529 plan.

Why a 529 Plan – When Is It Appropriate?

Although a 529 can be established for anybody (not just a relative), parents and grandparents are typically interested in providing for the welfare of their families' future generations. Surveys confirm that people want to save for education, but few do, even in tax-advantaged accounts such as 529s. Generations to come certainly will need the funds to keep pace with the ever-escalating costs of higher education, whether at universities or vocational schools.

Tax-free 529s enable you to save more money faster. In most cases, when saving for college, a 529 is the vehicle of choice.

Education funding with a 529 can connect generations by providing an easy wealth transfer from an older generation to their children and grandchildren. Keep in mind that 529s are not only for parents just starting out; they also work well for seniors in their later years wanting to reduce their estates.

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Cost Escalation

The increasingly competitive job market demands an educated and skilled workforce, prompting more students to seek training and advanced degrees. This coincides with a period during which education costs are skyrocketing: Inflation of tuition and fees has been higher than the general inflation rate.

Effects of inflation

When viewing inflation over the most recent 30-year period, consider that the Consumer Price Index (CPI) rose on average 4.16% per year while the average annual tuition and fees for a four-year private college rose 7.51%. Over time, those few percentage points translate into a considerable sum.

To illustrate how important inflation is in this educational equation, let's look at median household income, which has increased at an annual rate of 4.48%, a slightly faster pace than the CPI.

In 1977, the median household income was \$13,572 (in current dollars). At the same time, in the 1977-1978 school year, the average annual cost for tuition and fees was approximately \$2,700, or close to one-fifth of the median annual income. That is, in the household example cited, for every \$100 earned, \$20 would have had to have been spent on education for one student.

Today, the median annual household income is estimated at \$50,570, while average tuition and fees at a four-year college in 2007-2008 totaled \$23,712, or 47% of household income.

²According to Fidelity Investments College Savings Indicator, only 17% of respondents said they would not save for college. Out of the same group, only 26% reported using a 529 plan or other dedicated education-savings account.

In other words, for most households in this category, \$47 of every \$100 in income would go to education unless parents find alternatives such as home-equity loans to fund their children's educations, or unless students take out loans – resulting in thousands of dollars in debt by the time they graduate. Better yet, be prepared and start saving beforehand.

Save Now or Borrow Later – The Effect of Compounding

Another way of looking at education funding is to consider what happens if you choose between saving now and borrowing later. To keep it simple, let's say that you forecast a need of \$100,000 in education funds in 10 years. Look at the effect of compounding and whether you earn or pay the same interest rate of 6% (for this example, disregard any tax implications).

The person who saves the money could reach \$100,000 with monthly payments of \$610.21 over that time period, a total of \$73,224.60. In contrast, if someone were to borrow the funds, they would be required to make payments of \$1,110.21 each month for 10 years – a total of \$133,224.60 – to pay off the loan.

Tax-free compounding in a 529 has a dramatic effect on savings and investments.

The difference is astonishing. The person who plans ahead can save \$60,000!

Of course, we do not know what future interest rates will be, and the assumptions above may not prove realistic. Regardless, the point remains valid: Compounding has a dramatic effect on savings and investments. That is especially clear when it comes to choosing between saving now and borrowing later. We want this powerful force of compounding to work for you, not against you.

Two major points to make:

- | You might be surprised by just how expensive college has become and that it may not be feasible to pay for college out of current income. In the past, your parents' income may have been enough to put you through college without dedicated savings, but that doesn't mean the same will be true for you and your children.
- | 529s are designed to help meet the huge challenge of education funding over time. If you start early, you may well avoid having to float home equity or other loans to help your children through college.

Tax Benefits

529s provide for tax-deferred savings and tax-free withdrawal of funds used for higher education. In addition to the federal tax benefit, many – but not all – states allow a state tax deduction. In essence, 529s are similar to Roth IRAs, with much higher contribution limits, and with the added state tax benefit in some cases.

Estate tax benefits can be significant. Once a 529 plan is funded, it is considered a completed gift to the beneficiary for federal estate tax purposes even though the owner has full control of the account.

Contribution Amount

529s offer extremely generous contribution limits. Limits are defined in terms of the overall total – not annual – amounts. Typically, plans allow contributions until the aggregate account size ranges from \$235,000 to \$365,000. The amount varies widely, as legislation mandates each state to set limits that reflect the most expensive undergraduate and graduate school costs in that state. Once the ceiling is reached, no further contributions can be made, but the account can grow until the funds are withdrawn.

For practical tax purposes, most literature suggests a limit of \$13,000 per year, which is the current federal gift tax exclusion limit. By staying under this limit, you, the account holder, do not tap into your lifetime gift-tax exclusion.

However, another unique feature of the 529 is a rule that allows five years of contributions up front without gift-tax consequences. That is, by filing Form 709, a single filer can contribute in one lump sum up to \$65,000 (\$130,000, if filing jointly) to each beneficiary.

If this lump-sum contribution is made, additional contributions within the five-year period are possible, but would reduce the lifetime gift tax exclusion. The idea is that a large, early contribution has a chance for more tax-free growth than smaller contributions made annually.

Also, contributing earlier and in larger sums enables capital growth to take place outside of the estate, another important tax benefit.

The unique five-year contribution rule allows larger amounts to be invested earlier without tapping into the lifetime gift tax exclusion.

Control

The 529 plan requires an owner, sometimes called a participant, a contributor and a beneficiary. In most cases, the owner and the contributor are the same person. Typically, the beneficiary is a child or grandchild, but can be an unrelated person – or owner, contributor and beneficiary can all be the same person. The point of the legislation is to allow funds to be saved for educational purposes, not exclusively for traditional students.

A popular aspect of the 529 is that the owner controls the account and the money in it. This is important. You may recall that for estate tax purposes, the contributions are considered a completed gift to the beneficiary. However, legal rights to the money usually stay with the owner indefinitely.

For example, grandparents can set up a 529 for each grandchild, reducing their estates while retaining control of the money. They can even take back the funds if they so choose, although they would trigger taxes and a 10% penalty on the earnings portion if the funds were then used for something other than education. Nevertheless, 529 funds remain the owner's property.

Grandparents can set up a 529 for each grandchild, reducing their estates while retaining control of the money. They can even take back the funds if they so choose.

Beneficiary/Owner Change

The owner can change the account beneficiary at his or her discretion, an especially important feature when comparing a 529 to a UTMA/UGMA account. With a 529, if the beneficiary cannot use the plan for higher education, the account can be transferred to another beneficiary.

The owner controls the account; it is not transferred at a preset age or date to the beneficiary. The owner could choose, for example, to use the account for educational purposes for himself or herself. Most plans also allow an ownership change that permits someone else to take control of the account. In some plans, this provision is allowed only upon the original owner's death.

Other Important Features

Almost all 529s offer professionally managed investments that include asset allocation and well-diversified portfolios. Most also offer static asset allocation and age-based portfolios for added convenience.

In addition, many 529s provide asset protection against creditors. Although the level varies among the plans, look for plans that explicitly offer statutory protection from creditors. State laws differ, so clients should seek legal advice by an attorney in their state.

Federal bankruptcy law protects 529s and Coverdell accounts that meet certain time requirements. Assets held in the account less than one year have no protection. Up to \$5,000 of account assets held one to two years, and the entire amount that has been held for more than two years, are protected.

The following breakdown compares the 529 to other education-savings possibilities.

