

529 College Savings Plans

Questions and Answers

What is a 529 Saving Plan?

According to IRS Publication 970 a 529 Saving Plan is a college savings plan that is established by states who allow individuals to either prepay or contribute to an account for paying a student's qualified educational expenses.

Some colleges (**mostly private**) also maintain savings accounts that are normally used to prepay future tuition costs at today's rates. The 529 plans must satisfy a few basic requirements in order to receive special tax benefits for the owner of the contract.

There are two types of 529 plans, **prepaid** or **savings**. However, many plans have both elements combined in each plan.

For example, a state could have a Prepaid Tuition Plan that has an element for paying for tuition but also gives the owner of the contract the ability to use the funds for other qualified expenses as well.

In order for you to use the funds for expenses **other than tuition**, the owner can elect for the funds to go toward room/board. I normally call these types of plans **HYBRIDS**.

Every state has at least one 529 plan available. It's up to each state to decide whether or not they will offer a 529 plan (**or possibly more than one**).

All contributions into a 529 plan are **NOT** tax deductible on a Federal standpoint, however some states do allow a state tax deduction if an individual uses the state's sponsored plan and the person is a resident of the state and pays state income taxes.

This publication will cover some of the questions that we have received from our clients and other interested parties.

The information in this publication is general in nature and should not be viewed as giving investment, legal, or tax advice. Before incorporating any of the information in this publication, it is advised for the reader to talk to their financial advisors or CPA before making any financial or tax decisions.

On the next few pages we will cover some of the answers to many questions that deal with 529 college savings plans.

529 Plans: Questions and Answers

Q. What is a 529 plan?

Answer. A plan operated by a state or educational institution, with tax advantages and potentially other incentives to make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild.

Q. What is the main advantage of a typical 529 plan?

A. Earnings are not subject to federal tax and generally not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, books, as well as room and board. Contributions to a 529 plan, however, are not deductible.

Q. What is new this year with 529 plans?

A. A qualified, nontaxable distribution from a 529 plan during 2009 or 2010 now includes the cost of the purchase of any computer technology, related equipment and/or related services such as Internet access. The technology, equipment or services qualify if they are used by the beneficiary of the plan and the beneficiary's family during any of the years the beneficiary is enrolled at an eligible educational institution.

Q. What does “computer technology or equipment” mean?

A. This means any computer and related peripheral equipment. Related peripheral equipment is defined as any auxiliary machine (whether on-line or off-line) which is designed to be placed under the control of the central processing unit of a computer, such as a printer. This does not include equipment of a kind used primarily for amusement or entertainment. “Computer technology” also includes computer software used for educational purposes.

Q. Is this “cost of the purchase of any computer technology or equipment or Internet access and related services” available for any other education benefit under the tax laws?

A. No, it is only for 529 plan withdrawals. Such costs are not qualifying expenses for the American opportunity credit, Hope credit, lifetime learning credit or the tuition and fees deduction.

Q. How long have 529 plans been around?

A. Congress created them in 1996 and they are named after section 529 of the Internal Revenue code. “Qualified tuition program” is the legal name.

Q. Can anyone set up a 529 plan?

A. Yes. You can set one up and name anyone as a beneficiary — a relative, a friend, even you. There are no income restrictions on either you, as the contributor, or the beneficiary. There is also no limit to the number of plans you set up.

Q. Are there contribution limits?

A. Yes. Contributions can not exceed the amount necessary to provide for the qualified education expenses of the beneficiary. If you contribute to a 529 plan, however, be aware that there may be gift tax consequences if your contributions, plus any other gifts, to a particular beneficiary exceed \$13,000 during the year. For a general discussion of gift tax rules, see IRS Publication 950, Introduction to Estate and Gift Taxes. For information on a special rule that applies to contributions to 529 plans, see the instructions for Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.

Q. Are there different types of 529 plans?

A. There are two basic types: prepaid tuition plans and savings plans. And each state has its own plan. Each is somewhat unique. States are permitted to offer both types. A qualified education institution can only offer a prepaid tuition type 529 plan.

Q. Am I restricted to my own state's 529 Plan?

A. No. Your state's 529 Plan may offer incentives to win your business. But the market is competitive and you may find another plan you like more. Be sure to compare the various features of different plans.

Q. Who controls the funds in a 529 plan?

A. Whoever purchases the 529 plan is the custodian and controls the funds until they are withdrawn.

Q. Each 529 plan account has one designated beneficiary. What does that mean?

A. A designated beneficiary is usually the student or future student for whom the plan is intended to provide benefits. The beneficiary is generally not limited to attending schools in the state that sponsors their 529 plan. But to be sure, check with a plan before setting up an account.

Q. Can I change the beneficiary of a 529 plan I have set up?

A. Yes. There are no tax consequences if you change the designated beneficiary to another member of the family. Also, any funds distributed from a 529 plan are not taxable if rolled over to another plan for the benefit of the same beneficiary or for the benefit of a member of the beneficiary's family. So, for example, you can roll funds from the 529 for one of your children into a sibling's plan without penalty.

Q. What is an eligible educational institution?

A. An eligible educational institution is generally 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.

Q. I have not set up a 529 plan for my child. Can I start one now and take advantage of this new computer benefit?

Answer: You can start one anytime. But the benefit of a 529 plan comes with the tax-free withdrawal of earnings that build up in the plan based on the contributions made. Like other types of savings accounts, earnings are usually a function of time. A 529 plan which is set up while the student is already enrolled in college or in other postsecondary education may not accrue enough earnings to be of immediate benefit. However, that doesn't mean that such a student wouldn't benefit from a 529 plan as his or her postsecondary education continues.

Q. Where can I find more information about 529 plans?

A. A good source is IRS Publication 970, Tax Benefits for Education.

Q. Is setting up a 529 plan for my child right for me?

A. Only you can figure that out. 529 plans are not for everyone, and are also not the only option available for paying for college. Setting up a 529 plan is an investment decision, which means both the benefits and drawbacks must be considered, along with alternative ways of accomplishing the same thing. There are many independent sources of information on 529 plans. Also, you may want to consider consulting a trusted tax professional or financial planner.

Q. Will I receive a tax form indicating any distributions that are taken out during my student's stay in college?

Answer. Yes, when distributions are made from a 529 Plan the owner of the plan will receive Form 1099-Q, which falls under Sections 529 and 530 of the IRS Code. You will receive **Form 1099-Q** from each of the programs from which you have distribution modes to you or your beneficiary.

On Form 1099-Q you will find in **Box 1** of the form your gross distributions (**total amount of withdrawals**), **Box 2** will show the amount of earnings (**grow/profits**) that the 529 Plan has earned, which is taking your basis (**principal investment - the total value of the 529 account**). **Box 3** of Form 1099-Q will show return (**cash out**) of the investment.

Form 1099-Q should be sent to you by end of January or the first of February of the year following the year a distribution was taken out of the 529 plan.

How do scholarships or grants affect distributions from a 529 college plan?

Answer. Distributions from a 529 Plan must be adjusted for tax purposes, when certain tax-free benefits are given to the beneficiary for educational purposes. These tax-free benefits used to pay for certain qualified educational expenses must be taken into consideration when calculating the tax-free withdrawals from the 529 Plan.

According to the IRS, the qualified educational expenses must be reduced by the following tax-free educational assistance:

- **The tax-free part of scholarships, grants and fellowships**
- **Veterans' educational assistance**
- **Pell Grants**
- **Employer-provided educational assistance (Section 127 Plans)**
- **Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance**