FAQs on section 529

1. What is a "529 plan"?

   A "529 plan" is a college savings plan (also sometimes referred to as a "qualified state tuition plan") established pursuant to section 529 of the Internal Revenue Code. There are two types of 529 plans:

   - A "prepaid tuition plan" that offers families the option to prepay tuition based on today's costs of college tuition and provide a guarantee to keep pace with tuition inflation.
   - A "savings plan" that allows families to save on a tax-free basis for college expenses; the accounts receive returns based on the account's investment.

2. What expenses may be paid from 529 accounts?

   Amounts in 529 plans may be spent on "qualified higher education expenses." These include tuition, room and board, books and fees and any other expenses that students are required to pay to attend the college or university. States may further restrict the uses.

3. Who offers 529 plans?

   States or institutions of higher education may offer 529 plans. All 50 states and the District of Columbia provide 529 plans. Several hundred colleges and universities participate in a common 529 prepaid tuition plan (the "Independent 529 Plan").

4. Who may invest in a 529 plan?

   Usually, a parent or grandparent will make contributions to a 529 plan account with a child or grandchild as the beneficiary, but generally anyone can make contributions to a 529 plan for another person or themselves.

5. Is there a limit on how much can be invested in 529 plans?

   The amount that may be invested in 529 plans is effectively limited by the amount of qualified higher education expenses. There are also gift and estate tax rules that may impact contributions.

6. Can investors control the investments of the 529 savings plan?

   States set the investment parameters and options for their State's plan. Within those parameters states also decide how much investment discretion account holders have. Many States have contracted with investment managers to develop alternate portfolios keyed to the year when the beneficiary is expected to attend college.

7. What are the Federal tax benefits of 529 plans?

   Amounts contributed to 529 plans are not tax deductible. However, the amounts accumulate in the accounts tax free and are distributed tax free if used for qualified higher education expenses.

8. What are the state tax benefits of 529 plans?

   Tax benefits differ by state. Most states exempt earnings and distributions used for qualified higher education expenses from state income tax. Some states allow families to deduct the full or partial amount of their contributions from their state income taxes.

9. How do 529 plans affect the availability of other educational tax credits and eligibility for financial aid?

   If the family meets household income requirements, the family can claim the Hope Tax Credit and Lifetime Learning Credit in addition to the tax benefits of section 529. The same expense cannot be paid for from a 529 plan and still receive these credits. Savings in 529 plans may affect financial aid.

10. How many 529 plan accounts are there, and how much is invested in them?

    As of December 31, 2004, the College Savings Network reports that there were over 7 million accounts with approximately $65 billion.

11. Where can we get more information about 529 plans?

    The College Savings Plans Network, which is associated with the National Association of State Treasurers, is one good source of further information. Its website is www.collegesavings.org.

12. What does this legislation do?

The legislation would make permanent the changes made to section 529 by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) These changes include:

- Allowing educational institutions to establish prepaid tuition programs.
- Exempting the entire distribution from tax if used for qualified higher education expenses.
- Increasing the amount of room and board that could be included as qualified higher education expenses.
- Allowing use of HOPE credit or Lifetime Learning credit while using the 529 plan exceptions from taxes.
- Allowing beneficiaries to rollover amounts between qualified tuition programs but only once every 12 months.
- Expanding "family" for purposes of rollovers and changes of designated beneficiaries to include first cousins.

13. Why is this legislation necessary?

Without legislation these provisions would expire for years beginning after December 31, 2010 (pursuant to Section 901 of EGTRRA). The purpose of section 529 plans is to encourage parents and grandparents to put money aside today to pay for college many years in the future. However, with the special tax treatment added by EGTRRA scheduled to expire in a few years, we are asking families to make critical investment decisions without the promise of today's tax benefits. This is not a good way to encourage savings. This legislation will give them the certainty they need.