Education Account Comparison					
	529 Savings Plan	529 Prepaid Plan	UGMA/UTMA	Coverdell ESA	ROTH IRA
Contributions and Deductions					
Maximum annual contribution limit	\$65,000 per beneficiary in the first year of a five-year period to avoid gift-tax consequences (\$130,000 per married couple)	Same as 529 savings plan	\$13,000 per beneficiary per year to avoid gift tax consequences (\$26,000 per married couple)	\$2,000 ⁸ per year per beneficiary; contributions stop when child turns 18	\$5,000 per year plus \$1,000 for those age 50+ (limit includes all Roth and Traditional IRAs combined)
Maximum account lifetime limit	Varies by program – around \$300,000	Varies by program	Unlimited	Unlimited	Unlimited
Limitations on income to contribute	None	None	None	Single filers: \$95-110,000 Married filers: \$190-220,000	Single filers: \$105-120,000 Married filers: \$166-176,000 Account owner must have earned income to contribute
Age limitation to contribute	None	None	None	Contributions stop when child turns 18	None
Tax-deductible contributions	No federal deduction; state tax deduction varies by the account owner's state of residence and the plan	Same as 529 savings plan	No	No	No
Withdrawal and Taxation					
Control of withdrawals	Account owner/participant	Same as 529 savings plan	Transfers to child upon age of majority or later if state law permits	Account owner/participant; beneficiary has the legal right to be named as account owner at age of majority	Account owner
Use of proceeds	Expenses ¹ from any accredited college/post-secondary program in the U.S. and some foreign locations.	Often limited to tuition/fees from in-state post-secondary programs	Limited to any types of expenses for child's benefit (cannot be used for parents' expenses)	Expenses ^{1,6} from any accredited college/post-secondary program in the U.S. and some foreign programs and expenses ^{5,6} from elementary and high school ⁶	Expenses ¹ from any accredited post-secondary program in the U.S. and some foreign programs
Taxation – account earnings	Tax-deferred	Same as 529 savings plan	Taxable. Kiddie Tax under age 19, any investment income over \$1,900 taxed at parent's federal tax rate. Expanded Rule Full-time student under age 24 is now included	Tax-deferred	Tax-deferred. Tax-free only if the 5-year requirement is met and the withdrawal is for death, disability, attainment of age 59 ½ or first-time homebuyer. If not, earnings and possibly conversion amounts withdrawn are taxable at the account owner's rate. 10% penalty on earnings and any conversion amounts withdrawn unless some other exception ⁷ to the penalty applies
Taxation – qualified withdrawals	Federal: tax-free State: varies by the account owner's state of residence. ⁹	Same as 529 savings plan		Tax-free	
Taxation – nonqualified withdrawals	Federal and state: distributed earnings (prorata) taxed at account owner's or beneficiary's rate depending on to whom the 529 plan provider directs and reports the distribution.	Same as 529 savings plan		Distributed earnings (prorata) taxed at account owner's rate	
Penalties – nonqualified withdrawals	10% penalty on earnings	Same as 529 savings plan	None	10% penalty on earnings	
Other					
Ownership and federal financial aid impact	Account owner asset; aid is reduced by 3 to 5.64% of the 529 value if the parent is account owner. ²	Same as 529 savings plan	Student asset; aid is reduced by 20% of the UTMA/UGMA value	Account owner asset; aid is reduced by 3-5.64% of account value if parent is account owner ²	The taxable portion of a withdrawal for education is treated as income, which could affect financial aid
Ability to change beneficiary?	Yes ³	Typically yes, see specific plan rules	No	Yes ³ (beneficiary must be under age 30)	Yes
Funds removed from the donor's estate?	Yes ⁴	Typically yes, see specific plan rules	Typically yes, unless the donor dies while acting as custodian.	Yes	No
Investment options	Varies per plan; typically portfolios of mutual funds, fixed income options may also be available depending on the 529 provider	Tuition units guaranteed to match tuition inflation	UGMA: cash, bank accounts, stocks, bonds, mutual funds; UTMA options may also include real estate, LPs, fine art, patents and royalties	Wide range of securities (limit may be set by provider)	Wide range of securities (limit may be set by provider)

