Donald Rohner, A.W.M.A.
First Vice President -
Investments
1717 Arch Street
21st Floor
Philadelphia, PA 19103
215-665-6388
800-526-6397
drohner@janney.com

Trusted Advisors for Generations

529 FAQ's

Table of Contents

How many states currently have 529 plans?

Answer:

Currently, all states but Wyoming sponsor at least one 529 plan.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Do 529 plans include both college savings plans and prepaid tuition plans?

Answer:

Yes. Although most people associate 529 plans only with college savings plans (sometimes called college savings programs), prepaid tuition plans are another type of 529 plan. And though the two share some similarities, college savings plans and prepaid tuition plans differ in important ways (e.g., a prepaid tuition plan offers a guaranteed minimum rate of return, while a college savings plan does not). Make sure that you understand what type of 529 plan you're investing in.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

My child is the beneficiary of a 529 plan. Can we use the funds for elementary or secondary school?

Answer:

No, 529 funds can't be used to pay for an elementary or secondary school education. They can be used only for higher education expenses (college, graduate, or vocational school expenses).

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I opened a 529 plan with my child as beneficiary. If my mother contributes, is that a gift to me?

Answer:

It's considered a gift to your child. A contribution to a 529 plan is treated as a completed gift from the donor to the designated beneficiary of the account.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I roll over my existing 529 account to another state's 529 plan without penalty?

Answer:

Yes. You can do a rollover (without changing the designated beneficiary) once every 12 months without incurring a penalty. This might be attractive if you move to another state or if you simply prefer the investment options that a different state offers. However, if you want to roll over your account more than once a year, you'll need to designate a new beneficiary (you can change it back later) to avoid a penalty.

You must complete the rollover within 60 days in order to avoid a penalty. If you wish to roll over your account, be sure to check your plan's specific requirements.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

My child is the beneficiary of a 529 plan. Can he use the 529 funds for graduate school?

Answer:

It depends on which type of 529 plan--a college savings plan or a prepaid tuition plan. Most college savings plans use the federal definition of "qualified education expenses" and allow funds to be used for graduate school. But most prepaid tuition plans allow funds to be used only for undergraduate costs. Check the rules of any 529 plan you're considering to be sure.

And watch out for contribution limits if your child will be using 529 funds for both undergraduate and graduate school. All college savings plans limit the amount that can be contributed to a 529 account, so you may want to choose a plan whose contribution limit is high enough to cover the cost of six or more years of education.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Will I pay income tax when the money in my 529 plan is withdrawn to pay for college expenses?

Answer:

If the money you withdraw from a 529 plan (college savings plan or prepaid tuition plan) is used to pay qualified education expenses, then you won't owe federal income tax on the earnings portion of your withdrawal. However, depending on the state you reside in, you may owe state income tax, even if the withdrawal is used to pay qualified education expenses. So check the laws of your state. Keep in mind that withdrawals for purposes other than qualified education expenses will be subject to normal federal income tax treatment and may be subject to an additional 10 percent federal income tax penalty.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Who can legally offer 529 plans?

Answer:

It depends on the type of 529 plan. There are two types of 529 plans--college savings plans and prepaid tuition plans. With college savings plans, only states are allowed to operate them. With prepaid tuition plans, both states and colleges are allowed to operate them. To gain favorable federal tax treatment, any college savings plan or prepaid tuition plan must meet all of the requirements of Section 529 of the Internal Revenue Code.

Note: As a practical matter, states designate an agent (usually a financial institution or other professional money manager) to manage their particular college savings plan or prepaid tuition plan.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I invest in any state's 529 plan, or am I limited to my own state's plan?

Answer:

529 college savings plans are typically open to residents of any state, while 529 prepaid tuition plans are typically limited to state residents. States that let nonresidents join their 529 college savings plan may have different rules for residents and nonresidents (such as higher annual fees and higher minimum contribution requirements for nonresidents). And keep in mind that if you join a different state's 529 plan (either college savings plan or prepaid tuition plan), you won't enjoy any tax benefits offered by that state--your own state's tax laws would apply.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I'm contributing to a 529 plan for my grandchild. What about Medicaid spend-down requirements?

Answer:

Very possibly. So far, state laws have largely ignored this issue. But unless future legislation in your state exempts 529 plans from Medicaid rules, you'd be wise to assume that these assets will be subject to the state's grasp.

To be eligible for Medicaid, most states require that your assets and monthly income fall below certain limits. A state may count the assets and income that are legally available to you for paying bills. You can make assets unavailable by giving them away or by holding them in certain trusts. In some cases, though, such transfers may create a period of ineligibility before you can collect Medicaid.

The potential problem with 529 plans is that your contributions are "revocable." This means that you can contribute money to your grandchild's 529 account today, and then take it back (subject to income taxes and a penalty) later. Since it's possible for you to get your hands on the money, your state Medicaid authorities may consider your 529 gift to be a countable asset when considering your eligibility for Medicaid. That might prevent or delay your eligibility for Medicaid.

In addition, your state has the right to "look back" at your finances 60 months from the date you apply for Medicaid. Contributions you've made to your grandchild's 529 account within this period may delay your eligibility for Medicaid.

You may want to consult a Medicaid planning attorney and keep abreast of changes in your state's laws with respect to Medicaid and 529 plans.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Under what circumstances can the account owner of a 529 plan be changed?

Answer:

Many states allow an account owner to transfer ownership of the account to someone else. Some states allow this only at limited times, such as when divorce or separation occurs. Other states will only allow a change in account ownership after an account owner's death or incapacity. In some states, you may be able to designate an alternate account owner in the event of your death. You'll need to check your plan's restrictions to see when the change may be made.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Who can be a beneficiary of a 529 plan?

Answer:

The language of Section 529 of the Internal Revenue Code provides that any individual, regardless of age, can be a designated beneficiary of a 529 plan. A family relationship between the account owner and the beneficiary is not required. However, states can impose more restrictive requirements. For example, some plans have limits on a designated beneficiary's age or grade in school, and a few plans won't allow the account owner and the designated beneficiary to be the same person. Check the plans you are interested in for further information.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I move funds from my Coverdell education savings account to a 529 plan?

Answer:

Generally, yes. You may withdraw funds from your Coverdell education savings account and not pay federal income taxes on the withdrawal if you use the funds for qualified education expenses. The rules for Coverdell ESAs consider a rollover contribution to a 529 plan (for the same person who is the beneficiary of the Coverdell ESA) as a qualified education expense. So, the transfer will usually be a nontaxable transfer from the Coverdell ESA to the 529 plan. Such a transfer may produce state income tax advantages.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Is my rate of return guaranteed under a 529 plan?

Answer:

That depends on the type of 529 plan--a college savings plan or a prepaid tuition plan. Think of a college savings plan as an investment plan run by a state. The state or its agent invests your contributions in one of several pre-established investment portfolios. If the portfolio is age-based, the investments will be growth-oriented when the beneficiary is younger, and the state will shift money into more conservative investment vehicles as your child approaches college age. If the portfolio is not age-based, the types of investments (e.g., growth, balanced, conservative) will stay the same as the beneficiary grows older. Although you can potentially earn a higher rate of return with college savings plans, the rate of return is not guaranteed, and there's a chance you could lose money.

Prepaid tuition plans, though, generally guarantee you a minimum rate of return to ensure that you keep up with college inflation. In effect, you lock in tomorrow's tuition at today's prices. However, you'll generally be limited to the rate of return promised by your plan--you won't be entitled to any surplus.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How does the annual gift tax exclusion apply to contributions to a 529 plan?

Answer:

All contributions to 529 plans are considered present interest gifts and qualify for the annual federal gift tax exclusion. This means that you can contribute up to $14,000 per year, per beneficiary without incurring federal gift tax. So, if you contribute $17,000 to your son's 529 plan in a given year, for example, you'd ordinarily apply this gift against your $14,000 annual gift tax exclusion. The remaining $3,000 would be a taxable gift and you'd report it on a federal gift tax return.

However, under special rules unique to 529 plans, you can gift a lump sum in a given year--up to $70,000 for individual gifts and $140,000 for joint gifts--and avoid federal gift tax by making a special election to treat the gift as if it were made evenly over a five-year period. You make this election on your federal gift tax return (which you must file if your gift is over $14,000). For example, if you make a $70,000 contribution and make the election, your contribution will be treated as if you'd made a $14,000 gift for each of five years.

Lump sum gifts generally will not be considered part of your federal estate. But there is an exception. If you make a lump sum gift, elect to spread the gift over five years, and then die before the five-year period has ended, the portion of your contribution allocated to the years after your death will be included in your estate. For example, let's say you make a $50,000 contribution to a 529 plan in Year 1 and elect to spread the gift over five years. You die in Year 2. The result is that your Year 1 and Year 2 contributions of $10,000 each ($50,000 divided by 5 years) are not part of your estate, but the remaining $30,000 would be included in your estate.

Although your gifts over $14,000 in a year are taxable gifts, you may not actually write a check for the tax. Remember that you must use up your lifetime applicable exclusion amount before you'd be liable for an out-of-pocket payment for the gift tax.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

If I cash in Series EE bonds can I contribute the proceeds to a 529 plan to avoid paying tax?

Answer:

Yes. You can roll over the U.S. savings bonds into a 529 plan if you meet all of the requirements for income-tax-free use of the savings bonds. If you own certain Series EE savings bonds (which may also be called Patriot bonds) or Series I bonds, you may redeem them and exclude the interest from your income if you use the proceeds for qualified higher education expenses (tuition and fees) and if your modified adjusted gross income lies below a certain level in the year of the redemption.

Rolling the proceeds over to a 529 plan is considered equivalent to using the proceeds for qualified education expenses. So, meeting the income limitations in the year of rollover will be the key to avoiding tax on the proceeds of the savings bonds.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens if I need to use the funds in a 529 plan before my child goes to college?

Answer:

The good news is that you can withdraw money from your 529 account at any time and use it for any purpose. But unfortunately, if you're not using the money for qualified education expenses, you may have to pay a 10 percent federal penalty tax on the earnings portion of the funds you've withdrawn (a state penalty may also apply). And as the account owner, you may owe federal (and in some cases state) income taxes on the earnings portion as well. So, make sure you fully understand the financial consequences before tapping 529 funds for a reason other than to pay education expenses.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens to my 529 plan if my child wants to postpone going to college for a year or two?

