USING A 529 PLAN TO PAY FOR COLLEGE

Through tax-free growth, 529s can help you save more money faster, making it a vehicle of choice when saving for higher education.

RAYMOND JAMES®

This useful guide will give you a good overview of 529 plans and touch on the many features and benefits of this popular savings vehicle.

WHY A 529 PLAN?

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 now and in the future. A 529 plan is designed to help. If you start early, you may avoid having to take out home equity or other loans to help your children through college.

Although a 529 can be established for anybody (not just a relative), they are most often used by parents and grandparents interested in providing education funding for their children or grandchildren. In addition, a 529 can provide an easy wealth transfer. For this reason, they also work well for seniors wanting to reduce their estates.

WHAT MAKES A 529 PLAN A 529 PLAN?

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

Typically, the program will offer at least one age-based or years-to-college portfolio and several static portfolios. In general, the asset allocation will be more aggressive for younger children and less aggressive for children nearing college age. Many programs also offer individual fund portfolios.

Keep in mind that 529 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.

QUALIFIED HIGHER EDUCATION EXPENSES

Qualified expenses include tuition, fees, books, supplies and equipment required for the enrollment or attendance of the beneficiary at an eligible educational institution. Room and board is also included if the student is enrolled at least part time. (Limits are set by the educational institution.)

ELIGIBLE EDUCATION INSTITUTIONS

A 529 savings plan will pay for qualified expenses at any private or public college, university, or technical or vocational school in the country and abroad that qualifies for federal financial aid. You can look up eligible institutions by visiting the Department of Education website fafsa.ed.gov and clicking on School Code Search.

FEES AND EXPENSES

Typically, 529s 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.

Because 529s have gathered significant assets over the past few years, the result is 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.

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.

IT'S IMPORTANT TO DECIDE WHO OWNS THE PLAN AND HOW TO MAKE CONTRIBUTIONS

Each account has one account owner/participant and one named beneficiary (although the beneficiary must always be a person, the owner may be an entity such as a trust, partnership or corporation). Contributions may be made by the account owner/participant or by another person. However, all contributions become the property of the account owner/participant, and only the account owner can give instructions to distribute money from the account. Many 529s allow for transfer of ownership, often with certain limitations.

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.

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.

CONTRIBUTING TO A 529 PLAN

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 nonprofit organizations may also participate.

CONTRIBUTION LIMITS

The maximum amount that can be contributed to a 529 account 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 – by contribution or appreciation – is reached, no additional contributions are permitted. Currently, the maximum in the marketplace is more than $350,000 and growing. Of course, there is no limit on the amount the account can grow.

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

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

If this lump-sum contribution is made, additional contributions or other gifts to the same beneficiary 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.

CONTROL OF THE 529 ACCOUNT

The 529 plan requires an owner/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 the 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. While the contributions are considered a completed gift to the beneficiary, 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 used for something other than education. Nevertheless, 529 funds remain the owner's property.

THE OWNER CONTROLS THE ACCOUNT, BUT CONTRIBUTIONS ARE CONSIDERED COMPLETED GIFTS TO THE BENEFICIARY – OFFERING THE BEST OF BOTH WORLDS.

BENEFICIARY AND OWNERSHIP DESIGNATION RULES

An often overlooked consideration is that there may be – in 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.

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.

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. The beneficiary also may be changed to a non-family member. However, this would not be a tax-free transaction.

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 him or herself. Most plans also allow an ownership change that permits someone else to take control of the account.

	529 SAVINGS PLAN	529 PREPAID PLAN
CONTRIBUTIONS AND DEDUCTIONS		
Contribution limit	Contributions allowed until you reach maximum account size, varies by program up to $360,000. $65,000 per beneficiary in the first year of a five-year period to avoid gift-tax consequences ($130,000 per married couple).	Varies by type of contract.
Limitations on income to contribute	None	None
Age limitation to contribute	None	None
Tax-deductible	No federal deduction; state tax deduction varies by the account owner's state of residence and the plan.	Same as 529 savings plan
WITHDRAWALS AND TAXATION		
Control of withdrawals	Account owner/participant	Same as 529 savings plan
Use of proceeds	Expenses[1] from college/postsecondary program in the U.S. and some foreign locations.	Often limited to tuition/fees from in-state postsecondary programs.
Taxation – account earnings	Tax-deferred	
Taxation – qualified withdrawals	State: Varies by the account owner's state of residence.[9]	Same as 529 savings plan
Taxation – nonqualified withdrawals	Federal and state: Distributed earnings (pro rata) 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
Penalties – nonqualified	10% penalty on earnings	Same as 529 savings plan
OTHER		
Ownership and federal financial aid impact	Account owner asset; aid is reduced by 2.6% to 5.6% of the 529 value.[2]	Same as 529 savings plan
Ability to change beneficiary?	Yes[3]	Typically yes, see specific plan rules.
Funds removed from the donor's estate?	Yes[4]	Typically yes, see specific plan rules.
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.