¹Tuition, fees, books, supplies and equipment required as a condition of enrollment and room and board (amount set by the institution) as long as the student attends at least half time. For 2009 and 2010, computer and Internet expenses are considered qualified 529 expenses. ²In most cases, if the student's grandparent is account owner, the asset will have no impact on financial aid. This pertains to the federal student aid formula. Other types of financial aid may have different rules. ³There are no tax implications as long as the "new" beneficiary is a member of the original beneficiary's family and from the same generation. A family member of a designated beneficiary is a son, daughter, grandson, granddaughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, father, mother, stepfather, stepmother, niece, nephew, aunt, uncle, first cousin, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law, spouse or the spouse of any of the foregoing individuals. For this purpose, a child includes a legally adopted child, and a brother or sister includes a brother or sister by half blood. If the new beneficiary is a family member from a younger generation, the transaction may subject the original beneficiary to gift taxes and generation-skipping transfer taxes. The beneficiary may be changed to a non-family member; however, this is not a tax-free transaction. ⁴If the contributor front loads the contribution (e.g., \$65,000 contribution in a single year), then dies within the five year period, a prorated portion of the contribution may be included in the contributor's estate. ⁵Tuition, fees, academic tutoring, special needs services, books, supplies and other expenses which are incurred in connection with the enrollment and attendance at a public, private or religious school and expenses for the purchase of computer technology or equipment or Internet access to be used by the beneficiary during any years the beneficiary is in school. ⁶Distributions from a Roth IRA come out of the account in the following order: contributions, conversion amounts, earnings. ⁷Exceptions to the 10% penalty are: death, disability, attainment of age 59 ½, first-time home buyer, qualified higher education expenses, substantially equal payments, medical bills greater than 7.5% of AGI, and medical insurance premiums after losing a job. ⁸This is a provision of the Economic Growth and Tax Reconciliation Relief Act of 2001 (EGTRRA '01). Remaining provisions are scheduled to expire on December 31, 2010, at which time the law may or may not be reinstated. ⁹Favorable state tax treatment for investing in a Section 529 college savings plan may be limited to investments made in a Section 529 plan offered by your home state.

How to Select a 529 Plan

Tax Considerations

Although the federal tax benefit is the same for all plans, state tax benefits vary. Depending on where you reside, it's important to understand the tax deductions or tax credits that may be available to you – especially if you reside in a state with income tax.

States that offer a benefit tend to only do so for participants of the plan sponsored by their state, the in-state plan. In other words, there would be no tax benefit to a resident of State A if the 529 chosen were located in State B. However, Arizona, Kansas, Maine, Missouri and Pennsylvania allow a deduction for out-of-state plans as well as for their own. Your financial advisor can help you determine how much the deduction is worth. **In some cases, the tax savings offered are small, especially on a relative basis, when a large contribution is made, and for longer investment periods. In such cases, the significance of the tax consideration diminishes.**

Investments Offered

Although you may be familiar with the fund company that manages a 529, the plan may offer a different array of investments through the use of multiple managers. In addition to a range of individual funds, the owner may also choose static pre-constructed portfolios or age-based portfolios.

Keep in mind that current regulations limit investment changes, including rebalancing, to 529 portfolios to no more than once a calendar year.* Therefore, some investors prefer plans that offer pre-constructed static or age-based portfolios. New contributions can always be directed as the owner wishes.

* In 2009, by temporary relief, investors may make changes two times.

Fees and Expenses

529s have gathered significant assets over the past few years, resulting in reduced expense ratios. All things being equal, a plan with lower fees and expenses should produce better returns over time. However, actual performance is difficult to assess given the wide variations among plans.

Avoiding plans with excessive fees, of course, makes sense. However, when comparing plans with similar expense ratios, it also makes sense to select the plan with investments with which you are familiar rather than simply those with the lowest expenses. Although fees are likely to continue trending lower, we don't know which plan is going to be the least expensive going forward. Your selection should be guided primarily by the investments offered.

Beneficiary and Ownership Designation Rules

An often-overlooked consideration with regard to 529s is that there may be – in relatively rare instances – situations where the rules of ownership can be important. For example, these rules may come into play if a grandparent who opened an account later decides to have his or her child assume ownership. Plan details vary, so check the specifics to determine what ownership changes are allowed.