Answer:

A delay of 1 or 2 years shouldn't matter, but if your child postpones college indefinitely, you should read the details of the 529 plan. Look to see if the plan you own (or are considering) has any time limits. Most prepaid tuition plans require that the funds in the plan be paid out within 10 years of the date the beneficiary is scheduled to attend college. College savings plans generally have no such requirement, and in most states, money in the account can be left indefinitely.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How do I enroll in a state's 529 plan?

Answer:

Contact the plan administrator that runs the 529 plan that you want to join. (All plans have websites and toll-free numbers to help you get the information you need.) Plan administrators may be state agencies or companies established solely for the purpose of running a 529 plan, or they may be investment firms. In any case, the plan administrator operates under the authority of each state government, such as the state treasury department. The plan administrator will send you a packet of information that includes enrollment materials, along with a program description. Read the information thoroughly and make sure you understand the plan's rules before you enroll.

In addition, be sure to check the enrollment period for the plan. Many states offer open enrollment, meaning you can join the plan at any time. Other states have shortened enrollment periods, such as October to January.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Will I be penalized if the money in my 529 plan isn't used for college expenses?

Answer:

Whether your 529 plan is a college savings plan or a prepaid tuition plan, the money you withdraw must be used for qualified higher education expenses. These expenses include tuition, fees, books, and room and board (if the beneficiary is attending school at least half-time) for college and graduate school.

If you use the money for any other purpose, the earnings portion of the distribution will be taxable on your federal (and possibly state) income tax return in the year of the distribution. Also, you generally must pay a 10 percent federal penalty on the earnings portion of your distribution. (There are a couple of exceptions. The penalty is usually not charged if you terminate the account because your beneficiary has died or become disabled, or if you withdraw funds not needed for college because your beneficiary has received a scholarship.)

Bear in mind that the "distributee" is the one subject to tax. (The distributee is the person who actually receives the money from the 529 plan.) In most situations, this will be the account owner. So, if you fund a college savings plan for your son, for example, and withdraw the money three years later (before he reaches college age), you will probably be the one taxed and penalized. However, some plans specify who the distributee is, while others allow the account owner to determine the recipient of a nonqualified withdrawal.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What expenses and fees are generally associated with 529 plans?

Answer:

Many 529 plans pass along their costs of administration to account owners through fees and other expenses. These fees vary from state to state. Typical charges include an enrollment or application fee when you set up most prepaid tuition contracts. College savings plans charge account owners for fund expenses and investment management fees imposed by the program's investment manager, as well as other fees. Charges by the investment manager are in the form of a pre-set percentage of your account's accumulated value. Many college savings plans also impose a flat account maintenance fee unless you maintain a substantial balance or make automatic payments to your account.

You may also be charged a fee for changing your 529 account's beneficiary, owner, or payment schedule. Keep in mind, however, that the program administrator can waive fees, particularly if you're a resident of the state running the plan.

Make sure you have a full understanding of the fees that apply to a 529 plan you're considering. Such charges could have a significant impact on your account's return. But the plan with the lowest fees is not necessarily the best. Weigh fees and expenses with other factors, such as investment history, program flexibility, and state tax issues.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Do 529 plan expenses vary among states?

Answer:

Yes. There are great differences in the amount and types of fees and expenses that 529 plans charge in various states. Pay close attention to those charges when choosing a plan. In some cases, fees and expenses can significantly affect your account's return.

Fees commonly charged include enrollment fees, annual account maintenance fees, expenses charged for making changes to your account, and investment management fees (for a college savings account). Some fees and expenses apply only to out-of-state residents, and some fees may be higher for nonresidents. Some fees may be waived altogether under certain circumstances (e.g., if you set up a payroll deduction plan for automatic contributions to 529 plan).

Keep in mind that plans that contain the lowest fees and expenses aren't necessarily the best plans. Be sure to weigh these charges along with other factors, including investment performance and program management. In addition, before investing in a 529 plan outside of your state of residency, find out what state tax benefits (if any) you might lose if you do so. Your state may offer tax benefits only to residents who invest in their in-state 529 plan.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What can you tell me about employer-sponsored 529 plans?

Answer:

As 529 plans grow in popularity, companies are beginning to offer employer-sponsored 529 plans as part of their employee benefits packages. However, the term "employer-sponsored 529 plan" is somewhat misleading--the plan itself is not sponsored by the employer; rather, it is the means of contribution (i.e., automatic payroll deduction) that is sponsored. Having your 529 contributions automatically deducted from your paycheck is one way to make it easier to save for college. With this type of forced savings, you don't "miss" the money and won't be tempted to spend it on something else.

Once you enroll in an employer-sponsored 529 plan, your account works just as if you had opened an individual 529 plan account. But unlike the process of opening an account on your own--where you have an unlimited number of plans to choose from--your participation in an employer-sponsored 529 plan is limited to the 529 plan(s) that your employer has selected. So, it's important to do some research before you sign up for your employer's plan. Look into the types of investment choices that are offered by the plan. Is there a broad range of investments to choose from? Also find out if there are any plan restrictions (e.g., your child must attend college in state) or required fees. Most importantly, if your employer offers only 529 plans that are sponsored out of state, find out if you'll be missing out on any state tax benefits available if you were to contribute to your own state's 529 plan (e.g., a state income tax deduction for contributions).

If your employer doesn't offer a 529 plan or if you are unsatisfied with the plan(s) that your employer offers, you can still save in a 529 plan by opening an account on your own.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Must the funds in a 529 plan be used for tuition only, or can they be used for room and board?

Answer:

It depends on the state that sponsors the 529 plan, and whether you're talking about a prepaid tuition plan or a college savings plan. Under federal law, room and board costs are "qualified education expenses." But states aren't required to follow federal rules, and prepaid tuition plans typically won't allow 529 funds to be used for room and board expenses. Since most college savings plans follow federal rules, however, funds in a college savings plan can generally be used to pay for these costs as long as the student is enrolled in school on at least a half-time basis.

Room and board costs for students living on-campus are limited to the actual amount charged by the school or to the amount most residents are charged, whichever is higher. Room and board costs for students living off-campus, including students living with their parents, are limited to the amount the school decides is reasonable. Each state's plan will spell out the guidelines that govern room and board expenses and what procedures to follow when requesting a withdrawal.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What is the Private College 529 Plan?

Answer:

The Private College 529 Plan (formerly the Independent 529 Plan) is the country's first college-sponsored prepaid tuition plan. College-sponsored prepaid tuition plans (also referred to as private prepaid tuition plans) are an alternative to traditional state-run prepaid plans.

Both types of plans receive favorable federal tax treatment under Section 529 of the Internal Revenue Code (assuming they're structured properly) and both allow you to prepay tuition now for use in the future. The difference between them is that state-run prepaid tuition plans allow you to prepay tuition at one or more public state colleges, while college-sponsored prepaid plans allow you to prepay tuition at the private colleges in the plan.

How does the Private College 529 Plan work? Parents, grandparents, or other relatives or friends can open an account for a beneficiary and purchase certificates that buy a percentage of future tuition at any of the colleges across the nation that participate in the plan. The percentage varies, depending on the school's current tuition rate and the discount it offers.

You aren't required to choose a specific college when you purchase a certificate, but you may choose to have up to five colleges that you are considering displayed hypothetically on your quarterly statements. Your statements will show how much tuition your current certificates would cover at each of these institutions. At college time, certificates can be redeemed at the participating college the beneficiary actually chooses to attend.

A major benefit of the Private College 529 Plan is that it consists of a network of hundreds of private colleges, so the beneficiary isn't locked into attending only state colleges. Another advantage is that the participating colleges have promised to make up any financial shortfall if the plan's investment returns don't keep pace with tuition increases--they won't leave you holding the bag. Plus, the plan doesn't charge sales, application, or maintenance fees.

But despite the benefits, there are some drawbacks to consider. If the beneficiary doesn't attend one of the participating colleges, you'll get your original contributions back, but your refund will be adjusted by the actual investment return the program trust has earned (a cap of 2 percent applies, however, to either a gain or a loss). Keep in mind, too, that you'll pay a 10 percent federal penalty, as well as income tax, on the earnings part of any refund that is not used for college expenses (a state penalty may also apply). And although the plan lets you prepay only tuition and mandatory fees (those required as a condition of enrollment), you can't prepay room and board, books, or nonmandatory fees. In addition, your account must be open for at least 36 months before you can redeem any certificates.

For more information and a list of participating colleges, visit the Private College 529 Plan's website at www.privatecollege529.com.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How does a 529 plan compare with investing in a mutual fund in my name?

Answer:

Section 529 plans are often a more powerful tool than mutual funds because of the favorable federal tax treatment given to these plans. First of all, assets in a 529 are tax deferred. Plus, withdrawals from a 529 plan that are used to pay qualified education expenses avoid federal income tax. States may also offer income tax breaks for 529 plans, such as tax-free withdrawals and tax-deductible contributions.

In contrast, most mutual funds are taxable investments. This generally means that the income earned by the fund (e.g., dividends and capital gain distributions paid by the fund) will be taxable to you in the year it is paid. The result will be the same whether you receive the income in cash or have it reinvested into your mutual fund account. Also, when you sell your mutual fund shares to raise money for your child's education, you'll have to pay capital gains tax on any appreciation. Long-term capital gains rates are more favorable than income tax rates, but the bite can still be painful if your fund has appreciated dramatically.

But mutual funds do have certain advantages over 529 plans. Mutual funds do not impose any restrictions or penalties if you need to sell your shares before your child is ready for college. However, if you withdraw assets from a 529 plan and use the money for noneducational expenses, the earnings part of the withdrawal will be taxed and penalized. You keep more control over your investment decisions because you can choose from a wide range of mutual funds, and you're typically free to move money among a company's funds, or from one family of funds to another, as you see fit.

By contrast, you can't choose your investments with a prepaid tuition plan, though you are generally guaranteed a certain rate of return or that a certain amount of tuition expenses will be covered in the future. And with a college savings plan, you may be able to choose your investment portfolio at the time you join the plan, but your ability to make investment changes is limited. Some plans may let you direct future contributions to a new investment portfolio. States may also allow you to change the investment option for your existing contributions once per calendar year or when you change the beneficiary. But it's not a federal requirement, so check with your specific college savings plan for more details.

Keep in mind that both college savings plans and mutual funds entail risk--your ultimate college fund could be worth more or less than the principal you invested.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can contributions to a 529 plan be directly debited from my checking account?

Answer:

It depends on the plan. In general, many plans will allow you to set up an automatic debit arrangement to make contributions to your 529 account. But the only way to know for sure is to ask your plan administrators.

If your plan offers this feature, it's generally very easy to set up--you simply complete the required paperwork with your 529 plan. You'll typically have to provide your bank account information and indicate the desired amount and frequency of your contributions (e.g., $100 a month). Then you can sit back, because the money will be automatically deducted from your bank account and invested in your 529 account--you won't have to worry about sending in a check every time you want to make a contribution. That makes these arrangements a convenient and reliable way to save for your child's education, especially if you don't consider yourself a disciplined saver.

If you set yourself up for automatic bank account debits, be aware that the contribution limits and minimums that your 529 plan imposes will still apply (though some plans may waive the minimum deposit needed to open an account if you sign up for automatic debits). And be sure to find out if you'll be subject to any special charges (or discounts, for that matter) if you opt for automatic debits.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens if I open a 529 plan in one state and then move to another state?

Answer:

Essentially nothing. You can leave the account assets in your former state's plan with no penalty. Alternatively, you can roll the assets over from your old state's 529 plan to your new state's plan if both plans allow it. Check the details of each plan carefully before you start any transfers.

You can keep the same beneficiary when you do the rollover. But the rollover does bring with it a restriction: You can roll the assets over from one 529 plan to another only once every 12 months. If you want to immediately get out of the 529 plan you're in now and avoid this restriction, you'll need to change the account beneficiary when you request the transfer.

Some 529 plans also require a minimum time period, such as one year, before withdrawals (including rollovers) can be made from an account for any reason. Again, check both plans to make sure there are no withdrawal limitations.

One advantage of a rollover is that you can reallocate your 529 funds to a different investment portfolio (or portfolios) when you join the new plan. So, you might be able to invest more or less aggressively, depending on your personal situation and market factors.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I deduct my contributions to my 529 account?

Answer:

Section 529 plans, which include college savings plans and prepaid tuition plans, offer several tax and nontax benefits. But unfortunately, a federal income tax deduction is not one of them. You can't claim a federal income tax deduction for contributions you make to your 529 plan. However, certain states offer state income tax deductions for contributions to 529 plans. You should check with your individual 529 plan or your state's taxing authority to determine the tax treatment in your state.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How does a 529 plan compare with using U.S. savings bonds for college expenses?

Answer:

Section 529 plans and U.S. savings bonds are very different ways to save for college. Though both strategies offer federal tax advantages if certain conditions are met, there are few other similarities.

U.S. savings bonds--Series EE (which may also be called Patriot bonds) and Series I--are purchased at banks and other financial institutions in face values as low as $50 ($25 if purchased electronically). Typically, U.S. savings bonds earn a return in the range of 3 to 5 percent. And since they're backed by the full faith and credit of Uncle Sam, they're virtually guaranteed.

The interest you earn on U.S. savings bonds is exempt from state and local tax at the time you redeem (cash in) the bonds. And you may be able to exclude at least some of the interest from federal income tax if you meet the following conditions:

- Your modified adjusted gross income must be below $91,000 if you're single and $143,950 if you're married (2014 figures)
- The bond proceeds must be used to pay for qualified education expenses
- The bonds must have been issued in 1990 or later
- The bonds must be in the name of one or both parents, not the child's name
- Married taxpayers must file a joint return
- The bonds must have been purchased by someone at least 24 years old
- The bonds must be redeemed in the same year that qualified education expenses are being paid

Section 529 plans, which include both college savings plans and prepaid tuition plans, work differently. A college savings plan invests primarily in stocks through one or more pre-established investment portfolios that you choose upon joining the plan. So, a college savings plan has a greater return potential than U.S. savings bonds, because stocks have historically averaged greater returns (though past performance is no guarantee of future results). However, there is a greater risk of loss of principal. Your rate of return is not guaranteed with a college savings plan--you could even lose some of your original contributions. By contrast, a prepaid tuition plan generally guarantees you an annual rate of return in the same range as U.S. savings bonds (or maybe higher, depending on the rate of college inflation).

Perhaps the best advantage of 529 plans is the federal income tax treatment of withdrawals used to pay qualified education expenses. These withdrawals are completely free from federal income tax no matter what your income, and some states also provide state income tax benefits. Remember, in order to exclude federal income tax on the interest earned by U.S. savings bonds, your income can't exceed a certain level, and you must meet other criteria.

However, keep in mind that if you don't use the money in your 529 account for qualified education expenses, you will owe a 10 percent federal penalty tax on the earnings portion of the funds you've withdrawn (you may owe a state penalty too). Also, if you are the recipient of the distribution from the plan, you may owe federal (and in some cases state) income taxes on the earnings portion of your withdrawal, as well.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I open a 529 plan with a lump sum?

Answer:

Yes, although you will want to consider both the plan's terms and the gift tax rules. Every plan has a lifetime contribution limit--in the majority of states, this limit is at least $300,000. Unlike Coverdell education savings accounts, your annual income does not limit your contributions. So, it doesn't matter how much money you earn in a particular year--you can still contribute to a 529 plan.

As a donor to a 529 account, you can contribute up to $14,000 per year, per beneficiary with no gift tax problems. If you are married, your spouse can also contribute up to $14,000. So, the two of you could use $28,000 to start a 529 account for your child without any gift tax concerns.

Although $14,000 per year is the limit for tax-free gifts, you can actually "front load" a 529 account by putting in $70,000 per beneficiary ($140,000 for joint gifts) and avoid federal gift tax by making a special election to treat the gift as if it were made over a five-year period.. In effect, you're making five $14,000 contributions all at once. So, you can't make any more $14,000 contributions over the next five years for that same beneficiary without owing a gift tax. But in effect, two parents (or grandparents) could fund an account for one child with $140,000 all at once.

Any amounts contributed in excess of $14,000 per year (after any "front loading" as previously described) count toward an individual's lifetime applicable exclusion amount.. Once you exceed that amount, gift taxes must be paid. And any time you exceed the $14,000 amount in a year, you must file IRS Form 709 (the federal gift tax return) at the same time as your income tax return.

By the way, 529 accounts must be funded with cash only. So, if your lump sum is coming from a potential sale of appreciated securities (e.g., stocks), it may not make sense to sell the securities and pay capital gains taxes. Consult your tax advisor before you make a decision.

Also, if you're in a state that allows a state tax deduction for 529 plan contributions, you may want to avoid a lump-sum contribution and make annual contributions instead. This approach lets you qualify for the state tax break in future years.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

If I open a 529 account, will my child's choice of college be restricted?

Answer:

It depends on the type of 529 plan you open. There are two types of 529 plans--college savings plans and prepaid tuition plans. With a college savings plan, your child can use the money at any college in the country and abroad that is accredited by the U.S. Department of Education. By contrast, with a prepaid tuition plan, your child will only receive the maximum benefits under the plan if he or she attends one of the colleges in the plan. If your child chooses a different school, you may pay a penalty.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How does a 529 plan compare with an UGMA/UTMA custodial account in my child's name?

Answer:

There are several issues to consider here. One advantage of the 529 plan is your ability to retain control. If you transfer assets to a custodial account in your child's name, your child becomes the legal owner of the account upon reaching majority age (18 or 21, depending on the state). Your child can then use the assets as he or she pleases, even if that means buying a new Ferrari instead of funding college costs. A 529 account gives you much more control, assuming you name yourself as owner and your child as beneficiary. As the account owner, you decide when the money will be withdrawn and for what purpose.

Taxes are another important issue. Withdrawals from a 529 plan that are used to pay qualified education expenses are completely free from federal income tax. Your state may offer tax breaks for 529 plans, as well. In contrast, the earnings on assets in a custodial account are taxed to your child every year (even if no withdrawals are made) and are subject to special rules commonly referred to as the "kiddie tax." Children subject to the kiddie tax are generally taxed at their parents' tax rate on any unearned income over a certain amount. This amount is currently $2,000 (the first $1,000 is tax free and the next $1,000 is taxed at the child's rate). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.

This doesn't mean that there are no advantages to saving with a custodial account in your child's name. Custodial accounts offer more flexibility in accessing the funds. For example, if you need money to pay your child's medical bills, you can tap the custodial account without penalty. By contrast, the earnings portion of a 529 plan withdrawal will be taxed and penalized if the money isn't used for education.

Another advantage of custodial accounts is that you can fully control the underlying investments--you can be as aggressive as you want and you can change investments as often as you want. With 529 plans, however, you have only limited control over your investments. With a prepaid tuition plan, you have no say in how your money is invested (though you are generally guaranteed a certain rate of return or a certain amount of future tuition costs). With a college savings plan, you can generally select an investment portfolio at the time you join a plan (though never the portfolio's underlying investments). Beyond that, plans differ on the investment flexibility they give you. Some plans may let you direct future contributions to a new investment portfolio. States may also let you change the investment option for your existing contributions once per calendar year or when you change the beneficiary. Check with your college savings plan for more details.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Will the value of my 529 account be included in my estate or my beneficiary's estate?

Answer:

All contributions to 529 plans are considered present interest gifts. So, in general, the value of a 529 plan is included in the estate of the designated beneficiary.

There is an exception if you contribute more than $14,000 to the 529 account of a particular beneficiary in a given year and you make the election to treat your contribution as if made evenly over a five-year period. If you make this election and then die before the five-year period is up, the portion of the contribution allocated to the years after your death will be included in your gross estate.

For example, let's say you make a $35,000 contribution to a college savings plan in Year 1 and elect to treat the gift as if made over five years. You die in Year 2. The result is that your Year 1 and Year 2 contributions--$7,000 each year ($35,000 divided by 5 years)--are completed gifts to the beneficiary. The remaining $21,000 ($35,000 minus $14,000) is included in your gross estate.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I contribute my own stocks and bonds to the 529 account I've set up for my child?

Answer:

No. Your contributions to a 529 plan must be made in cash (e.g., checks, credit card payments), so you cannot contribute stocks, bonds, mutual funds, or any other property. If you have money tied up in such investments and would like to move the money to a 529 account for your child, you must liquidate (sell) the investments first. But before you do so, be sure to seek sound financial advice about the tax consequences and other related issues.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How much can I invest in a 529 plan?

Answer:

Section 529 of the tax code requires that a 529 account not accept more contributions than are necessary to meet the qualified education expenses of the account beneficiary. A plan will pass this test if it limits total contributions to the amount needed to fund five years of the beneficiary's tuition, fees, and room and board at the most costly college allowed under the program, and many states are including graduate school costs in the tally. Each plan can set its own limit within this guideline. When the value of a beneficiary's account reaches the limit chosen by the state, no more contributions may be made to that state's 529 plan for the beneficiary. (Some states may also impose an annual contribution limit.) In the majority of states, the maximum contribution limit is at least $300,000.

Keep in mind that the contribution limit for a 529 plan is a per-beneficiary limit. For example, you, your father, and your sister each open a 529 account in the same state's plan for the benefit of your son. The plan has a lifetime contribution limit of $300,000, but that doesn't mean that you can each contribute $300,000. Instead, none of you may contribute after the value of your son's accounts reaches $300,000. This per-beneficiary limit can work in your favor if you have more than one child who will be attending college. Using the same $300,000 limit, if you have four children, you could set up a separate 529 account for each child and invest up to $300,000 in each account (a total of $1.2 million for the four children).

Another thing to keep in mind is that plans periodically raise their contribution limit to keep pace with rising college costs. If so, make sure that you can keep contributing as the limit increases.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

If I am the account owner when I die, will the value of my 529 account be included in my estate?

Answer:

Probably not. Generally, the value of a 529 plan is included in the estate of the designated beneficiary. All contributions to 529 plans are considered present interest gifts to the beneficiary.

However, there is an exception if you contribute more than $14,000 for a particular beneficiary in a given year and you elect to treat your contribution (up to $70,000 for individual gifts and up to $140,000 for joint gifts) as if made evenly over a five-year period. If you make this election and then die before the five-year period is up, the portion of the contribution allocated to the years after your death will be included in your gross estate.

For example, let's say you make a $35,000 contribution to a college savings plan in Year 1 and elect to treat the gift as if made over five years. You die in Year 2. The result is that your Year 1 and Year 2 contributions are considered to be $7,000 each ($35,000 divided by 5 years). The remaining $21,000 is included in your gross estate.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How does a 529 plan compare with a Coverdell education savings account?

Answer:

Several key restrictions apply to Coverdell education savings accounts that don't apply to 529 plans. First, the annual contribution limit for Coverdell ESAs is $2,000, much less than you can contribute to most 529 plans (most plans have lifetime contribution limits of at least $300,000 per beneficiary). Second, depending on your income, you may not be able to contribute to a Coverdell ESA. To contribute anything, single filers must have a modified adjusted gross income (MAGI) under $110,000, and married filers must have a MAGI under $220,000. Another drawback is that you can't contribute to a Coverdell ESA for a beneficiary who is 18 or older, unless the beneficiary is a child who has special needs. By contrast, 529 plans don't restrict your ability to contribute based on your income, and most plans let you contribute after the beneficiary reaches age 18.

The tax treatment of Coverdell ESAs and 529 plans is generally similar. At the federal level, withdrawals from both a Coverdell ESA and a 529 plan that are used to pay the beneficiary's qualified education expenses (qualified withdrawals) are free from income tax. Such withdrawals may also be exempt from state income tax, depending on the state you live in. Keep in mind, though, that there is no federal deduction for contributions made to a Coverdell ESA or a 529 plan, but states may offer their residents a deduction for contributions made to that state's 529 plan.

Not surprisingly, withdrawals from a Coverdell ESA and a 529 plan that aren't used to pay the beneficiary's qualified education expenses (nonqualified withdrawals) aren't treated as favorably. Specifically, the earnings portion of such withdrawals is subject to a 10 percent federal penalty (a state penalty may also apply to 529 plan nonqualified withdrawals) and federal income tax. For 529 plans, the person who receives the distribution pays the tax--usually the account owner--while the beneficiary of a Coverdell ESA generally pays the tax. And depending on the state you live in, state income taxes may also apply.

Yet Coverdell ESAs do have a couple of advantages over 529 plans in funding your child's education. First, you can use Coverdell ESA funds for elementary, secondary, and higher education expenses (529 plan funds can be used only for higher education expenses). Second, you have full control over your underlying investments with a Coverdell ESA.

By contrast, 529 plans give you only limited control over your investments. Specifically, with a prepaid tuition plan, you have no say in how your money is invested (though you are generally guaranteed a certain rate of return or that a certain amount of future tuition costs will be paid). With a college savings plan, you can generally select an investment portfolio at the time you join the plan (though never the portfolio's underlying investments). However, college savings plans differ with regard to the investment flexibility they give you. If you want to change your investment option due to poor performance, the IRS has given states the discretion to let you change your investment option once per calendar year, or anytime you change the beneficiary. Plans may also let you direct future contributions to a different investment option. But it's up to the individual plans whether to offer such flexibility, so check with your specific plan.

If your college savings plan doesn't offer this investment flexibility, you have another option guaranteed by federal law--a rollover. You can roll over your existing 529 account (college savings plan or prepaid tuition plan) to a different 529 plan once every 12 months without penalty (and without having to change the beneficiary).

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Should I make tuition payments directly to my grandchild's college or contribute to a 529 plan?

Answer:

Direct payment of tuition to an educational institution is not considered a taxable gift. Therefore, you're able to "give away" more than $14,000 per year (the amount of the annual federal gift tax exclusion) for your grandchild's college education and not worry about gift taxes. The money used to pay the tuition also will not be part of your estate.

With 529 plans, all contributions are considered gifts, so you want to use your annual federal gift tax exclusion. This exclusion lets you give to another person, like your grandchild, up to $14,000 per year without any gift tax or estate tax consequences. If you contribute more than $14,000 to the same beneficiary during a given year, though, you can avoid the gift tax if you elect to treat your contribution (up to $70,000 for individual gifts and up to $140,000 for joint gifts) as if made evenly over a five-year period. However, informational gift tax returns must be filed. In any case, no gift tax must be paid out of pocket until you've used up your lifetime applicable exclusion amount.

Section 529 plans offer certain advantages over the direct payment of tuition. First, withdrawals from 529 plans can be used to pay for tuition, fees, books, and even room and board for college and graduate school. The exclusion for direct payment of educational expenses, on the other hand, applies only to tuition. Your grandchild might need significantly more financial assistance.

You should also consider the possibility that you may not live long enough to pay your grandchild's tuition in the future. In such a case, nothing will be removed from your taxable estate (and the money your grandchild needs for education may not be available). If you contribute money to a 529 plan now, though, your contributions will be considered present interest gifts, and the value of your gifts to the plan will be taken out of your estate. (That is, unless your total gifts in one year are more than $14,000, you elect to treat the gifts as if made over a five-year period, and then you die within the five years. In such a case, the portion of the contribution allocated to the years after your death will be included in your gross estate.)

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How will my 529 account be treated for financial aid purposes?

Answer:

The federal government treats 529 plans (college savings plans and prepaid tuition plans) as an asset of the parent, if the parent is the account owner. So if you're a parent and the account owner of a 529 plan, you must list the value of the account as an asset on the federal government's financial aid application, the FAFSA. Under the federal formula, a parent's assets are assessed (counted) at a rate of no more than 5.6 percent (by contrast, student assets are assessed at a rate of 20 percent). In addition, a 529 plan owned by a student or a 529 plan funded with UTMA/UGMA assets is also reported as a parent asset if the student files the FAFSA as a dependent student.

Distributions from a 529 plan that is listed as a parent asset on the FAFSA are not counted as student income.

If a grandparent or other relative is the account owner of the 529 plan, then it doesn't need to be listed as an asset on the FAFSA. However, distributions from a grandparent-owned 529 account are counted as student income on the FAFSA.

Colleges typically treat 529 plans the same way when distributing their own institutional aid. However, colleges might differ in their treatment of plan withdrawals. Contact the financial aid administrator at each individual college for more information.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens if I open a 529 account for my child and then I die--who would control the account?

Answer:

That depends on the rules of your 529 plan. Some states, for example, permit the account owner to name a contingent account owner (also called a successor owner). This contingent account owner would then have all your ownership rights when you die. In other cases, ownership may pass to the designated beneficiary or to the guardian of the beneficiary (if the beneficiary is a minor child). And some states may treat the account as part of your probate estate--the account would then pass according to your will (or by the state's intestacy laws if you have no will).

Check your 529 plan's account ownership rules. You might also want to check with an attorney familiar with Section 529 and estate planning.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I transfer my child's UGMA/UTMA custodial account to a 529 plan?

Answer:

There are two ways to explore this rather tricky question. The first way is to examine whether it's possible to liquidate an UGMA/UTMA account and invest the proceeds in a 529 plan. The second way is to see whether it's possible to transfer existing UGMA/UTMA assets to a 529 plan.

Before looking at these two questions, it's helpful to know some basics about UGMA/UTMA (which, by the way, stands for Uniform Gifts (Transfers) to Minors Act) accounts. All gifts to an UGMA/UTMA account are considered irrevocable gifts to the child named as the beneficiary of the account. Once a gift is made, the custodian (usually the parent) can withdraw funds only if the money is used for the child's benefit. This may include things like private elementary or secondary school, summer camp, a computer, violin lessons, a secondhand car, and so on.

This requirement that the money must be used for the child's benefit also includes making an investment in a 529 plan (college savings plan or prepaid tuition plan), as long as the 529 plan is established for the same beneficiary as the custodial account. You can liquidate the investments in the UGMA/UTMA account and invest all of the proceeds in a 529 plan (though you may incur tax liability). The key is that the proceeds must be used for the benefit of the same beneficiary. So, you wouldn't be able to invest the UGMA/UTMA proceeds in a 529 plan established for a different beneficiary.

The question of keeping your child's UGMA/UTMA account intact and transferring the assets to a 529 plan is more difficult. Whether this is allowed usually depends on the rules of the 529 plan. In either case--liquidating the UGMA/UTMA account or transferring the assets in the UGMA/UTMA account--there are important things to keep in mind.

