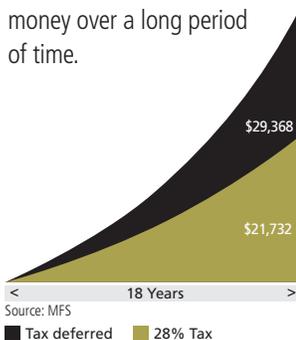


## By the numbers

### Less taxing, greater growth potential

An investment that is allowed to grow tax deferred has the potential to accumulate more money over a long period of time.



Annual return: 6%

Initial investment: \$10,000

Tax bracket: 28%

This example is for illustrative purposes only and is not intended to predict the returns of any investment choices. The underlying investments of your 529 plan may have fees and expenses that are not taken into account in this illustration. The performance of the investments will fluctuate with market conditions. If there were no earnings, the account would not grow.

<sup>1</sup>Source: MFS estimates using College Board 2005-2006 tuition and college inflation data. Assumes college costs increase at 5% a year on average for public and private schools.

# 529 college planning

With the average cost for four years at a private college (tuition, room, board, and other expenses) climbing to \$125,106 (\$52,269 at a public university), it is little wonder that many American families are concerned about their college savings.<sup>1</sup>

529 plans are investment programs designed with one basic purpose in mind — providing families with an easy and effective means to save for future college costs. But they also have tax, retirement, and estate planning implications that extend far beyond this basic purpose.

All states have a 529 plan of some sort. Most of these programs are open to residents and to nonresidents of the sponsoring state, so you can shop among them for the one that best meets your objectives.

### Anyone can use a 529 plan

Don't assume you are not in a position to use a 529 plan. Unlike most other tax-advantaged programs, 529 plans are open to everyone, no matter what their income level or the age of their children or grandchildren. You don't even need to have children or grandchildren — you can establish an account for your favorite niece, or with some plans, yourself. Many plans

will allow you to place \$250,000 or more into an account with no time limit on its use.

Your investment professional can show you how a 529 plan may fit into your financial picture and help you select the one that is right for your family. You could do the research on your own, but you will find that the investment options and program features vary considerably among the different programs, and the comparisons can become confusing.

### Types of 529 plans

There are two general types of 529 plans: prepaid tuition plans and savings plans. States may choose to offer one type of plan or the other, and some states are now offering both.

- **Prepaid tuition plans** are state- or institution-operated trusts offering contracts that promise to cover future tuition costs at public and private institutions.

The price of the contract is pegged to

*(continued on page 2)*

## Key points

### 529 college plans provide several benefits, including

- tax-free accumulations of earnings
- flexibility in selecting investments
- higher contribution limits than other college savings programs

### 529 plans allow you to

- roll over money from one state's 529 plan to another
- change beneficiaries as long as the new beneficiary is within the same immediate family

- set up a 529 plan to fund the education of a child, grandchild, niece or nephew, family friend, or even yourself
- control account withdrawals even after the beneficiary reaches legal age

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current tuition levels, although some plans may provide discounts under certain circumstances. These programs may be restricted to in-state residents.

- **Savings plans**, on the other hand, are essentially state-sponsored investment portfolios, and many are open to residents as well as nonresidents. The account owner's contribution to the 529 plan potentially will grow in value over time to help keep up with the increasing price of higher education. As with any investment, returns will depend on the market and on the portfolio's allocation between stocks and bonds.

Most of the newer plans are 529 savings plans, and they generally are viewed as more flexible than prepaid tuition plans.

### Tax-advantaged investing

Earnings in 529 plans are tax deferred, and withdrawals are free from federal tax if used for qualified higher education expenses. If you withdraw money for something other than qualified higher education expenses, you will be subject to federal income tax on your earnings and may face a 10% federal tax penalty. There are exceptions to the penalty if the beneficiary dies, becomes disabled, or receives a scholarship that reduces his or her need for college funds.

Qualified education expenses from a 529 savings plan include the following costs at just about any accredited

post-secondary institution in the country, including graduate schools:

- tuition
- fees
- books
- equipment
- supplies

In addition, room and board expenses can qualify (subject to limits) if the student is attending college on at least a half-time basis.

As its name implies, a prepaid tuition plan covers only tuition and mandatory fees.

