

# Section 529 College Savings Plans

## WHAT IS A SECTION 529 PLAN?

Also known as Qualified State Tuition Programs, Section 529 Plans are state-sponsored investment programs that help you save for your child's higher education. Qualified State Tuition Programs, given special tax status under Section 529 of the Internal Revenue Code, generally fall into three categories: prepaid tuition plans, tuition savings plans and special, state-issued municipal bonds. Each state may develop its own program, and while each program may be different, the potential benefits can be tremendous.

## PREPAID TUITION PLANS

The Prepaid Tuition Plans, sometimes called guarantee savings plans, allow for the pre-purchase of tuition based on today's rates and are then paid out at the future cost when the beneficiary is in college. This plan protects you from the rising costs of college education — the “return” on your investment is the difference between the college cost when your child attends and the prepaid tuition cost. These plans are only offered in 13 states.

## COLLEGE SAVINGS PLANS

College Savings Plans allow you to contribute to an “investment pool” — or a stock/bond portfolio. Though savings plans have the potential of growing faster than the prepaid tuition plan college inflation rate, returns on savings plans are based upon the market performance of the underlying investments and therefore there is no guarantee of this. Most savings plans offer a variety of age-based investment options where the underlying investments become more conservative as the beneficiary gets closer to college-age. In effect, you are investing in a mutual

fund. You can use the money at any accredited school for any qualified higher education expenses. If your state does not offer a savings plan, or has one with unattractive features, you can join one in another state, assuming no residency requirements exist in that particular state's program.

## STATE ISSUED MUNICIPAL BONDS

A third option is state-issued municipal bonds, which offer incentives if you use the bond receipts to pay for in-state higher education. You may exclude the interest on these municipal bonds from your taxable income.

## WHO CAN BE A BENEFICIARY?

You can establish an account for yourself, your child, grandchild, spouse, another relative, or even someone not related to you, and the beneficiary may be of any age. Only one person, however, may establish each account. At present, joint accounts are not permitted, and corporations may not establish accounts.

## WHAT ARE KEY ADVANTAGES OF SECTION 529 PLANS?

Unlike the Coverdell Education Savings Account, which sets a maximum adjusted gross income in order to qualify, Section 529 Plans have no adjusted gross income limits; anyone can establish and contribute to a Section 529 Plan. Your contributions to the plan can be withdrawn tax-free (federal) if the proceeds are used for qualified higher education expenses\*.

*For more information regarding college savings plans, please visit [www.collegesavings.org](http://www.collegesavings.org). Participation in a 529 Plan does not guarantee the investment return on contributions, if any, will be adequate to cover future tuition and other higher education expenses. State programs vary, therefore you should carefully review individual program documents before investing or sending money. Federal income tax on the earnings and a 10% penalty on distributions for non-qualified expenses may apply.*



RBC Wealth Management®

## Section 529 College Savings Plans, continued

The contributor maintains control of the plan's assets (unlike UTMA/UGMA accounts), but the assets may be excluded from the contributor's estate in the case of death. The contributor of the account can even withdraw all the funds, although this withdrawal is subject to a penalty (typically 10%) on the investment gains from the plan, plus tax on the gains. In addition, if the beneficiary dies, becomes disabled, or receives a college scholarship, the contributor can withdraw the funds without penalty. He or she is still subject to ordinary income taxation at the contributor's rate, however.

### WHAT ABOUT STATE TAXES?

Depending upon a particular state's program, certain state or local tax advantages may be available to resident participants. Some states allow the contributor to deduct contributions on a state tax return, while other states do not tax earnings.\*\* Consult your tax advisor for more information on the state tax requirements of a specific plan. Consider these benefits carefully before investing out of state.

### WHAT ARE THE GIFT TAX ADVANTAGES OF SECTION 529 PLANS?

Normally, a gift of more than \$13,000 made by an individual to a single person in one year is subject to federal gift tax. Section 529 Plans allow you to gift up to \$13,000 annually without paying gift taxes. You may also accelerate up to five years' worth of the annual exclusion amount by contributing up to \$65,000 per beneficiary. Any further gifts may be subject to gift tax. Portions of the accelerated gift may also be subject to an add-back feature in the event of death of the giftor prior to the five year acceleration period. You must elect to treat the entire gift as a series of five equal annual gifts. While Section 529 allows you to contribute up to \$65,000 in one year per beneficiary, it is ultimately up to individual states as trustees to decide what amounts their respective plans will allow.

### WHAT IF THE BENEFICIARY DOES NOT ATTEND COLLEGE?

You can name another member of the beneficiary's family — the original beneficiary's sibling, parent, child, or other family member — as the new beneficiary of the account without any income tax consequences. If the new beneficiary is of a younger generation in the family than the original beneficiary, a federal generation-skipping gift tax may apply for the year in which the beneficiary change is made. In this situation, you should consult your tax advisor.

### HOW MUCH WILL I PAY FOR A 529 PLAN?

Like mutual funds, 529 Plans may charge a sales charge. In addition, you may pay an annual fee for participating in the plan. You will also pay administrative and management fees that are deducted directly from plan assets much like the expense ratio of a mutual fund. Consult the plan documents for a more comprehensive explanation of the fees.

### HOW CAN I GET ADDITIONAL INFORMATION REGARDING SECTION 529 PLANS?

Contact your RBC Wealth Management® Financial Advisor.

*\*\* Some states provide matching grants.*

*RBC Wealth Management is not a tax or legal advisor. All decisions regarding the tax implications of your investments should be made in connection with your independent tax advisor.*

*© 2011 RBC Capital Markets, LLC. All rights reserved.*