Frequently Asked Questions

Section 529 college savings plans: Common questions with answers

Program Participation

Who can contribute to a Section 529 savings plan?

Almost anyone can contribute to a 529 regardless of age or income. This includes an individual, a corporation, a partnership, trust, guardian, committee, trustee, an executor, an administrator or any person acting in a fiduciary capacity. Local governments and some non-profit organizations may also participate.

Each account has one account owner/participant and one named beneficiary. Contributions may be made by the account owner/participant or by another person. However, all contributions by another contributor become the property of the account owner/participant regardless of the contributor's identity or the contributor's relationship to the account owner/participant.

Can a 529 have joint account owners? Can it have joint beneficiaries?

No. Each account has one account owner with one named beneficiary. Only the account owner can give instructions to distribute money from the account, whether the funds are to pay for the beneficiary's college expenses or for any other reason.

Can I transfer the account assets or name someone else as the account owner?

Many 529s allow for transfer of ownership, often with certain limitations, while others do not. Transfer of ownership is irrevocable. It transfers all rights, title, interests in and powers of the account, and is a non-taxable event.

Can the account owner or the beneficiary be a trust?

By code, the account owner may be a trust; however, verify that the plan you have selected permit trusts as owner. The beneficiary must always be a person, which excludes a trust.

Can I open a 529 for myself?

Some 529s allow individuals to open accounts for themselves, while others do not. However, keep in mind that opening an account for yourself will not remove the assets from your estate.

Who can be a beneficiary?

The beneficiary must be a person. A beneficiary can be your child, your grandchild, your spouse, yourself or even someone not related to you.

Can I invest for one beneficiary in more than one state's 529? Are there contribution limitations?

Yes. A beneficiary can have as many accounts as desired. However, total contributions to 529s (including 529 prepaid accounts) cannot exceed the maximum amount deemed necessary to meet the beneficiary's qualified higher education expenses in a relevant state. As a result, some 529s prohibit additional contributions once that threshold is reached.

What is the deadline for contributing to a 529?

Contributing to a 529 is considered gifting to the plan's beneficiary. The deadline to gift to a 529 for a tax year is December 31 of that year.

Contributions

What is the maximum amount that can be contributed to a 529?

The maximum amount that can be contributed to a 529 is established by the relevant state program's rules and may be changed each year to reflect the increasing costs of higher education. Once this limit or, in some cases, a lower "cutoff" limit is reached, no additional contributions are permitted. Currently the maximum in the marketplace is more than \$300,000 and growing.

Can securities be contributed?

No. Contributions must be made in cash only. Checks, money orders and bank transfers are considered “cash” for contribution purposes.

Are contributions to a 529 deductible?

Contributions to a 529 are not deductible for purposes of determining federal income tax. Contributions to a 529 are deductible in certain states up to a specified maximum for state income tax purposes.

What are the gift tax and estate planning benefits of 529s?

Contributions to a 529 are considered completed gifts for federal gift and estate tax purposes and are excludable from your taxable estate. Up to \$65,000 (\$130,000 for married couples) can be contributed to a beneficiary in a single year without federal gift-tax consequences, provided you do not make any additional gifts to that beneficiary over a five-year period. Contributions in excess of these amounts can be made, but will incur gift taxation that is credited against a participant’s lifetime gift exclusion (\$1,000,000 for 2006-2009). Before contributing to a 529, become familiar with your state’s gift tax and inheritance tax rules.

What happens if an account owner contributes \$65,000 in single year (treating it as made over five years), then dies before the five-year period is up?

The portion of the contributions allowable to the balance of the five-year period, excluding the year the account owner died, would be included in the account owner’s gross estate and subject to federal estate taxes, if applicable.

Can I contribute to a 529 and a Coverdell education savings account (ESA) in the same year?