First, federal law requires that all contributions to 529 plans be made in cash. Therefore, all assets in an UGMA/UTMA account would first need to be converted to cash if they were not already (e.g., stocks, real estate, certificates of deposit). So, even if the 529 plan accepts the transfer of assets, you will be required to turn those assets into cash. Keep in mind that this may trigger income tax liability.

Second, because the cash will now be held within the UGMA/UTMA account, which, in turn, is in the 529 plan (sort of a cup within a bucket), you are still bound by the rules of UGMA/UTMA accounts. This means that you can't change the beneficiary of the 529 plan, because gifts to an UGMA/UTMA account are considered irrevocable gifts to the beneficiary. In addition, you must relinquish control of the 529 plan to your child when he or she reaches the age of majority (18 or 21, depending on state law), because this is what happens with an UGMA/UTMA account. And finally, all future contributions you make to the 529 plan will be treated as UGMA/UTMA contributions, meaning that they will be considered irrevocable gifts to the beneficiary. Third, some 529 plans might require that you name the child as the owner (as well as the beneficiary) of the 529 plan after UGMA/UTMA funds are contributed.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can a non-U.S. citizen open a 529 account?

Answer:

Yes, with a few limitations. Section 529 plan account applications generally ask for the Social Security number of the account owner and the beneficiary. If you will be the account owner and you don't have a Social Security number, check with the administrator of the 529 plan before you send any money to see how you'll be handled. Some 529 plans allow resident aliens to be the account owner, but normally these plans still require a Social Security number.

Another issue can be state residency. Some 529 plans require the account owner to be a resident of their particular state (for a certain time period) before an account can be opened. Alternatively, some plans require that either the owner or the beneficiary be a resident. So if the beneficiary is a resident, you may still be able to open an account even if you're not a U.S. citizen or resident.

You may expect the beneficiary to attend a foreign college or university. Some foreign colleges and universities are recognized by the U.S. Department of Education as "eligible educational institutions"--a key factor in the income tax treatment of withdrawals from the 529 plan. You should still check the requirements of the 529 plan you are considering to make sure a particular foreign college is an eligible institution.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I open a 529 account for a nonrelative?

Answer:

Yes. There is no legal requirement that the designated beneficiary of a 529 account (college savings plan or prepaid tuition plan) be related to you. So, for example, you can open an account for a friend, neighbor, or coworker. Also, there is no federal requirement that the designated beneficiary be a certain age. States may have their own requirements, however, so check the details of any plan you're considering.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I contribute to a 529 account and a Coverdell ESA in the same year for the same beneficiary?

Answer:

Yes. You can fund a Coverdell education savings account and a 529 account in the same year for the same beneficiary without giving rise to penalties. There is a small annual contribution limit for Coverdell accounts, while most 529 plans have lifetime contribution limits of at least $300,000.

And keep in mind that, unlike a 529 plan, your ability to contribute to a Coverdell ESA depends on your income level.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can a 529 account have more than one beneficiary?

Answer:

A 529 account can have only one beneficiary. If you have more than one child, you may want to open a 529 account for each. Alternatively, you could open one 529 account and, after funds have been withdrawn for your first child's college expenses, change the designated beneficiary of the remaining funds to your second child. However, this change of the designated beneficiary could have gift tax consequences.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What's the difference between college savings plans and prepaid tuition plans?

Answer:

Although both college savings plans and prepaid tuition plans are 529 plans (assuming they meet the statutory requirements), there are important differences between them.

The main difference is that with a college savings plan, you contribute to an individual investment account to pay for a child's future education. Your money is invested in a particular investment portfolio at the time you join the plan, and you take your chances on what your rate of return will be--there are no guarantees. If your portfolio performs well, you reap the benefits. If it doesn't, you suffer the losses.

By contrast, with a prepaid tuition plan, you prepay all or part of a child's future tuition by investing in units or contracts (depending on how the particular plan is structured), and you're guaranteed a minimum rate of return. However, you aren't necessarily entitled to any extra money that the plan may earn.

There are other important differences, too. A college savings plan lets you use the funds at any college home or abroad that's accredited by the U.S. Department of Education, while funds in a prepaid tuition plan may typically be used only for undergraduate tuition at public colleges in your state. Also, there is generally no time limit on when withdrawals from a college savings plan must be made, though tuition credits in a prepaid plan must generally be used by the time the beneficiary reaches age 30. And while you can generally contribute to a college savings plan at any time, prepaid tuition plans typically have select open enrollment periods, which are the only times you can open an account or contribute money.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How often can I make contributions to my child's 529 account?

Answer:

It depends on the rules of your 529 plan. Many plans will allow you to contribute as often as you like. This gives you flexibility to tailor the frequency of your contributions to your own needs and budget, as well as to "dollar cost average" your contributions. Remember that 529 plans stop accepting contributions when the value of the accounts for any one beneficiary reaches a maximum limit. The limit is typically the amount needed to fund five years of tuition, fees, and room and board at the highest-cost institution allowed under the plan. In addition, some plans impose a maximum limit on annual contributions.

Some plans may also have contribution minimums. This could mean one or more of the following: (1) you have to make a minimum deposit to open an account, (2) each of your contributions has to be at least a certain amount, or (3) you have to contribute at least a certain amount per year (annual minimum). However, some plans may waive (or lower) some of these minimum requirements if your contributions will be made through payroll deduction or automatic debits from your bank account. Many plans also waive or lower these minimums for residents.

Consult the plan administrator of any 529 plan you are considering for details regarding contribution minimums, maximums, and other restrictions imposed by the plan.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can my spouse and I open a joint 529 account for our child?

Answer:

No. A 529 account--whether a college savings plan or a prepaid tuition plan--can only be established by one person. That person is legally referred to as the participant, though the commonly used term is the account owner. In some states, the 529 plan can only accept contributions from the participant. And under federal law, only the participant can give instructions to the plan to distribute money for college expenses or for any other reason. Although you and your spouse can't open a joint account, each of you can open an account for the same child. Then each of you would be a participant in the 529 plan.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Is there an income limit on who can open a 529 account?

Answer:

No. There is no income limit that controls who is eligible to open an account in either a college savings plan or a prepaid tuition plan. In addition, contributions may be made to a 529 account regardless of your income. By contrast, to contribute to a Coverdell education savings account, your income must be below a certain limit, depending on your filing status.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can more than one 529 account be opened for the same child?

Answer:

Yes. You (or anyone else) can open multiple 529 accounts for the same beneficiary, as long as you do so under different 529 plans (college savings plan or prepaid tuition plan). For instance, you could open college savings plan accounts with State A and State B for the same beneficiary, or you could open a college savings plan account and a prepaid tuition plan account with State A for the same beneficiary. But you can't open two college savings plan accounts in State A for the same beneficiary.

Also, keep in mind that if you do open multiple 529 accounts for the same beneficiary, each plan has a limit, and contributions can't be made after the limit is reached. Some states consider the accounts in other states to determine if the limit has been reached. For these states, the total balance of all plans (in all states) cannot exceed the current year's maximum contribution amount.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens if the beneficiary of the 529 account dies?

Answer:

You'll have to look to the rules of your plan. Generally, though, the account owner retains control of the account if the beneficiary dies. The account owner may be able to name a new beneficiary (which may create gift tax or estate tax consequences). Or the account owner might make a withdrawal from the account. If so, the earnings portion of the withdrawal will be taxable.

Note that if the beneficiary dies with a balance within his or her Section 529 account, the balance may be included in the beneficiary's taxable estate.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I change the beneficiary of a 529 account?

Answer:

Yes. You can generally change the beneficiary of a 529 account as long as the new beneficiary is a family member of the old beneficiary. Members of the family include children and their descendants, stepchildren, siblings, stepsiblings, parents, stepparents, nieces, nephews, aunts, uncles, first cousins, and in-laws of the original beneficiary. There is no penalty for changing the beneficiary, although gift taxes and generation-skipping transfer taxes might be a result. Many states charge an administrative fee to process the change. Also, states are free to impose certain restrictions. For example, a state may prohibit a beneficiary switch once the original beneficiary has begun making withdrawals from the 529 account.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I have two children. Should I open one 529 account for both children or one 529 account for each child?

Answer:

From both a paperwork and account fee standpoint, opening one account makes sense. And though a 529 account can have only one beneficiary, you can change the beneficiary as needed--just be sure to check the plan for any limitations on the frequency of changes. So, for instance, after your first child finishes college, you could change the beneficiary to your second child. Keep in mind, though, that a change in the beneficiary may cause gift taxes and generation-skipping transfer taxes.

If you do decide to open just one 529 account and intend to choose an age-based portfolio (one whose asset mix grows more conservative as your child gets older), it may make sense to name your younger child as the beneficiary. This will give you the most aggressive investment allocation, which may maximize the growth in the account. Then, when you need the money for your older child's college expenses, you can change the beneficiary to your older child. Or, you could simply transfer (or roll over) the account money to an account with your older child as beneficiary.

Section 529 plans differ when it comes to rules about partial rollovers, so check the rules of any 529 plans that you're considering. In some cases, you may need to transfer money to a different state's 529 plan. Again, check on any potential withdrawal limitations before you open an account. Keep in mind, too, that although you intend to fund the college education of two children, the total amount you can contribute is limited by the contribution maximum imposed by the single 529 plan.

Yet opening just one 529 account if you have two children may have a gift tax downside. The money you contribute to a 529 account is considered a gift to the beneficiary. Generally, you are free to gift up to $14,000 per year, per beneficiary. Otherwise, you'll be required to complete a federal gift tax return and report a taxable gift. However, a special rule unique to 529 plans allows you contribute up to $70,000 to a 529 account ($140,000 for joint gifts) and avoid federal gift tax by making a special election to spread the gift evenly over five years.

In any case, you'd probably be able to accumulate more funds for your kids if you opened two separate 529 accounts. That way, you'd be able to give $14,000 to each child per year ($28,000 maximum) instead of depositing $14,000 into only one account. And, if you take advantage of the $70,000 special election for each child's account ($140,000 for joint gifts), the funds may grow even faster.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I use 529 funds to pay for college in the same year I take the Hope or Lifetime Learning credit?

Answer:

Yes. You can claim an education credit such as the American Opportunity credit (Hope credit) or Lifetime Learning credit in the same year that you withdraw funds from a 529 plan. Your 529 withdrawal will not be free from federal income tax, though, if you apply the 529 withdrawal and one of these education credits against the same qualified higher education expenses.

