



A GUIDE TO

Understanding 529 Plans

A **529 plan** is a qualified tuition program to help finance qualified higher education expenses.



Table of Contents

| | |
|--|----|
| It Pays to Save for Education..... | 2 |
| Education Costs Outpace Inflation..... | 3 |
| The Importance of Starting Early..... | 4 |
| Ways to Save for Education..... | 5 |
| College Savings Plans..... | 6 |
| Prepaid Tuition Plans..... | 7 |
| Income Tax Considerations..... | 8 |
| Selecting a 529 Plan..... | 8 |
| Selecting a 529 Plan: “Checklist”..... | 10 |
| Frequently Asked Questions..... | 12 |

Understanding 529 Plans

IT PAYS TO SAVE FOR EDUCATION

Benjamin Franklin once observed, “An investment in knowledge always pays the best interest.” That statement is as true today as it was in Franklin’s time. Education contributes to individual success and to the nation’s productivity and competitiveness. The importance of education is especially significant as the American workplace evolves. Today, an estimated 85 percent of jobs are categorized as “skilled,” requiring education beyond high school.

Today, the demand for educated and highly skilled workers has outpaced the supply of new graduates from professional, trade, and business schools; junior colleges; community colleges; other two-year colleges; and four-year colleges and universities. As a result, the financial value of higher education has increased. According to the Business-Higher Education Forum, the average difference in lifetime earning potential between someone who spends two years in college and a high school graduate is \$500,000. The typical bachelor’s degree recipient can expect to earn about 67 percent—or about \$1.5 million—more over a working life than a typical high school graduate.

EDUCATION PAYS

| Level of Education | Median Weekly Earnings | Median Annual Earnings |
|----------------------------------|------------------------|------------------------|
| College graduate | \$1,013 | \$50,900 |
| Community college graduate | \$699 | \$40,600 |
| High school graduate, no college | \$583 | \$31,500 |
| Less than a high school diploma | \$409 | \$23,400 |

Source: Bureau of Labor Statistics (Fourth Quarter 2005 Averages); College Board, Education Pays 2007

EDUCATION COSTS OUTPACE INFLATION

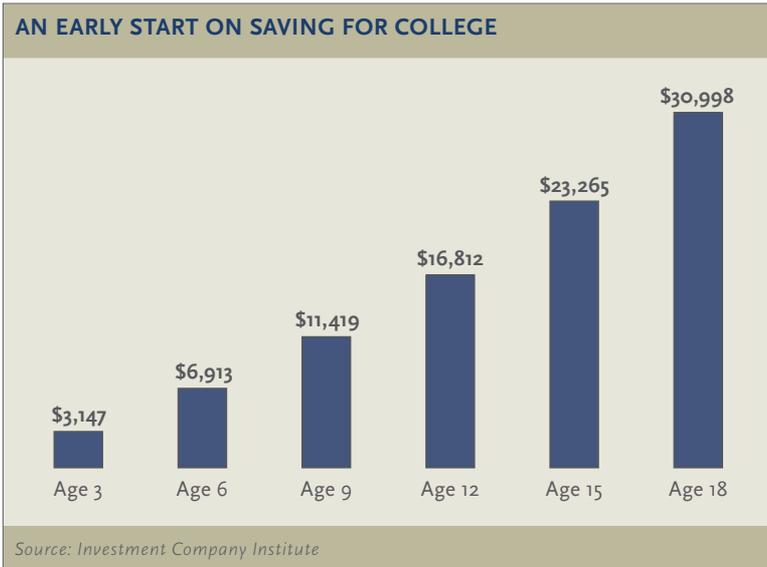
While most parents today expect their children to receive a postsecondary education, research shows that only one-third say they expect to be prepared to pay for their child’s education. Since 1980, the cost of higher education has been rising about twice as fast as the Consumer Price Index, according to the College Board.

In the past year, average tuition and fees increased by 6.3 percent at private four-year colleges and 4.2 percent at two-year public colleges, according to the College Board. During the same period, median family income increased by only 0.7 percent from \$47,845 to \$48,201. Moreover, in recent years, federal financial aid for higher education has shifted largely toward loans and away from grants. As a result, the percentage of family income required to pay the cost of higher education has increased significantly.

THE IMPORTANCE OF STARTING EARLY

Because of compounding, forward-thinking parents can be better prepared for their children's higher education costs. By starting early enough, you can reach your goal even with saving relatively small amounts.

Suppose, when your child is born, you decide to start taking your lunch to work instead of buying it, saving \$4 each working day, or about \$80 a month. Let's say you invest that money in an account that earns, on average, 6 percent per year. The graph below shows how that money can grow if invested in an account that earns, on average, 6 percent per year.



WAYS TO SAVE FOR EDUCATION

Saving for education is a long-term investment. The more you save, the less you'll need to borrow or seek from other sources. To encourage greater savings for higher education expenses, federal and state lawmakers have developed innovative programs, such as qualified tuition programs, to make higher education financially accessible to more Americans.

“EDUCATION IS BECOMING THE FAULT LINE BETWEEN THOSE WHO WILL PROSPER IN THE NEW ECONOMY, AND THOSE WHO WILL BE LEFT BEHIND.”

—The U.S. Department of Education

In recent years, growing numbers of families have taken advantage of qualified tuition programs, commonly known as “529 plans” for the section of the tax code that authorizes them, as a way to help finance the future qualified higher education expenses of their children or grandchildren.

There are two types of 529 plans: prepaid tuition plans, which are set up to allow an individual to prepay a student's future tuition and fees at today's rates; and college savings plans, which allow individuals to contribute to an account established to pay a student's qualified higher education expenses at any eligible educational institution. Today, all 50 states and the District of Columbia provide access to at least one type of 529 plan. In addition, a group of close to 300 private U.S. colleges and universities offers a prepaid tuition program called the Independent 529 Plan, which allows investors to purchase discounted tuition at any of the colleges and universities that participate in the program.

COLLEGE SAVINGS PLANS

College savings plans allow individuals to contribute to an account to pay a beneficiary's qualified higher education expenses, such as tuition, fees, books, supplies, and room and board. The value of college savings plans is based on the performance of the particular investments or investment strategy chosen by the contributor. As a result, college savings plans generally carry investment risk, which means the account value may increase or decrease depending on market conditions.

Contributions to college savings plans have been growing as the public becomes aware of their desirability as savings vehicles. For example, a survey of state plans indicates that assets held in 529 savings plans grew from \$2.6 billion at year-end 2000 to \$90.1 billion at the end of 2006. The asset growth was mostly attributed to an increase in the number of accounts, which rose to more than seven million.

Many mutual fund companies manage college savings plans for states, and mutual funds are the most commonly used investment vehicle in these plans. At the end of 2006, 96 percent of 529 savings plan assets were invested in mutual funds. Each state's plan typically offers more than one investment option. These options typically include a portfolio of stocks and bonds whose percent composition changes automatically as the beneficiary ages; a portfolio with fixed shares of stocks and bonds; or individual portfolios with varying investment strategies.

PREPAID TUITION PLANS

Prepaid tuition plans allow a parent, grandparent, or family friend to establish an account in the name of a student to “lock in” the cost of a specified number of academic periods or course units in the future at current prices, typically at the public colleges and universities located in the state sponsoring the program. For example, if an account holds shares worth two years' tuition, these shares will always be worth two years' tuition even several years later when tuition rates may have doubled. The account may be funded by a lump sum or periodic cash payments.

There are two main types of prepaid tuition plans—prepaid units and contracts. Prepaid unit plans sell units representing a fixed percentage of tuition. While the price of a unit may increase each year, once purchased, the unit remains valued at the same percentage of tuition it had when originally purchased. Under a contract plan, participants agree to purchase a specified number of years of tuition and mandatory fees and/or room and board. The purchase price depends on the age of the child, the type of payment (lump sum or installment), and the number of years or units purchased. Contract plans usually offer lower prices for younger children because the state has more time to invest the money.

Prepaid tuition plans provide a hedge against tuition inflation and enable the state to pool money to make long-range investments so that the earnings meet or exceed college tuition increases. Most prepaid tuition plans also have some type of guarantee from the state, ranging from full faith and credit obligations to a statutory guarantee. The specifics of prepaid tuition plans vary greatly from one state to another.

INCOME TAX CONSIDERATIONS

Contributions to 529 plans are made with after-tax dollars and any earnings grow tax-free at the federal level. Earnings withdrawn from 529 plans to pay for qualified higher education expenses are free from federal income tax for state-sponsored programs and programs of any eligible higher education institution.

State-tax treatment of college savings plan contributions, earnings, and withdrawals vary from one state to another. A number of states allow residents who participate in their own state's plan to claim a partial or full state income tax deduction on contributions. In addition, many states provide residents with a state tax break on earnings distributions from 529 plans that are used to pay qualified college expenses. Check with your tax advisor for your state's tax treatment of contributions to, and earnings distributions from, both in-state and out-of-state 529 plans.

SELECTING A 529 PLAN

No two 529 plans are exactly alike. Before selecting either a prepaid tuition plan or a savings plan, you should consider what type of plan best suits your needs and obtain copies of its offering documents, which are provided free of charge by the plan and discuss the plan's features in detail. Rather than obtaining documents for just one plan, you may want to examine documents for a number of different plans, including those offered by your home state because they may offer benefits not available in another state's program. Doing so will enable you to compare the features offered by each of the programs and determine which plan best suits your needs. An excellent source for these materials is the College Savings Plans Network (CSPN) website (www.collegesavings.org).

Some investors may even consider both kinds of plans — a prepaid plan to cover tuition and fees and a savings plan to pay for additional expenses, such as room and board, books, and required supplies and equipment in connection with a postsecondary education.

Investors with questions about any of the plan's features should contact the state or the plan sponsoring the program. Most plans offer toll-free phone numbers to assist investors. Contact information for each of the states is available through the CSPN website.

When considering opening a 529 account you may want to consult with a financial adviser. If you consult with a financial adviser, you should ask whether the adviser has a relationship with any particular plan he or she is recommending. You also should be sure to ask an adviser about the plans offered by your home state to ensure that the plan you ultimately select is the plan that best suits your needs. If your financial adviser does not recommend your home state's plan, you should obtain and review information on your home state's plan before making an investment decision.

SELECTING A 529 PLAN:

“Checklist”

Use this checklist to compare the features of different 529 plans. All of this information is readily available from the offering documents each plan provides.

- ✓ Who may open the account?
- ✓ Is there any limit on who qualifies as an eligible beneficiary?
- ✓ Are there any age requirements for the account owner or beneficiary?
- ✓ Can I change the account beneficiary? If so, are there any fees assessed by the plan for the change?
- ✓ Is the plan available to residents in my state?
- ✓ At which colleges, universities, or vocational schools may withdrawals be used? (For example, if the 529 plan is a prepaid tuition plan there may be limits on the institutions whose tuition is covered in full.)
- ✓ Do I have to name a specific school when buying a prepaid tuition plan? If the plan is school-specific, what happens if the student decides to attend a different school or isn't admitted by the school?
- ✓ Are prepaid tuition benefits guaranteed by the state?
- ✓ How are prepaid plan benefits indexed to tuition inflation? Are they guaranteed to equal actual tuition increases, the state average increase, or a projected increase?
- ✓ Does the plan impose any minimum contribution requirements?
- ✓ Is there a limit on how often I can invest in the account or on how much I can annually invest in the account?
- ✓ What is the maximum amount that I can invest in the account over the life of the account?
- ✓ What expenses are covered by plan withdrawals?