[1]Tuition, 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. [2]In most cases, if the student's grandparent is account owner, the asset will not be included in the federal student aid formula. Other types of financial aid may have different rules. [3]There 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. [4]If 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

UGMA/UTMA	COVERDELL ESA	ROTH IRA
$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.	The lesser of $5,000 or 100% of earned income plus $1,000 for those age 50+.
None	Single filers: $95,000-110,000 Married filers: $190,000-220,000	Single filers: $110,000-125,000 Married filers: $173,000-183,000. Account owner must have earned income to contribute.
None	Contributions stop when child turns 18.	None
No	No	No
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
Limited to any types of expenses for child's benefit (cannot be used for parents' expenses).	Expenses[1,8] from any accredited college/ postsecondary program in the U.S. and some foreign programs and expenses[5,8] from elementary and high school.[8]	Expenses[1] from any accredited postsecondary program in the U.S. and some foreign programs.
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 59½ or first-time homebuyer. If not, earnings and possibly conversion amounts withdrawn are taxable at the account owner's rate.[6] 10% penalty on earnings and any conversion amounts withdrawn unless some other exception[7] to the penalty applies.
	Tax-free	
	Distributed earnings (prorata) taxed at account owner's rate.	
None	10% penalty on earnings	
Student asset; aid is reduced by 20% of the UTMA/UGMA value.	Account owner asset; aid is reduced by 3% to 5.64% of account value if the parent is account owner.[2]	The taxable portion of a withdrawal for education is treated as income, which could affect financial aid.
No	Yes[3] (beneficiary must be under age 30)	Yes
Typically yes, unless the donor dies while acting as custodian.	Yes	No
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).

the contribution may be included in the contributor's estate. [5]Tuition, fees, academic tutoring, special needs services, books, supplies and other expenses which are incurred in connection with the enrollment or 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. [6]Distributions from a Roth IRA come out of the account in the following order: contributions, conversion amounts, earnings. [7]Exceptions to the 10% penalty are: death, disability, attainment of age 59½, first-time homebuyer, qualified higher education expenses, substantially equal payments, medical bills greater than 7.5% of AGI, and medical insurance premiums after losing a job. [8]This is a provision of the Economic Growth and Tax Reconciliation Relief Act of 2001 (EGTRRA '01). Remaining provisions were scheduled to expire on December 31, 2010, but were extended until December 31, 2012, by The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. [9]Favorable 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.

NO TAX IMPLICATIONS EXIST AS LONG AS THE NEW BENEFICIARY IS A MEMBER OF THE ORIGINAL BENEFICIARY'S FAMILY AND FROM THE SAME GENERATION.

WE'RE SURE YOU'LL WANT TO KNOW HOW 529 PLANS CAN MAKE LIFE LESS TAXING

GIFT TAX AND ESTATE PLANNING BENEFITS

Contributions to a 529 are considered completed gifts for federal gift and estate tax purposes and are excludable from your taxable estate. By filing IRS Form 709, 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.

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. If you use the five-year election, the contributor has to stay alive or else it's prorated back on a calendar year basis.

Contributions in excess of these amounts can be made, but will incur gift taxation that is credited against a participant's lifetime gift exclusion ($5 million in 2011-2012 reduces the estate tax applicable exclusion amount).

Unless extended or modified, in 2013 current law will revert back to $1 million gift tax exclusion amount. Before contributing to a 529, become familiar with your state's gift tax and inheritance tax rules.

TAX-DEFERRED SAVINGS AND TAX-FREE WITHDRAWALS

All 529s provide for tax-deferred savings and tax-free withdrawal of funds used for higher education. In addition, many 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.

POSSIBLE STATE TAX BENEFITS

Although the federal tax benefit is the same for all plans, state tax benefits vary. 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. However, some states allow a deduction for out-of-state plans. Your advisor can help you determine how much the deduction is worth.

In some cases, the state 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.