For purposes of your 529 plan, your qualified higher education expenses are first reduced by expenses used to compute your American Opportunity credit or Lifetime Learning credit. The remaining expenses may be paid with the funds you withdraw from the 529 plan (and you won't pay any federal income taxes on those funds). You will pay federal income tax (and, in most cases, a penalty and maybe some state income taxes) on any part of your 529 plan withdrawal that remains after paying these expenses. From an income tax standpoint, it may be best for you to pay for college expenses with a combination of 529 plan withdrawals, tax credits, and other resources.

You're allowed to waive the American Opportunity credit or Lifetime Learning credit. This waiver may make sense if the value of the education credit is less than the value of federal income tax-free (and penalty-free) withdrawals from your 529 account.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens if my child finishes college and there is money left over in the 529 account?

Answer:

If you withdraw the money that is left over in your 529 account and don't use it to pay for the beneficiary's qualified higher education expenses, you'll have to pay a federal penalty tax of 10 percent on the earnings portion of the withdrawal (a state penalty may apply as well). You may also have to pay federal, and in some cases state, income taxes on the earnings portion of the withdrawal.

However, if you have money left over in your account, withdrawing it and paying a penalty isn't your only option. All 529 plans allow the account owner to change the beneficiary without penalty (although depending on the plan, there may be a fee for this service). In addition, you may be able to receive a "rollover" distribution from your 529 plan and recontribute the proceeds within 60 days to the same or a different state's program with a new beneficiary. Keep in mind that in both instances the new beneficiary must be a qualifying family member, or taxes and a penalty will be due.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I'd like to make a lump-sum contribution to my grandchild's 529 account. Will I owe gift tax?

Answer:

That depends on the amount of your lump-sum contribution, as well as the extent to which you've used your lifetime applicable exclusion amount of $5,340,000 (in 2014).

All contributions to 529 plans are considered present interest gifts that qualify for the $14,000 annual federal gift tax exclusion. So, a gift of $14,000 or less to your grandchild's 529 account will not cause a gift tax. A contribution of $14,000 or less to your grandchild's 529 account is also excluded for purposes of the federal generation-skipping transfer tax (GSTT) (you also have an exemption from the GSTT, which is also $5,340,000 in 2014).

However, 529 plans offer a special accelerated gifting option. Specifically, if you make a lump-sum gift to your grandchild's 529 plan of up to $70,000 in a single year (or $140,000 for married couples), you can avoid gift tax if you treat the gift as having been made in equal installments over a five-year period and you don't make any other gifts to that beneficiary during the five-year period. (This effectively treats your gift as five consecutive annual gifts of $14,000 each.) You must make this special election on your federal gift tax return (which you must file if your gift is over $14,000). If you don't make this election, any amount over $14,000 in a year to the same beneficiary is a taxable gift. (But keep in mind that you must use up your lifetime applicable exclusion amount before any gift tax is actually paid.)

You'll also need to investigate the gift tax rules of your state, since state tax treatment can differ.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Does it make sense to cash in my prepaid tuition plan and contribute to a college savings plan?

Answer:

It might. College savings plans offer some advantages over prepaid tuition plans--withdrawals can be used for expenses not allowed under a prepaid tuition plan, and funds in a college savings plan can be used at any accredited college in the country or abroad (compared to only in-state public colleges for prepaid tuition plans). In addition, the value of your account may increase greatly, depending on how well your investments do.

On the other hand, prepaid tuition plans provide a measure of security. In effect, they allow you to buy future tuition at today's prices.

Most prepaid tuition plans require that either the owner or the beneficiary be a resident of the state operating the plan. So if you move to another state, you may have to cash in the prepaid tuition plan. And if you do cash in the plan, you will receive only your contributions (and possibly a low rate of interest).

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Are 529 college savings plans a good way to save for college?

Answer:

Yes, they can be an excellent way to save for college. College savings plans are established by states and typically managed by an experienced financial institution designated by the state. Each plan has slightly different features.

A 529 college savings plan lets you save money for college in an individual investment account that offers federal tax advantages. You (or anyone else) open an account in your child's name and thereafter contribute as much money as you wish, subject to the plan's limit.

The state's selected money manager takes your contribution and invests it in one or more of the plan's pre-established investment portfolios, which typically consist of mutual funds. Some plans automatically place your contribution in a portfolio that's tailored to the age of your child. (The younger your child, the more aggressive the percentage of stocks. As your child grows older, the portfolio gradually shifts to more conservative investments.) Other plans let you choose the portfolio you want at the time you join the plan, without regard to your child's age. This lets you take into account your risk tolerance and other factors that may be important to you.

College savings plans are popular because they combine many desirable tax features with the ability to use the money at any accredited college in the country or abroad. Your contributions grow tax deferred, and if withdrawals are used to pay the beneficiary's qualified education expenses, the earnings are completely free from income tax at the federal level. Many states also add their own tax benefits, such as tax deductions for contributions and exemption of the earnings from state income tax. However, if a withdrawal isn't used to pay the beneficiary's qualified education expenses (known as a nonqualified withdrawal), the earnings portion is subject to a 10 percent federal penalty and is taxed as income at the rate of the person who receives the withdrawal (a state penalty may also apply).

There are no income limits that determine whether you are eligible to open a college savings plan account--everyone is eligible. And if your child decides not to go to college or gets a full scholarship, the money in the plan can be transferred to a qualified family member without penalty.

But investment returns aren't guaranteed. If your investment portfolio performs poorly, you're still bound by the investment decisions of the plan's money manager, unless the plan lets you change the investment strategy for your existing contributions, which it may do once per calendar year. College savings plans are also free to let you change your investment option for future contributions. If your plan doesn't provide this flexibility, then you are allowed by federal law to roll over your college savings plan account to a different 529 plan (college savings plan or prepaid tuition plan) without penalty once every 12 months.

You are not limited to your own state's college savings plan. Most states allow anyone to participate in their plan. You may also participate in the college savings plan of more than one state.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

My child will be going to college next year and using 529 funds--what do I need to do?

Answer:

Now would be a good time to review the terms, conditions, and procedures of your 529 plan. Not all plans are alike. So don't assume that the procedures your sister follows for her Iowa college savings plan will be the same for your Rhode Island college savings plan (or prepaid tuition plan). At a minimum, you should investigate the following issues.

First, bear in mind that you'll probably have to notify the 529 plan administrator that your child will be making a withdrawal for college expenses. In most prepaid tuition plans, the payout procedures are standardized. For example, some prepaid tuition plans require that all plan withdrawals must occur within 10 years of the time the beneficiary starts college. College savings plan procedures can differ considerably from plan to plan, though. No matter what your plan, consider the following questions:

- What education expenses does the plan consider "qualified"?
- When must you notify the plan administrator that you wish to withdraw funds from the plan?
- How do you document that the withdrawal has been used to pay qualified education expenses? How soon must you provide this documentation?
- Are college expenses paid directly from the plan to the educational institution, or is the beneficiary reimbursed for expenses? How long will reimbursement take?
- Is a minimum withdrawal amount required, or is there a limit on the number of withdrawals per semester?
- Does the state's definition of "eligible educational institution" differ from the federal definition, and does your child's college satisfy the definition?
- Does the plan require a minimum level of attendance (e.g., half-time enrollment) for qualified expenses other than room and board?

Second, make sure you understand how a qualified withdrawal from a 529 plan will affect your state income taxes. And remember--you're entitled only to the state tax benefits (if any) offered by the state in which you reside.

Third, explore how a withdrawal from a 529 plan will affect your child's eligibility for financial aid from the college as well as federal financial aid.

And finally, investigate how to coordinate a 529 plan withdrawal with the American Opportunity credit (Hope credit) and Lifetime Learning credit (which you may be able to claim on your federal income tax return) to maximize your income tax benefit. Although you may claim one of these education credits in the same year you withdraw funds from a 529 plan, your 529 plan withdrawal may not be completely tax free on your federal income tax return that year.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Are qualified withdrawals from college savings plans exempt from state income taxes?

Answer:

Although qualified withdrawals from college savings plans won't be taxed on your federal income tax return, state income tax treatment may differ. Some state income tax benefits (e.g., tax-free treatment of qualified withdrawals, tax deduction for contributions) may be provided only to state residents who invest in their state's 529 plan. You'll need to check the laws of your state.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Are there rules on who can open a 529 account?

Answer:

In theory, almost anyone can open a 529 account, but rules vary from state to state. Here are a few you may encounter.

First, some plans require that the account owner be a certain age, such as 18. Other plans have no restrictions at all on the age of the owner.

Second, although many 529 plans have no residency requirements, a few require that an account owner live in the state for a certain period of time (e.g., at the time of application, or one year or more before application) before opening a 529 account. Some require that either the account owner or the beneficiary be a resident of the state; others require that both be residents.

Third, some plans require that an account owner be a U.S. citizen or a resident alien with a valid Social Security number or taxpayer identification number.

Fourth, some plans permit corporations, trusts, and other legal entities to open accounts, while other plans do not.

Finally, some plans allow the account owner and the beneficiary to be the same person, while other plans do not.

Check the rules of any 529 plan you're considering before you decide to open an account.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What happens to the funds in my 529 account if my child doesn't go to college?

Answer:

If your child decides not to go to college, relax--you'll have several options. First, you can leave the funds in the account. It's possible that your child will change his or her mind about college at some point in the future. Just keep in mind that prepaid tuition plans generally require that you use the funds within 10 years of the date of expected college entrance (college savings plans usually allow you to keep the funds in the account indefinitely).

Second, you can change the beneficiary of the 529 account to another family member who will use the funds for college. And finally, you can withdraw the funds and use them for any purpose you choose. The drawback to this option, though, is that you may owe a 10 percent federal penalty tax on the earnings that have accumulated (a state penalty may apply as well). You may also owe federal, and in some cases state, income taxes on the earnings that you withdraw.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Does it make sense to open a 529 account if my child is only two years away from college?

Answer:

The answer depends on your reasons for opening the account. If you have a high net worth and want to move money out of your estate, opening a 529 account still makes sense. This strategy lowers the value of your taxable estate and reduces any potential estate taxes due in the future.

If you simply want to save money for college expenses, it may still be worthwhile to open a 529 account. Even if you've waited until your child is a sophomore or junior in high school to start saving for college, you'll potentially enjoy a few years of tax-free growth on your money (assuming it eventually pays for college expenses).

You should check one issue carefully before you open an account this close to college. Some plans impose a minimum holding period, such as one or two years, before any withdrawals can be made (without penalty). If you're going to need this money for the first year of college expenses, plans with withdrawal restrictions would not make sense. Check the individual 529 plans for more details.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What's the difference between how a college savings plan and a prepaid tuition plan invests?

Answer:

The two basic types of prepaid tuition plans are contract plans and unit plans. With a contract plan, you invest your money in exchange for a promise that the plan will pay you a certain amount in future college tuition and fees. A unit plan allows you to purchase units or credits that increase in value each year (similar to an index that keeps pace with rising tuition) and are later redeemed to pay for tuition and other expenses. With both types of prepaid plans, your money is placed in a plan trust fund that also includes the money contributed by other participants in the plan. Professional money managers invest the trust fund assets in investments whose rate of return is expected to cover the future payments owed by the plan.

With a college savings plan, your contributions go into an individual account that's invested in a portfolio of investments (typically mutual funds). Many plans let you choose from a variety of investment portfolios at the time you open an account, allowing you to take into account your risk tolerance and general market conditions. At one time, most plans didn't offer you a choice--your portfolio was simply based on your child's age, and the investments in the portfolio gradually shifted to more conservative ones as your child grew.

But be aware that college savings plans entail risk because your investment returns are not guaranteed. You may even lose some of the original amount you invested. If you're not happy with the performance of your investment portfolio, you may be able to direct future contributions to a different portfolio, depending on the rules of your specific plan. Also, the IRS has given states the discretion to allow you to change the investment option for your existing contributions once per calendar year or at the time you change the beneficiary of your plan. Check with your plan for more details. Keep in mind, too, that you can roll over your college savings plan to a different 529 plan (college savings plan or prepaid tuition plan) once per year without changing the beneficiary. Please note, however, that rollover contributions may not be eligible for a state income tax deduction if your state offers one for 529 contributions. Check with your tax professional for more information.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I opened a college savings plan from a different state. Will I get that state's tax benefits?

Answer:

No. Often, state income tax benefits are provided to a state's residents who invest in their state's 529 college savings plan. These benefits could take the form of a state income tax deduction for contributions, tax-free treatment of qualified withdrawals, or a waiver of brokers' fees.

You should look to the tax laws of your own state to determine the income tax treatment of deductions and withdrawals from a college savings plan. In general, you should expect that you won't be required to pay income taxes to another state simply because you opened an account in that state's 529 plan. You'll probably be taxed in your state of residency on the earnings in your 529 plan (no matter where situated) unless your state grants a specific exemption.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Can I open a 529 account in anticipation of my future grandchild?

Answer:

You can open an account before the birth of a child, though you have to go about it in a roundabout way.

First, you need to know the two key players involved in any 529 account. One is the account owner, who controls when the money is paid out and to whom. That may be you. (The account owner is usually the person who establishes the account and who puts money into the account.) The other key person is the designated beneficiary, who will use the money to pay for qualified education expenses. The account owner selects the designated beneficiary.

Since the person you want to name as the beneficiary is not yet born, you'll need to take two steps. First, you'll need to open an account and name a beneficiary who is a family member who will be related to your grandchild. Next, when your grandchild is born, you (the account owner) can change the beneficiary to your grandchild.

Check the details of each state's plan carefully, because some plans impose age restrictions on the beneficiaries (such as being under age 21). That may pose a problem if you plan to name your adult son or daughter as the initial beneficiary. Other plans may require that the funds be spent within a certain time period, such as within 10 years of when the original beneficiary would be expected to enter college.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Does a college savings plan allow me to choose my own investments?

Answer:

The quick answer is no. Under federal law, 529 plan account owners aren't allowed to directly or indirectly control their plan investments (a college savings plan is a type of 529 plan). This lack of control is often cited as the major disadvantage of college savings plans.

However, depending on the college savings plan, you may have a limited say in how your money is invested. When you open an account, you might be able to choose from a variety of investment portfolios with different levels of risk. The options might include an all-stock portfolio, an all-bond portfolio, and several "blend" portfolios. Some plans may even let you spread your contributions over several portfolios. Other plans will select a portfolio for you based solely on your child's age (known as an age-based portfolio). The more investment options you have, the better you can take into account your risk tolerance, time horizon, and overall market conditions. But keep in mind that you can never choose the underlying assets that a portfolio invests in. That job is for the plan's professional money manager.

All college savings plans entail risk, because your investment returns are not guaranteed by the state sponsoring the plan. In fact, there's a chance you could lose some of the original amount you invested. If you're not happy with your portfolio's investment performance, you have a few options. First, depending on the rules of your specific plan, you might be able to direct any future contributions into one or more different portfolios. Also, the IRS has given states the discretion to allow you to change your investment option for your existing contributions once per calendar year (twice per calendar year for 2009 only), or if you change the beneficiary of your account. Check with your plan for more details.

You're allowed to roll over your college savings plan account once every 12 months to another 529 plan (college savings plan or prepaid tuition plan) without changing the beneficiary. When you do the rollover, you may get to select from among the new plan's different investment options. Please note, however, that rollover contributions may not be eligible for a state income tax deduction if your state offers one for 529 contributions. Check with your tax professional for more information.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I opened a college savings plan for my grandchild. Does he list this asset on financial aid forms?

Answer:

You are considered the owner of the college savings plan account, not your grandchild's parents and not your grandchild. Therefore, neither the parents nor your grandchild are required to list your college savings plan as one of their assets under the federal financial aid rules. However, the financial aid office at a private college may have different rules when disbursing the college's own financial aid.Your grandchild should contact the colleges he or she is applying to for more information.

Keep in mind, however, that when money is withdrawn from the 529 plan to pay college expenses, the federal government generally counts distributions from grandparent-owned 529 plans as student income, as do colleges.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How do I know whether to choose a college savings plan or a prepaid tuition plan?

Answer:

Your investment preferences and the college you think the beneficiary (let's assume it's your child) might attend will affect your choice.

A prepaid tuition plan generally guarantees you a minimum rate of return to ensure that you keep up with college inflation. Essentially, by contributing to such a plan, you lock in tomorrow's tuition at today's prices. However, if the stock market enjoys an extended period of high returns, you'll generally still be limited to the return that your plan promises--the entire surplus won't trickle down to you. Also, to receive the maximum benefits under a prepaid tuition plan, your child must attend a college in that plan. If your child chooses a different school, you may pay a penalty.

By contrast, a college savings plan doesn't guarantee you any minimum rate of return. When you invest your money in a plan's portfolio (whether it's an age-based portfolio geared to your child's age or another portfolio), you take your chances. If your portfolio earns a high rate of return, you're entitled to all of it. But if it earns little or nothing (or even loses money), you may end up with less than you need to pay for your child's education. The good news, though, is that your child can use the funds in a college savings plan at any college in the country or abroad that is accredited by the U.S. Department of Education.

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

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What recourse do I have if I'm unhappy with my college savings plan's investment performance?

Answer:

Unfortunately, not as much as you would probably like. Under federal law, 529 plan account owners aren't allowed to directly control their investments. This can present a problem if your college savings plan investments are not performing as well as you expected.

But you may have some options. First, depending on your plan's specific rules, you might be able to direct any future contributions into one or more portfolios that are different from what your existing contributions are invested in. Also, the IRS allows states to let you change your investment option for your existing contributions once per calendar year. But it's up to individual states whether to allow this flexibility. Check with your specific plan for more details. Keep in mind, though, that even if you can change your investment portfolio, you can never choose the underlying investments that a portfolio invests in--the plan's money manager is responsible for this.

Besides these options, there's a more drastic (though effective) way to get rid of college savings plan investments that are performing poorly. You can roll over your college savings plan account to another 529 plan (college savings plan or prepaid tuition plan) once every 12 months without penalty and without changing the beneficiary. Since different plans offer different investment choices, the rollover option gives you a way to exchange poorly performing investments for new ones. Please note, however, that rollover contributions may not be eligible for a state income tax deduction if your state offers one for 529 contributions. Check with your tax professional for more information.

Finally, if you have more than one child, you might consider changing the beneficiary of your account. If your account was previously invested in an age-based portfolio (one that depends on your child's age and gradually shifts to more conservative investments as your child grows older), many plans will change the investment option to a different portfolio to reflect the new beneficiary's age. But if the plan doesn't impose a new age-based portfolio on you, you might still be given the opportunity to change your investment option for the new beneficiary, because the IRS has given states the discretion to allow such an investment change when a new beneficiary is named.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

I've decided on a college savings plan, but how do I go about choosing one?

Answer:

Most college savings plans let nonresidents join, so you have quite a few options. In choosing a particular college savings plan, there are many factors you should consider.

First, because you're entitled only to the state tax benefits (if any) offered by the state in which you reside, it's always a good idea to look at your own state's plan first (assuming your state offers one) and research what state tax benefits are available. For example, some states exempt a plan's earnings from income tax if used to pay qualified education expenses, similar to the way the federal government exempts such earnings from tax. Some states may also let you deduct some or all of your contributions in a given year, or they may match a portion of your contributions. Remember, if you join another state's plan, you won't be entitled to any state tax benefits offered by that state.

Another important factor to consider is a plan's investment choices. Some plans may restrict you to a certain portfolio based on the beneficiary's (child's) age, while others may let you choose a portfolio that's more or less conservative than this age-based portfolio. You may also want to look at the past investment performance of a particular portfolio and compare it with other similar portfolios in different plans.

Also check to see if the plan lets you change the investment option you've chosen for your existing contributions once per calendar year, something that plans are permitted to do under federal law. Find out, too, whether the plan allows you to direct future contributions to a different portfolio in the plan.

Finally, you may want to compare fees and expenses among plans. Also, the reputation, experience, and track record of the state's designated agent who will manage the plan are important. Customer issues like the ease with which you'll be able to make contributions and otherwise manage your account are important factors, too.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

What's the difference between how a college savings plan and a prepaid tuition plan invests?

Answer:

If you want to contribute to your college savings plan and use dollar cost averaging at the same time, you can simply invest a fixed amount in your account at regular intervals (e.g., $100 a month). One way to do this may be to arrange for automatic payroll deductions or bank account debits to be invested in your college savings account. But assuming you have a lump sum of money to invest, is dollar cost averaging better than making a single large contribution? That's a more difficult question, and the answer depends on your particular circumstances.