- ✓ What is the plan's refund policy?
- ✓ Are there any special incentives for state residents?
- ✓ What fees are associated with my account?
- ✓ Is there an account minimum I must maintain to avoid certain fees?
- ✓ Can I buy the plan directly from the state or plan sponsor, or must it be purchased through a broker-dealer?
- ✓ If I purchase the plan through a broker-dealer, will the broker-dealer impose any additional fees in connection with opening the account?
- ✓ Can I change how my money is invested?
- ✓ If I consult with a financial adviser, what relationship, if any, does that adviser have with the plan he or she is recommending?
- ✓ What investment options are offered by the plan?
- ✓ What are the risks associated with each of the investment options?
- ✓ Are any of the investment options “age-based” such that the portfolio will be automatically adjusted as the beneficiary gets older?
- ✓ What has been the performance of the various investment options offered by the plan?
- ✓ Does my state offer any tax advantages for either contributions made to the account or withdrawals from the account?
- ✓ Does the plan limit how soon I can begin taking withdrawals from the account?
- ✓ Does the plan impose any penalties for withdrawals from the account or impose any account termination fees?
- ✓ What customer services does the plan provide (toll-free phone numbers, online account information, regular bulletins, or mailings)?
- ✓ What happens to existing investments and future investments if the investment manager is changed by the state?
- ✓ What if my child does not pursue a postsecondary education?

FREQUENTLY ASKED QUESTIONS

Are prepaid tuition plans and college savings plans different?

Yes. With a prepaid tuition plan, parents, grandparents, and others essentially “lock in” today’s tuition rates, and the program will pay out future college tuition at any of the state’s eligible colleges or universities (or a payment to private and out-of-state institutions). A college savings plan is an investment program that allows participants to invest in a special account designated for qualified higher education expenses. In general, college savings plans offer a rate of return that depends on the performance of the plan’s investments. As such, the value of a college savings plan account may increase or decrease over time.

How much can be contributed to a 529 plan?

Each state sets its own contribution limit under federal regulations. For a prepaid tuition plan, the maximum contribution is the amount necessary to prepay the number of years or units of tuition offered by the state. This amount will vary from state to state. A majority of states with college savings plans have maximum contribution limits of more than \$250,000. These limits also may be adjusted annually for inflation. In 2007, individuals can contribute up to \$60,000 in one year for each beneficiary—or \$120,000 from married couples—without incurring federal gift taxes, as long as no further gifts to or for that individual are made during the next five years.

Who can contribute to 529 plans?

Generally an account holder can open an account on behalf of any student or potential student. For example, grandparents can save on behalf of grandchildren. Even someone who is not a family member can open a 529 plan account for an unrelated child or adult.

Can I open more than one account in the name of the same student?

Yes. You can open multiple accounts for the same student, and more than one person can contribute to a college savings plan for the same beneficiary. However, a state’s maximum contribution limit would limit the total amount that may be invested for a single beneficiary under that state’s program, regardless of how many accounts are held in the beneficiary’s name.

Do 529 plans vary from state to state?

Yes. Each state with an existing plan offers various investment options specifically designed to save for education expenses. Determining which plan to invest in will depend on individual circumstances, taking into account several factors associated with the programs, such as fees, expenses, investment options, and performance. In addition, investing in the plan offered by an individual’s own state might lower that individual’s state income tax burden, depending on the laws of the state. Participants may transfer 529 assets from one state’s plan to another, tax-free, once every 12 months, or more often if there is also a change to the account’s beneficiary. There may, however, be state tax implications when you transfer from one.

Can I have more than one student in a single account?

No. When you invest in a college savings plan or prepaid plan you are investing on behalf of a designated individual beneficiary. You can transfer your account to any member of the beneficiary’s family, as defined by the Internal Revenue Service, without incurring any taxes or penalties.

When can a 529 plan be opened?

The answer depends on the type of 529 plan being opened. A college savings plan generally can be opened anytime after a child is born. Most prepaid tuition plans, however, have a set enrollment period established by the state during which new accounts may be opened and have age limits for the beneficiary.

Where can 529 college savings plan withdrawals be used?

Withdrawals from 529 savings plans can be used to pay for qualified higher education expenses at any college, university, vocational school, or other accredited postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. This includes virtually all accredited public, nonprofit, and privately owned profit-making postsecondary institutions.

What expenses can 529 plan withdrawals be used for?