Yes. Contributions may be made to both the ESA and a 529 savings plan for the same beneficiary in the same tax year. Keep in mind that the total annual \$13,000 (or \$26,000 for a married couple filing jointly) gift-tax exclusion applies.

Can I contribute to a 529 savings plan and a 529 prepaid plan in the same year?

Yes. You can contribute to both a savings plan and a prepaid plan for the same beneficiary, however, you will need to pay special attention to the gifting rules and the maximum contribution limits set by each state's 529 plan.

In contributing to both a savings and a prepaid plan, a total of up to \$65,000 (\$130,000 for married couples) can be contributed for a beneficiary in a single year without federal gift-tax consequences, provided you do not make any additional gifts to that beneficiary over a five-year period.

Contributions in excess of these amounts can be made but will incur gift taxation, which is credited against a participant's lifetime gift exclusion (\$1,000,000 for 2006-2009). Many 529 programs prohibit additional contributions once the account plus all other 529s for that beneficiary reach the program's maximum contribution limit. This means that if a beneficiary is named on one or more 529 savings plans and/or one or more 529 prepaid plans, no more contributions may be made to any of the accounts once the total balance of all accounts reaches the lowest maximum contribution limit of any of the beneficiary's 529s.

Will having a 529 affect the beneficiary's ability to receive financial aid?

Yes, but to a lesser degree than money kept in a custodial account when using the federal methodology in calculating needs-based financial aid. The ownership of a 529 can affect financial aid differently when using an institutional (private) formula. The federal government and public universities use the Expected Family Contribution (EFC) formula to determine how much of a child's college expenses a family is expected to cover. The EFC formula assumes that a large percentage of family income is available to pay for college and considers only about 5% of a parent's savings and 20% of the child's assets in the equation. A 529 is considered to be the parent's asset rather than the child's. Thus, it allows the child to receive more financial aid when using a 529 compared to some other savings vehicles. If the 529 is owned by a grandparent, none of the assets are included as grandparents' assets are not considered in the formula. While private schools use this formula when dispersing federal financial aid, they may have different guidelines when using their own financial aid pools.

Change of Beneficiary and Transfers

Can the beneficiary be changed?

Yes. The account owner/participant may change the beneficiary on an account an unlimited number of times. No tax implications exist as long as the new beneficiary is a member of the original beneficiary's family and from the same generation. For 529 purposes, a family member of a designated beneficiary is a:

Son	Father	Daughter-in-law
Daughter	Mother	Father-in-law
Grandson	Stepfather	Mother-in-law
Granddaughter	Stepmother	Brother-in-law
Stepson	Niece	Sister-in-law
Stepdaughter	Nephew	Spouse
Brother	Aunt	The spouse of any of the foregoing individuals
Sister	Uncle	
Stepbrother	First cousin	
Stepsister	Son-in-law	

This definition includes legally adopted children and half-siblings. Once money is contributed to a 529, it is considered a completed gift to the beneficiary. Thus, if the new beneficiary is a family member from a younger generation than the original beneficiary, the original beneficiary may be subject to gift taxes and generation-skipping transfer taxes. A change of beneficiary down a generation is a gift from the old beneficiary to the new beneficiary. The beneficiary also may be changed to a nonfamily member. However, this would not be a tax-free transaction.

Can I roll my existing 529 into a different state's plan?

Yes, a rollover into a different 529 may be done once every 12 months. However, more than one rollover can be done in a 12-month period by changing the beneficiary on the account each time. In any case, the rollover must be completed within 60 days, and you should look into any restrictive terms and charges that may apply.

Can I transfer my existing UTMA/UGMA account to a 529?