PLANNING AHEAD CAN OFFSET THE BURDEN BROUGHT ON BY INFLATION

INFLATION'S EFFECTS

When viewing inflation over the most recent 30-year period, consider that the Consumer Price Index (CPI) rose on average 2.96% per year while the average annual tuition and fees for a four-year private college rose 8.3%. (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 1981, the average household income was $22,787 (in current dollars). In the 1981-1982 school year, the average annual cost for tuition, fees and room and board was approximately $4,600, or about 20% of the average annual income.

In 2010, the average annual household income was $50,570, while average tuition and fees at a four-year college in 2010-2011 totaled $26,567, or 52% of household income.

In other words, for many households, more than half of their income would go to education expenses unless parents find alternatives such as home-equity loans or students take out loans resulting in thousands of dollars in debt. The lesson here? It's better to be prepared and start saving beforehand.

COMPOUNDING AND CREDITOR PROTECTION ARE IMPORTANT ADVANTAGES

THE EFFECT OF COMPOUND INTEREST

Consider what happens if you choose between saving now and borrowing later. Let's say 10 years from now, you'll need $100,000 for education. Look at the effect of compounding when you either earn or pay a 6% interest rate (for this example, disregard any tax implications).

Save the money and you could reach $100,000 by making monthly payments of $610.21 over 10 years, a total of $73,224.60. In contrast, if you borrow the funds, you would make monthly payments of $1,110.21 for 10 years – a total of $133,224.60 – to pay off the loan. In other words, you can save $60,000 by planning ahead.

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. You want it to work for you, not against you.

PROTECTION FROM CREDITORS

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 you should seek legal advice.

Federal bankruptcy law protects 529s 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.

ARE YOU WONDERING HOW YOUR 529 PLAN AFFECTS FINANCIAL AID OR CONTRIBUTIONS TO OTHER PLANS?

WILL HAVING A 529 AFFECT RECEIVING FINANCIAL AID?

It will, but to a lesser degree than money kept in a custodial account when using the federal methodology in calculating needs-based financial aid. Ownership of a 529 can affect financial aid differently when using an institutional formula.

The Free Application for Federal Student Aid (FAFSA) uses 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.

IF THE BENEFICIARY EARNS A SCHOLARSHIP, THE ACCOUNT OWNER MAY WITHDRAW AN AMOUNT EQUAL TO THE SCHOLARSHIP AMOUNT WITHOUT PENALTY.

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, (but the withdrawal from a grandparent-owned 529 may affect 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.

CONTRIBUTING TO OTHER PLANS SIMULTANEOUSLY

Contributions may be made to both an education savings account (ESA) and a 529 savings plan for the same beneficiary in the same tax year. Keep in mind that the total annual gift-tax exclusion applies.

You can also contribute to both a 529 savings plan and a 529 prepaid plan for the same beneficiary, however, you will need to pay 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 ($5 million for 2012). 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 highest maximum contribution limit of any of the beneficiary's 529s.

YOU CAN TRANSFER OTHER EDUCATION SAVINGS ACCOUNTS OR SAVINGS BONDS TO YOUR 529 PLANS

TRANSFERRING AN EXISTING UTMA/UGMA ACCOUNT TO A 529

To accomplish this, the UTMA/UGMA assets must be liquidated and then the cash may be contributed to the 529. This is a taxable transaction that 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 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. Consider having two 529s for the beneficiary, one that is funded with UTMA money and one "regular" 529 that you can control indefinitely.

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, 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.

STRATEGY FOR FEDERAL FINANCIAL AID PURPOSES: IT CAN MAKE SENSE TO MOVE ASSETS FROM A UTMA ACCOUNT TO A 529 PLAN AS THOSE ASSETS ARE CONSIDERED PARENTAL ASSETS FOR THE FAFSA FORMULA.

TRANSFERRING A COVERDELL EDUCATION SAVINGS ACCOUNT (ESA) TO A 529

Cash distributed from an ESA for the purpose of contributing to a 529 savings account is considered a qualified higher education expense and is not subject to federal income tax or penalties.

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.)

ROLLOVER OF EXISTING U.S. SAVINGS BONDS INTO A 529

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.

Contact your Raymond James financial advisor.

All considered, 529 plans can be a valuable tool for funding a college education. Your Raymond James financial advisor can answer any questions you may have and help you get started today.

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.

LIFE WELL PLANNED.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER

880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863

LIFEWELLPLANNED.COM