

What Is a 529 Plan?

For your 529 plan to make the grade, you've got to master the basics.

A 529 savings plan is a specific investment program designed to ease the burden of paying for college by providing a tax break. By opening a 529 plan, you can contribute money—in regular installments or in lump sums—to an investment account set up for a specific beneficiary. The beneficiary can be anyone—a child, grandchild, cousin, or friend.

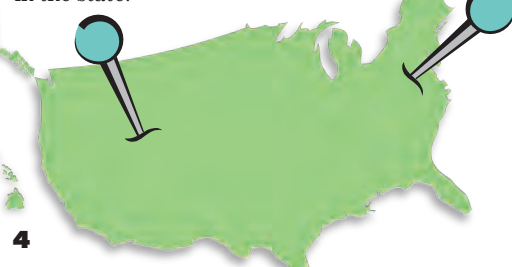
Your money grows **tax deferred** in the 529 plan and can be withdrawn **tax free** for qualified educational expenses. That means you'll owe no federal income tax, and in some cases, no state tax, on withdrawals as long as you use the money to pay the beneficiary's college bills, including tuition, books, and some room and board. Graduate, professional, and technical school expenses also qualify.

Although individual states sponsor 529 savings plans, each plan is managed by a mutual fund company, brokerage firm, or insurance company. The state works together with the company to determine the investment options that will be offered in the plan. Each of the choices, typically described as a **track**, is a portfolio of mutual funds, exchange traded funds, or other products.

IN AND OUT OF STATE

One of the questions you may have about opening a 529 savings plan is whether you must live in the state offering the plan. The answer is no. Most states allow out-of-state residents to open an account in the college savings plan they sponsor. And since each plan has different investment options, contribution levels, and fees, you may find that another state's plan suits you better than the one your home state offers.

Where you live often matters, however, if you want to participate in a state's prepaid tuition plan. Many states require that either you or the beneficiary be a resident to buy tuition credits for use at a public college or university in the state.



A CHANGING LANDSCAPE

A number of recent changes help make both types of 529 plans even more attractive ways to save for college. Perhaps most important, their tax-exempt status is now permanent thanks to Congressional action. Without that legislation, the tax-exempt provision was scheduled to end in 2011.

What's more, both types of plans plus Coverdell

ESAs are considered parents' assets rather than student assets in calculating eligibility for financial aid. That's a big help because parents are expected to contribute a smaller percentage of their savings than students are: 5.6% vs. 35%.

In addition, individual states are altering their rules, typically to add benefits or make their rules more flexible. You'll want to be prepared to take the greatest advantage you can of these provisions.

FREEDOM OF CHOICE

Another common question is whether or not your beneficiary must attend a school in the state that sponsors the plan you've chosen. Again, the answer is no. The money you've accumulated in your 529 savings plan can be used at any accredited US college or university, as well as at more than 700 international schools.

If you've prepaid for tuition credits through a PTP, you can transfer the value of your account to another state or private school where your beneficiary will be going. But be aware that the full value doesn't usually transfer—so you may have to add more than you had planned to cover the full cost.

DO YOUR HOMEWORK

As the popularity of 529 plans increases, the plans themselves are getting more sophisticated. You have more plans to choose from and more investment options within each plan.

Under current legislation you also have more control—you can switch investment tracks or roll over your assets from one savings plan to another plan once every 12 months. Being able to improve the performance of your plan is the major reason to make a switch, but it means taking responsibility for tracking your investment.

It's also critical to examine your plan at least once a year and make sure you know about any changes in the rules. Talking to a knowledgeable financial adviser, reading articles in newspapers and magazines, and doing research on the Web can help you stay on top of your 529 plan and the progress you're making.

TWO TYPES OF PLANS

COLLEGE SAVINGS PLAN

Investing in a college savings plan is similar to investing in a mutual fund—your contributions are combined with other contributors' money and invested by the manager the state has hired to run the plan. When you invest in this type of plan, your goal is to accumulate enough in contributions and investment earnings to be able to cover the cost of your beneficiary's education when he or she is ready to enroll. Remember, though, the value of your investment is subject to what happens in the investment markets and the economy in general, so there's no guarantee you'll reach your goal.

There are two general types of 529 plans: **college savings plans** and **prepaid tuition plans (PTPs)**. Savings plans are more common, but either type can help you cover college costs.

PREPAID TUITION PLAN

Most state-sponsored plans cover only public colleges and universities in the state. Other plans include all in-state schools, public and private. One of the most flexible prepayment plans, the Independent 529 Plan, is offered by a group of more than 200 private institutions across the country. Unlike savings plans, many prepayment plans, including the Independent plan, guarantee the future value of the credits you purchase.

529 PLAN