Yes. To do this, the UTMA/UGMA assets must first be liquidated, then the cash may be contributed to the 529. Because this is a taxable transaction, it may trigger capital gains or other tax consequences. Also, when UTMA/UGMA funds are moved to a 529, the money remains irrevocably vested in the minor; therefore, the beneficiary on the 529 may not be changed at any time. When that minor reaches the age of majority, he or she legally has the right to be named account owner, which means he or she has complete ownership and control of the money at that time. Assets in a 529 are considered assets of the account owner, typically a parent, which is a benefit to the financial aid equation. If assets were contributed from a UTMA/UGMA, the minor is considered to be the assets' owner. However, beginning in the 2009-2010 school year, 529s owned by a dependent are considered a parental asset for the FAFSA formula. To take advantage of all benefits that a 529 offers, you should make any new contributions for a beneficiary to a 529 account that is separate from the "529-UTMA/UGMA."

Can I transfer my existing Coverdell education savings account (ESA) to a 529?

Yes. Cash distributed from an ESA for the purpose of contributing it to a 529 savings account is considered a qualified higher education expense that is not subject to federal income tax or penalties. Before transferring from an ESA, you should remember that qualified withdrawals are federally tax-free for both education savings accounts and 529s. Also, ESAs offer more investment flexibility than 529s and can be used for elementary and secondary education. Therefore, you should carefully consider the pros and cons before making this move. Since an ESA is treated as a custodial account, it is debatable whether or not the account owner will have the ability to change the beneficiary of the 529 account once assets are transferred. State law may require that the 529 be established in a way that protects the minor's ownership rights.

Can I roll my existing U.S. savings bonds into a 529?

Yes. However, for a rollover of U.S. savings bonds into a 529 to be a tax-free transaction, you must meet all the qualification requirements for the education exclusion, including the dependency requirements and income limits in the year of the redemption/rollover. See Internal Revenue Service Publication 970 for details.

Withdrawals

What are qualified higher education expenses?

Qualified higher education expenses include tuition, fees, books, supplies and equipment required for the enrollment or attendance of the beneficiary at an eligible educational institution (definition below). Room and board is also included if the student is enrolled at least half-time. Room and board limits are set by the educational institution. Any withdrawal for qualified expenses is called a “qualified withdrawal.” All other withdrawals are “nonqualified withdrawals.”

Which schools are considered “eligible education institutions”?

529 savings plans will pay for qualified expenses at any accredited private or public college, university, or technical or vocational school in the country and some foreign countries. You can look up eligible institutions on the Department of Education’s school code search page at fafsa.ed.gov/fotw0203/fslookup.htm.

How are earnings taxed?

Earnings are tax-deferred federally until withdrawn. The way earnings are taxed depends on whether the withdrawal is qualified or non-qualified (see above for definition). Each withdrawal, whether qualified or non-qualified, consists of pro-rata amounts of contributions and earnings.

When a withdrawal is taken to cover qualified expenses, earnings on qualified withdrawals are tax-free on the federal level and may or may not be taxed at the recipient’s state income tax level.

When earnings are taxable at the state level, most programs deem the beneficiary to be the recipient of a qualified withdrawal, therefore any state income taxes due on earnings are taxed at the beneficiary’s state tax rate.

When a withdrawal is taken to cover non-qualified expenses, earnings are taxed at the recipient’s federal and state income tax rates and a 10% penalty on the earnings will apply.

It is important to read the program description. For non-qualified withdrawals, most programs deem the account owner to be the recipient of the withdrawal but some programs distribute to the beneficiary, or either. In any case, the recipient’s federal and state tax rates are used for earnings distributed. Tip: For non-qualified withdrawals, request that the distribution be made to the person in the lower tax bracket, usually the beneficiary.

What happens if I change my mind about investing in the program?

You may withdraw funds at any time. However, if you withdraw funds that are not used for qualified higher education expenses, the earnings on the investments will be subject to state and federal taxes at the recipient's tax rate and a 10% penalty will be assessed.

What if the beneficiary receives a scholarship, becomes disabled or dies?

If the beneficiary earns a scholarship, the account owner may withdraw an amount equal to the scholarship amount without penalty. If a beneficiary becomes disabled or dies, all assets in the account may be withdrawn without penalty. In all cases, the earnings withdrawn are taxable at the recipient's tax rate and not subject to penalties.