Withdrawals from 529 savings plans can be used penalty-free only to pay for qualified higher education expenses, such as tuition and fees; the cost of books, supplies, and other equipment; and in some situations the cost of room and board. (The cost of room and board may be a qualified higher education expense if the designated beneficiary is enrolled at least half time at an eligible educational institution.) Section 529 prepaid tuition plans typically cover tuition and required fees. Unlike the Independent 529 Plan, some states' prepaid plans may also cover room and board.

What if my child does not pursue a postsecondary education?

You may request a refund, and the account will be refunded according to the policy of your specific 529 plan. For 529 savings plans, the refund would include any earnings in the account. Under federal law, there may be income tax consequences including a refund penalty of 10 percent, except in the case of the student's death, disability, or receipt of a scholarship. In lieu of requesting a refund, you may choose either to hold the 529 plan investment until a later date when the student may decide to attend college, or transfer the benefits to another member of the student's family.

Will 529 savings plans affect a student's chance to qualify for financial aid?

Financial aid treatment of investments changes through the years so it is impossible to know how assets will be treated in the future. Typically, however, any investment may impact a student's eligibility for need-based financial aid. In addition, it is uncertain as to how much or what types of financial aid will be available to families in the future. You should contact the financial aid office of your local college or university for specific information on its financial aid treatment of 529 accounts.

What happens if I move from one state to another?

You have a choice of leaving your money in the existing plan or rolling it over into the plan of your new state. Assets of one 529 plan can be transferred tax-free to another 529 plan for the same beneficiary once during a 12-month period. There may, however, be state tax implications when you transfer from one 529 plan to another. Also, if you decide against changing plans after moving, you may lose any state tax deduction on future contributions and state tax exemptions on withdrawals made to the plan offered by your former home state. (The money invested will still grow tax-deferred.) Your new state also may offer favorable tax treatment for investments made in its plan. As a result, when moving, you should investigate the tax implications of each state's plans. An account owner does have the option of establishing accounts in more than one state for the same beneficiary.

Where can I find more information on 529 plans?

Many mutual fund company websites provide information on education savings programs they offer. Individuals seeking additional information on prepaid tuition plans and college savings plans may want to visit the website of the College Savings Plans Network, an affiliate of the National Association of State Treasurers, at www.collegesavings.org. Additional information about 529 plans and their regulation is available through the websites of the Municipal Securities Rulemaking Board (www.msrb.org), which regulates the offer and sale of such plans, and of the Financial Industry Regulatory Authority (www.finra.org), which regulates broker-dealers.



In 1991, the College Savings Plans Network formed as an affiliate to the National Association of State Treasurers. Intended to make higher education more attainable, the Network serves as a clearinghouse for information among existing college savings programs. Additionally, CSPN monitors federal activities and promotes legislation that will positively affect state programs. It is a networking conduit for professional staff from across the nation to share innovations and experiences. More information on CSPN is available at www.collegesavings.org or by contacting them at:

P.O. Box 11910
Lexington, KY 40578-1910
1-877-CSPN4YOU



The Investment Company Institute is the national association of the investment company industry. Its members include mutual funds, closed-end funds, sponsors of unit investment trusts, and exchange-traded funds. The Institute's website, www.ici.org, is an educational and reference tool for individuals seeking information about the mutual fund industry. Hyperlinks at the site enable users to go directly to the SEC, FINRA, and other sites for additional information about mutual funds. If you would like to know more, please visit our website at www.ici.org or, for a catalogue of additional investor awareness materials, write to:

ICI Investor Awareness Program
P.O. Box 27849
Washington, DC 20038-7850
202/326-5800



The North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 66 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, Canada, and Mexico. In the United States, NASAA is the voice of the 50 state securities agencies responsible for efficient capital formation and grassroots investor protection. More information on NASAA is available at www.nasaa.org or by contacting them at:

10 G Street, NE
Suite 710
Washington, DC 20002
202/737-0900



1401 H Street, NW, Suite 1200
Washington, DC 20005-2148
202/326-5800

www.ici.org

Copyright © 2007 *Investment Company Institute*