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MAKING SENSE OF INVESTING

An Investor's Guide to 529 College Savings Plans

A 529 college savings plan, created by Section 529(b) of the Internal Revenue Code, is designed to help save for future post-secondary school expenses of your child or another beneficiary.

A 529 plan is a state-sponsored education savings option that offers greater tax advantages, flexibility and control than other education savings alternatives. Each state can sponsor its own plan or plans, and typically you don't have to be a resident to contribute. If your state sponsors a 529 plan, you may be eligible for additional state tax benefits if you participate in that plan.

Numerous 529 plans are available for your consideration through Edward Jones. There may also be other plans, not offered through Edward Jones, that are appropriate. Choosing between an in-state and out-of-state 529 plan can be complicated. We recommend you discuss complex tax issues related to 529 plans with a tax professional.

Types of 529 Plans

College Savings Plan – Most states offer a college savings plan. Contributions can be made to any of the 529 investment options offered by the plan, and the amount of money available for withdrawal will depend on the performance of those investments. In the case of a 529 college savings plan, the investor takes on the investment risk.

Prepaid Contract – This type of plan allows individuals to purchase units of tuition/credits at today's prices for a student's attendance sometime in the future. Contributions are limited to amounts needed to pay the beneficiary's eligible higher education expenses, often limited to tuition and fees. Many prepaid tuition programs are sponsored by the specific state's government and may have residency requirements. In the case of a 529 prepaid contract, the investment risk is the burden of the state agency investing the money.

Details about a 529 plan's investment options, share classes, fees, expenses, risks and other important information can be found in each plan's program description or offering statement. Read it carefully before making any investment decisions.

Contributions

Contributions are made with after-tax dollars and accumulate tax free.[1] Other rules and restrictions on 529 plan contributions include the following:

- There are no age or income limitations for either the account owner or the beneficiary.
- Contributions must be made in cash. If assets are sold to make these contributions, taxes must be paid on any gains generated from the sale.
- Anyone can contribute to any beneficiary's 529 plan. You do not have to be the parent or even a relative of the beneficiary to make contributions.
- Contributions are considered completed gifts to the beneficiary and not part of the grantor's estate.

You may contribute up to $14,000 per year per beneficiary without exceeding the annual gift tax exclusion (less any other gifts made that year). All 529 plans prohibit contributions once the account balance for the beneficiary reaches a certain point, which is generally in excess of $200,000 but can vary depending on the plan. In addition, a 529 plan has a special gifting provision that allows contributions of up to $70,000 per contributor, per beneficiary in a single year.[2] The provision allows the gift to be considered prorated over five years. For example, a married couple with two children can contribute $140,000 to each child in one year.

As a result, you can contribute a much larger sum than the annual gift exclusion, meaning a larger amount may begin to accumulate tax-free earnings. In addition, not only is the amount contributed potentially removed from the grantor's gross estate but also the future earnings that the gift may ultimately generate.[2] As this election accelerates the annual exclusions over the five-year period, any additional non-excludable gifts from that donor to the same beneficiary within that time period would be taxable (which may be offset by one's lifetime exclusion amount).

Distributions

Any distribution is a proportionate amount of contributions and earnings within the plan. Distributions, if used for qualified higher education expenses at an eligible institution, are federally tax free. These expenses include:

- Tuition and fees
- Books and supplies
- Room and board, if the beneficiary is considered at least a half-time student (including off-campus housing – the equivalent of what it costs to live on campus)
- Other equipment or expenses required for enrollment

Eligible institutions include:

- Any college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education
- Certain foreign institutions participating in federal student aid programs administered by the U.S. Department of Education

To determine whether a foreign or domestic institution is eligible, visit www.fafsa.ed.gov.

An educational credit (American Opportunity or Lifetime Learning Credit) or the tuition and fees deduction can be claimed in the same year a beneficiary takes a tax-free distribution from a 529 plan, but the credit or deduction may not be used for the same qualified higher education expenses.

If a distribution is taken from a 529 plan but not used for a qualified expense, the portion of the distribution representing earnings is subject to ordinary income tax and a 10% federal penalty. The 10% penalty does not apply to distributions that are:

- Paid to a beneficiary, or the estate of the beneficiary, on or after the death of the beneficiary
- Made because the beneficiary is disabled
- Included in income because the designated beneficiary received a tax-free scholarship or fellowship, veterans educational assistance or employer-provided educational assistance
- Made on account of the designated beneficiary's attendance at a U.S. military academy
- Included in income only because the qualified education expenses were taken into account in determining the American Opportunity or Lifetime Learning Tax Credit.