According to the experts, the benefit of dollar cost averaging is that it helps you ride out the ups and downs of the market--you buy more shares when the prices are low, and fewer shares when the prices are high. But your decision may be more complicated than it seems. Let's say you have $100,000 that you'd like to invest in your college savings plan over time using dollar cost averaging. Where will you keep the money in the meantime (e.g., money market fund), and how does your expected return on that investment compare with your expected return on your college savings plan? If you expect to do better with the college savings plan, it might make more sense to invest the lump sum. Remember to compare after-tax return figures, since college savings plan investments grow tax free.

Other factors may also enter into this decision. Fees imposed by your college savings plan may decrease as you contribute more money, so investing a lump sum may save you fees over the long run. But a lump-sum contribution may have gift tax consequences that could be avoided by gradually investing the money.

Gradual investing might also help you better diversify your college savings plan holdings, since many plans let you direct new contributions to a different investment option. However, the IRS has given states the discretion to allow you to change the investment option on your existing (lump-sum) contribution once per calendar year. Check with your specific plan for more information. Also, be sure to consult a financial professional before making this decision.

Note: Dollar cost averaging does not ensure a profit or protect against a loss in a declining market. You should consider your ability to invest continuously when the market is down.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

The Economic Growth and Tax Relief Reconciliation Act contains sunset provisions. Should I worry?

Answer:

No. The Economic Growth and Tax Relief Reconciliation Act of 2001 made qualified withdrawals from a 529 plan tax free at the federal level until December 31, 2010, when the benefit was scheduled to sunset, or expire. But the Pension Protection Act of 2006 removed the sunset provision, making qualified withdrawals from a 529 plan permanently tax free at the federal level.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How do I prove that a distribution request is for my child's college expenses?

Answer:

All 529 plans have procedures to ensure that a withdrawal is being used for the designated beneficiary's qualified higher education expenses. Some plans require that the expenses be paid directly by the plan to the educational institution. Others will prepay or reimburse the beneficiary for qualifying expenses paid out of pocket (as long as a receipt is provided). Your plan administrator can tell you what procedures you must follow when requesting a distribution.

Remember, unless you can prove that the withdrawal is used for qualified higher education expenses, federal (and probably state) income taxes must be paid, and possibly a 10 percent federal income tax penalty may apply.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

My child got a full scholarship to college--now what?

Answer:

Since your child has received a full scholarship, you can withdraw--without penalty--some of the funds in your 529 account. In each withdrawal from your 529 plan, you receive some earnings and some of the contributions that were made to the account. Generally, a penalty is imposed on the earnings portion of each withdrawal that you don't use to pay qualified higher education expenses. Your child's scholarship creates an exception. As long as your withdrawals during the year don't exceed the amount of the scholarship for the year, you will not owe a penalty.

Keep in mind that you may owe federal, and in some cases state, income taxes on the earnings portion of each withdrawal. However, you won't owe federal income taxes if your withdrawals during the year don't exceed the amount of your child's scholarship for the year.

Withdrawing the funds isn't your only option. You can leave the funds in the 529 account for your child's future use (some plans allow 529 funds to be used for graduate school). Or, you can change the beneficiary of the 529 account. If the new beneficiary and your child are members of the same family, you won't owe federal income taxes or a penalty when you make the change. But the change of beneficiary could cause a gift tax or a generation-skipping transfer tax, so pick the new beneficiary with care.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Are there any assets that are not counted for financial aid purposes?

Question:

Are there any assets that are not counted for financial aid purposes?

Answer:

Yes, assuming you are talking about federal financial aid. Under the federal government's financial aid formula, four main types of assets are excluded from consideration when determining your child's financial need:

- All retirement accounts (e.g., IRAs, 401(k)s, 403(b)s)
- Home equity in a primary residence
- Annuities
- Cash value life insurance

These assets are known as nonassessable assets. All other assets that belong to you and your child are known as assessable assets and include items like checking and savings accounts, stocks, bonds, mutual funds, 529 plans, Coverdell education savings accounts, custodial accounts, trusts, and investment property. The more assessable assets you have, the more money you will be expected to contribute to college costs before any financial aid is forthcoming.

For example, Mr. and Mrs. Green have a Roth IRA worth $50,000, home equity of $75,000, cash value life insurance of $100,000, and a mutual fund worth $25,000. Under the federal financial aid formula, the Greens are considered to have only $25,000 worth of assets (i.e., the mutual fund).

By contrast, Mr. and Mrs. White have stock holdings worth $50,000, a 529 plan worth $35,000, a Coverdell account worth $15,000, and home equity of $100,000. Under the federal financial aid formula, the Whites are deemed to have $100,000 worth of assets (i.e., stock holdings, 529 plan, and Coverdell account).

Keep in mind that financial aid programs that are funded by individual colleges may use a formula that differs from the one used by the federal government to determine financial need. Specifically, the formula may take into account the value of your retirement accounts and/or home equity, and may even expect you to borrow against these assets.

Should I open a Coverdell education savings account?

Answer:

A Coverdell education savings account can play a part in your college savings strategy, but its relatively small annual contribution limit makes it more useful as a supplement to an overall larger savings strategy.

Once a Coverdell account is open, you can contribute at any time during the year, and you even have until April 15 of the following taxable year to make a contribution for the current taxable year. In addition, contributions can be made by an entity, including a tax-exempt entity, on behalf of a selected beneficiary.

The main benefit of Coverdell ESAs is tax related. Specifically, money you withdraw to pay your child's college education expenses is completely tax free, including earnings. (Generally, distributions are tax free if they are not more than the beneficiary's education expenses for the year.) Coverdell ESAs have many favorable features:

- You can contribute up to $2,000 per year for a selected beneficiary
- You can use Coverdell ESA funds to pay elementary and secondary school expenses
- You can contribute to both a Coverdell ESA and a 529 plan (prepaid tuition plan or college savings plan) in the same year for the same beneficiary
- You can claim either the American Opportunity credit (Hope credit) or the Lifetime Learning credit in the same year you take a tax-free distribution from a Coverdell ESA (though the education expenses paid with the Coverdell ESA distribution can't be the same expenses used to qualify for the credit)

Before you consider opening a Coverdell ESA, though, you'll have to meet certain income limits. Single filers must have a modified adjusted gross income (MAGI) of $95,000 or less to make the maximum $2,000 contribution, and joint filers must have a MAGI of $190,000 or less. A partial contribution is allowed for single filers with a MAGI between $95,000 and $110,000, and for joint filers with a MAGI between $190,000 and $220,000.

Should I establish a trust for my child's college education fund?

Answer:

The answer depends first on your financial objectives and then on other factors that will influence those objectives. Trusts are frequently used to minimize estate taxes, get professional management of assets, and control funds while providing for minor children. If these features correspond with your overall financial strategy, a trust can be an efficient way to fund a college education.

However, trusts have certain disadvantages. Generally, you need a significant lump sum to initiate a trust. Also, trusts are often expensive to maintain (e.g., a trust must file a separate tax return). Tax consequences, attorney fees, and the possibility that your child's eligibility for financial aid will be negatively impacted may also be drawbacks to this type of funding.

Two types of trusts that can be used for college education funding are a Section 2503(c) trust and a Crummey trust. The Section 2503(c) trust controls funds like a classic trust: A trustee manages the funds for the child's benefit, and at age 21, the child receives the remaining principal and income. With a Crummey trust, the beneficiary can withdraw periodic contributions made to the trust for a set period of time after they're made. It is also unique in that it allows multiple beneficiaries and does not mandate distribution at age 21.

If you have a large lump sum to gift, you may want to investigate section 529 plans. Under special rules unique to 529 plans, you can make relatively large lump sum gifts and avoid federal gift tax if you elect to spread the gift evenly over five years.

Should I use my 401(k) to fund my child's college education?

Question:

Should I use my 401(k) to fund my child's college education?

Answer:

You can, but it isn't your best option. Your 401(k) plan should be dedicated primarily to your retirement.

There are two primary drawbacks to using your 401(k) for college funding. First, if you withdraw funds from your 401(k) before you are 59½, you may owe a 10 percent premature distribution penalty on the withdrawal. This penalty is in addition to income taxes you will owe on the withdrawal. Second, frequent dips into your 401(k) reduce the amount of money you ultimately have available to reap the benefits of compounding and tax deferral. This, in turn, reduces the overall funds for your retirement.

If you really need to use your 401(k) to pay for college, a better option might be to borrow from it if your plan allows loans. Plan loans are not taxed or penalized, as long as you repay the funds within a specified time period. But make sure you compare the cost of borrowing college funds from your plan with other finance options. Although interest rates on plan loans may be favorable, the amount you can borrow is limited, and you generally must repay the loan within five years. In addition, some plans require you to repay the loan immediately if you leave your job. Your retirement earnings will also suffer as a result of removing funds from a tax-deferred investment.

If you want to save for college in a retirement vehicle, consider using a traditional IRA or Roth IRA instead. With these IRAs, you will not owe the 10 percent premature distribution penalty on withdrawals you make before age 59½, as long as the money is used to pay your child's qualified college expenses. If you have some time to plan your child's college fund, you might consider a Coverdell education savings account or a 529 plan established and maintained by a state or eligible educational institution. Each of these vehicles is specifically geared to college investors and offers numerous tax advantages.

Janney Montgomery Scott LLC Financial Advisors are available to discuss the suitability and risks involved with various products and strategies presented. We will be happy to provide a prospectus, when available, and other information upon request. Please note that the information provided includes reference to concepts that have legal, accounting and tax implications. It is not to be construed as legal, accounting or tax advice, and is provided as general information to you to assist in understanding the issues discussed. Neither Janney Montgomery Scott LLC nor its Financial Advisors (in their capacity as Financial Advisors) give tax, legal, or accounting advice. We would urge you to consult with your own attorney and/or accountant regarding the application of the information contained in this letter to the facts and circumstances of your particular situation.

Janney Montgomery Scott LLC, is a full-service investment firm that is a member of the NYSE, the FINRA and SIPC.

Donald Rohner, A.W.M.A.
First Vice President - Investments
1717 Arch Street
21st Floor
Philadelphia, PA 19103
215-665-6388
800-526-6397
drohner@janney.com