What happens if the beneficiary dies before the account is used in full?

Unless the account owner is able to name a new beneficiary (a member of the original beneficiary's family), the amount remaining in the account is included in the beneficiary's estate. Even though the beneficiary never had control of the account, contributions and earnings in the account are disbursed from the 529 and returned to the account owner. While no 10% penalty applies, the earnings portion of the withdrawal is taxed at the federal (and possibly the state) level at the account owner's tax rate.

What happens to control of the account if the account owner dies or becomes incapacitated?

If a successor owner has been designated by the account owner prior to death or incapacitation, the successor owner takes on all of the rights of the original account owner. This means the successor owner has complete control of the account including the right to change the beneficiary and to withdraw funds from the account for any purpose.

For this reason, the account owner should designate a trustworthy individual as successor owner. It is common for a spouse, the beneficiary or a trust to be named as successor owner.

If the account owner has not designated a successor owner, the estate is typically treated as the successor owner and the account will pass through the deceased participant's will or, if there is no will, by operation of law.

Some programs automatically name the beneficiary as account owner. The individual who is ultimately named as successor owner receives complete control of the account, which includes the right to change the beneficiary and to withdraw funds from the account for any purpose. Some 529s do not allow for a successor owner to be named. It is important to read the program description for details on how control of the account will be handled by the 529 provider in case of death or incapacitation.

Is there a time limit on the use of the funds for college expenses or otherwise?

While a few state programs have a set mandatory age or time frame for withdrawal of account balances, most state programs have no such limitations.

Investments

What are 529s invested in?

All 529s offer a number of set investment portfolios that are allocated among stocks, bonds, mutual funds, certificates of deposits and money market instruments.

Typically, the program will offer at least one “age-based” or “years-to-college” portfolio and several “static” portfolios. The age-based or years-to-college portfolio allows you to divide your investment according to a given asset allocation determined by your child’s age or the number of years until that child is likely to attend college. In general, the asset allocation will be more aggressive for younger children and less aggressive for children nearing college age. Some programs also offer individual fund portfolios.

Can I choose the investments that make up my portfolio?

Only to a limited degree. You may choose individual funds that are invested in specific securities according to a certain style or investment theme. Hence, you can select a portfolio of funds if this option is available in the program you have selected. The investments and the allocation of each investment within a fund are set by the investment manager. This is because IRC 529 prohibits you from directing the investments in a 529, directly or indirectly. Many plans now offer individual fund portfolios, allowing greater control of investments.

Can I switch into a different portfolio than originally selected?

While IRC 529 states that no one may “directly or indirectly direct the investment of any contributions” to a 529 program, Notice 2001-55 modifies this restriction by allowing a portfolio’s investment strategy to be changed once a year* or upon a change in the designated beneficiary of the account, which can be changed an unlimited number of times.

What are the expenses associated with a 529 account?

529s typically charge an enrollment fee, an annual fee or both. Also, most investments carry a load on the actual investment share. The program description will detail any other fees that may apply. Other possible fees include:

Application fee	Beneficiary substitution fee
Out-of-state transfer fee	Late notification of enrollment fee
Insufficient/returned check fee	Reinstatement fee for contracts in default
Late payment fee	Account maintenance fee
Account owner substitution fee	

Is my investment guaranteed?

No. Contributions and investment returns are not insured nor guaranteed by the FDIC, the plan provider, or any state or federal government agency.

Are my assets protected from creditors?

Assets in a 529 may be protected from the claims of creditors through state statutes, through the 529 program if “spendthrift provisions” are spelled out in the program description. However, how these protections hold up in court is still untested.

Other**How do I decide which state’s plan is best?**

In deciding on a 529 plan, there are many factors to consider such as whether your state of residence offers a plan with state income tax deductions for contributions, cost and investment choices.

For more information, please contact your Raymond James financial advisor.

* In 2009, by temporary relief, investors may make changes two times.

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