### Estate planning features

With a 529 plan, you can help fund a college education and at the same time potentially reduce estate taxes — which makes it a great tool for many grandparents. Under current rules, you can gift up to \$12,000 per year (\$24,000 per married couple) per beneficiary without incurring federal gift-tax consequences. Or you may gift up to \$60,000 (\$120,000 per married couple) to each beneficiary. You will not incur federal gift taxes as long as no additional gifts are made to the beneficiary for four years after the year during which you make the one-time gift.

### Control of assets

For each prepaid tuition contract or savings plan account, there is an “owner” (generally the donor) and a “beneficiary.” You name a beneficiary when you set up an account; the individual you name does not have to be related to you.

With a 529 plan, you are the owner and retain all rights to the account, including the right to determine when withdrawals are taken and for what they are used. You can change the beneficiary to another relative at any time, and you can even decide to revoke the account and obtain a refund.

### The following example demonstrates how powerful this opportunity can be

Grandma and Grandpa have significant wealth, including \$1 million in bonds and cash. They want to reduce their estate tax exposure and like the idea of targeting some of their money for the college education of their seven young grandchildren. They decide to contribute a combined \$120,000 into a 529 plan on behalf of each grandchild. The result is that Grandma and Grandpa have removed \$840,000 ( $\$120,000 \times 7$  grandchildren) from their estates in one day, without gift tax consequences and without incurring the costs associated with irrevocable trusts. Further, the contributions are invested in a professionally managed investment account that may grow tax deferred without the burden of annual income taxes. And best of all, Grandma and Grandpa can always get the money back if they don't mind paying the 10% penalty tax on their earnings.

### Financial aid treatment

According to the U.S. Department of Education, if the parent is the account owner, the assets in a 529 savings plan account are treated in

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the federal financial aid formula as assets of the parent. Since parental assets are assessed at a maximum 5.6% in determining aid eligibility (as compared with 35% for assets owned by the student), a 529 plan owned by the parents helps families qualify for more student aid.

### Investment issues

Each state-sponsored 529 plan is free to design an investment approach that it feels will best accomplish the goal of saving for college. One condition imposed by tax law is that the participant in the 529 plan may not have unlimited ability to direct the investment of the account. For example, as the account owner you can reallocate your contributions and earnings among investment options only once a year or upon a change to the designated beneficiary of the account. Although this somewhat paternalistic provision is seen by some people as a reason not to use 529 plans, the fact of the matter is that, among the many 529 plans offered, there are a variety of investment approaches. Many plans have outsourced the investment and program management to large financial services companies that provide professional investment management to plan participants.

Many plans now offer an “age-adjusted” investment program. Your account is invested primarily in equity funds while your child is young and shifts to more conservative fixed-income funds as your

child gets closer to college age. In addition to an age-adjusted program, some plans now include a menu of fixed allocation investment portfolios, ranging from all-equity portfolios to 100% fixed-income portfolios.

### Important considerations

There are additional fees associated with 529 savings plans. Investments in 529s involve investment risks. You should consider your financial needs, goals, and risk tolerance prior to investing. Some states may limit your ability to roll over your 529 account from their plan to another state’s plan.

Be sure to investigate the 529 plan in your own state and see if it offers any special benefits to state residents (such as tax deduction for your contribution, matching grants, or state financial aid preference). Depending on your state of residence and the state residence of the beneficiary, an investment in a 529 plan may not afford you or your beneficiary state tax benefits.

Shop around and look at other 529 programs, both those sponsored by other states and those sponsored by institutions. Consult your investment professional for help with understanding how 529 plans work and to compare the details of competing plans. The effort may be worth it if you are looking for a tax-advantaged way to save for future college expenses.

Contact your investment professional for more information, or visit [mfs.com](http://mfs.com).

### Resources

College Board [collegeboard.org](http://collegeboard.org)

Calculate college costs online with the “College Costs Calculator” available on [mfs.com](http://mfs.com) in College Planning/Calculate for College.

*This infosheet was written by Joseph F. Hurley, CPA, president of SavingForCollege.com LLC and author of The Best Way to Save for College — A Complete Guide to Section 529 Plans. He has more than 20 years of experience in providing tax planning services to individuals and has appeared in hearings before the IRS and the Department of the Treasury to provide comments on the proposed regulations issued under Tax Code Section 529.*

*Joseph F. Hurley and Saving for College.com LLC are not affiliated with MFS Investment Management.*

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