Ownership and Control

The account owner has full control of the account and should name a successor-owner in the event he or she dies or becomes legally incompetent. If this happens, a child beneficiary may not gain control or ownership until reaching the age of majority. Only the owner can:

- Change the beneficiary to another family member of the original beneficiary
- Request a distribution[3]
- Elect to change investment options[4]

Keep in mind that family members include, but are not limited to, siblings, children, nieces or nephews, parents and first cousins. Be sure to check your plan's program description or offering statement to review a list of qualified family members. Changing the beneficiary to a family member is income tax- and penalty-free within 60 days of the distribution. Transfer taxes may apply in certain situations.

It's possible to roll the balance of one 529 plan to another; however, steps must be followed exactly to avoid potentially significant tax consequences. Specific circumstances apply if a 529 plan is funded with assets from a custodial account. Also, some plans offer rollovers at Net Asset Value (NAV). Please ask your Edward Jones financial advisor for more information.

Investment Options

Many 529 plans offer a range of professionally managed portfolio options, including the following:

- Individual portfolios invest in a single mutual fund to accommodate your beneficiary without regard to age.
- Fund-of-funds portfolios invest in multiple funds to accommodate your beneficiary without regard to age.
- Age-based portfolios are weighted and invest in several funds that automatically reallocate as your beneficiary ages.
- Some portfolios include guaranteed options or money market funds.
- Changes may be made to current investment options only once during a calendar year for the same beneficiary.

Risks

All 529 plans are state-sponsored, but the state doesn't guarantee against investment loss. The investments within the savings plans are subject to market risk and fluctuation. It's important to understand the market risks involved with any investment before the initial purchase. In the case of 529 plans, details about the plan's investment options, share classes, fees, expenses, risks and other important information can be found in each plan's program description or offering statement. Read it carefully before making any investment decision.

Share Classes, Fees and Expenses

The 529 plans offered through broker-dealers have different share classes. The most typical are A and C. Each has important features that should be considered, including the age of the beneficiary, the amount being invested and the investment time frame.

A 529 college savings plan may charge various fees and expenses such as:

- An enrollment fee
- An annual maintenance fee
- Sales charges (front end)
- Deferred sales charges (back end)
- Administrative and management fees

Class A shares typically carry a front-end sales charge applied to the total amount being invested and can range up to 5.75%. There are discounted sales charges (breakpoints) available at different levels. Breakpoints vary by vendor but are generally reached at the $50,000, $100,000, $250,000, $500,000 and $1 million levels. Class A shares usually do not have a back-end sales charge and, of the three classes mentioned, typically offer the lowest fees.

Class B shares generally do not have a front-end sales charge but may have a back-end sales charge applied when money is withdrawn. B shares typically have higher annual distribution and expense fees versus A shares. In some cases, B shares will convert to A shares after a number of years. Please note that few plans offer B shares; however, they are not available to purchase at Edward Jones.

Class C shares may have front- or back-end sales charges. C share sales charges (if any) are typically lower than those on A or B share classes. Annual distribution fees and expenses on C shares, however, are usually higher than those of A shares and will usually not convert to another class over time.

For long-term investors or those investors eligible for higher breakpoint levels, A shares may be less expensive than B or C shares. For shorter-term investors, or those not eligible for a substantial breakpoint, C shares may be the most cost-effective. Before deciding which share class to purchase, consider the intended holding period versus the A share breakpoint schedule to determine whether A or C shares are the most cost-effective.

Some employers may offer a corporate or employer-sponsored 529 plan with sales charge discounts. If your employer offers this benefit, you should compare any potential benefits of that program to those of other 529 plans.

To help decide which plan may be right for you, visit FINRA's 529 College Savings Plan Expense Analyzer Tool. To access this analyzer tool, go to www.finra.org, select the Investors link, locate the subhead Smart Investing in the far left-hand column, and click on Saving for College. The analyzer tool is a Related link in the far right-hand column.

Additional Information

- You may contribute to both a 529 plan and a Coverdell Education Savings Account for the same beneficiary in the same year. Gifting limitations apply.
- For federal financial aid purposes, a 529 plan is considered an asset of the account owner, generally the parent.[5]

For additional information and resources, please visit www.finra.org, www.msrb.org, www.sec.gov and www.fafsa.ed.gov.

1 Contributions may be eligible for a state tax deduction or credit in certain states for those residents.

2 In the event of the grantor's death within the five-year period, the portion of the original gift allocated to years following the year of death will be considered part of the grantor's estate for estate tax purposes.

3 Nonqualified withdrawals are taxed as ordinary income to whomever the check is made payable – account owner or beneficiary – and subject to a 10% penalty on earnings.

4 New contributions are not considered changes to investment options.

5 Student and parental assets and income are considered when applying for financial aid. A 529 plan is considered an asset of the parent, which may be an advantage over saving in the student's name. Make sure you discuss potential financial aid impacts with a financial aid professional.