

Courtesy of: Royalty Owner Help Desk

Education
planning

By the numbers¹

- All states and the District of Columbia now offer 529 plans.
- Coverdell Education Savings Accounts allow you to invest up to **\$2,000 per year**.
- Depending on your state, 529 college savings plans typically allow you to invest up to **\$366,000** over the life of the account.

¹www.finaid.org

Understanding your college savings options

Parents today have more choices than ever for college savings. While that variety gives families greater flexibility, it also means parents need to do more research to find the strategy that is right for them. Recent changes in the tax laws governing educational savings plans make it especially important for parents to do their homework.

Choosing the right savings approach

For most parents, paying for their children’s college education will be one of their greatest financial challenges. While financial aid is available for many students, statistics show only 52.3% of aid comes from scholarships and grants — almost 41% is in the form of loans.² However, parents can reduce the burden of student loans for their children by saving wisely for college expenses. In addition to traditional saving and investment accounts, parents can choose from a number of different educational savings vehicles designed to help families meet their goals. While each of these options offers certain advantages, you will need to consider carefully the

² Source: *Trends in Student Aid 2008*, College Board

following factors when choosing one or more of these plans.

- Does the money potentially grow tax deferred? Are earnings on withdrawals taxed?
- Is there flexibility in how the funds may be used?
- Is a parent or child the account owner? How will this affect financial aid?
- Can you change investments? How often?
- Are there contribution limits per year? For the life of the fund?
- Can you change beneficiaries?
- Are there penalties on nonqualified withdrawals?

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Key points

Coverdell ESAs

- Qualified uses include K-12 costs, as well as college expenses.
- Earnings are tax deferred, and withdrawals are tax free if used for qualified educational expenses.

529 plans

- Prepaid tuition plans can help to keep pace with inflation.
- Any earnings are tax deferred, and withdrawals are tax free if used for qualified educational expenses.

Custodial accounts

- Unlimited investment amounts are allowed.
- Earnings over \$1,800 are now taxed at the parent’s income tax rate.



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The savings options you choose can have a significant impact on your family's eligibility for federal financial aid, depending on whether you or your child is considered the account owner.

Generally, up to 5.6% of parental assets can be factored into the financial aid equation, in contrast to the 20% of student assets that can be applied. As a result, assets owned by the child can reduce substantially the amount of need-based financial aid a student may receive.

The following is an overview of three kinds of college savings accounts: Coverdell ESAs, 529 plans, and UGMA/UTMA custodial accounts. Each of these accounts has its strengths and weaknesses, and all are governed by a complex set of tax laws. That is why it is important to consult with your financial or tax advisor before choosing one or more of these options.

Coverdell Education Savings Accounts (ESAs)

These plans, originally known as Education IRAs, were introduced in 1997 and let parents set aside only \$500 per year. Under 2001 tax legislation, the plans were given a new name, Coverdell ESAs, and higher contribution limits. Now, parents can invest up to \$2,000 per child, per year, and investments in an ESA potentially grow tax free as long as withdrawals are used to pay for qualified school expenses. In addition, because the custodian of an ESA, typically a parent, is considered to be the owner, money accrued in these accounts may allow for a larger grant of financial aid than money saved in a traditional custodial account, where the child is the actual owner.

ESAs have another feature that could prove helpful to many families — qualified withdrawals cover not only college costs but also expenses for grades K-12, including equipment such as computers. However, unless Congress acts, certain ESA provisions are scheduled to expire in 2010. At that time, expenses for grades K-12 will no longer be qualified withdrawals, and ESA contribution limits will return to the \$500 annual limit.

Income restrictions apply to any year you contribute to a Coverdell ESA. The top contribution of \$2,000 is allowed only for individuals whose modified adjusted gross income falls under \$95,000 for single filers or below \$190,000 for joint filers. However, if your circumstances change, there is no tax penalty for converting an ESA to a 529 plan — a college savings plan with no income limits and similar tax benefits.

529 plans

Named for the section of the Internal Revenue Code that governs them, 529 plans come in two varieties — prepaid tuition plans and college savings plans — and generally are state sponsored. Like ESAs, both types of plans allow deferral of annual taxes on account earnings, and earnings on withdrawals used for qualified higher education expenses are tax free.

529 prepaid tuition plans

Prepaid tuition plans offer protection against tuition increases by letting parents buy tuition credits for the future at today's prices. As most prepaid tuition plans are operated by state governments, the projected tuition is generally based on in-state public college tuition rates. In the event the student decides to attend a private or out-of-state institution, typically the plan will pay an amount equal to public in-state rates, and the family will pay the difference.

The features of prepaid plans can vary significantly from state to state, including fees, contribution limits, and maximum account balances, although prepaid plans usually cover up to five years of college expenses. Although there is no risk to principal, it is important to note that the returns on most — but not all — prepaid plans are guaranteed by their respective states.

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529 college savings plans

College savings plans, unlike some prepaid plans, provide no guarantees on investment returns. As with an IRA or 401(k), they allow the account owners to choose their investment strategies from among the options offered under the particular plan. This offers parents the potential to earn returns above the yearly tuition inflation rate a prepaid plan offers but also may involve greater risks. You should consider your financial needs, goals, and risk tolerance prior to investing.

There are no annual contribution limits on 529 savings plans, and depending on the state, account balances can accumulate up to \$366,000. 529 plans also offer special gifting and estate tax benefits. You can gift up to \$13,000 per year per beneficiary without federal gift-tax consequences. Under the unique accelerated gifting features of 529 plans, an individual can contribute as much as \$65,000 (\$130,000 per couple), or the equivalent of five years of gifts, to a 529 plan in one year. You will not incur gift-tax ramifications as long as no additional gifts are made to the beneficiary for four years after you make the one-time gift.³ This feature might be valuable to a grandparent, for example, who might want to help fund a grandchild's education while at the same time reducing the size of his or her estate.

Choosing the right state plan

All states and the District of Columbia offer 529 plans; some offer only college savings plans, while several offer only prepaid tuition plans. While some plans are restricted to in-state residents, many 529 plans are available to residents of any state. About half of the states' plans offer in-state residents additional state income tax benefits. Still, even parents who live in states with tax benefits for residents may want to compare all their options. A college savings plan from another state may offer advantages — such as better investment performance, plan features, or flexibility — that could outweigh the tax benefits of participating in an in-state plan. When putting money into any 529 plan, however, parents need to be mindful of the fact that they may have additional plan fees that other investments, such as custodial accounts, do not.

While 529 savings plans have always been considered a parental asset, until recently the treatment of 529 prepaid tuition plans was a different story. 529 prepaid tuition plans were categorized as a student resource that could reduce need-based financial aid awards 100%. In other words, for every dollar in a prepaid tuition plan, potential financial aid would be reduced a dollar as well. This changed in 2006 when a new law went into effect that made both types of 529 plans a parental asset, a clear advantage when applying for financial aid.

Custodial accounts

These are the old standbys for college savings. They are also known as UGMAs and UTMAs, which are the initials for the state laws that govern them — the Uniform Gifts to Minors Act and the Uniform Transfers to Minors Act.

Custodial accounts do not provide the potential to defer or escape taxes on investment benefits. Previously, they offered significant tax benefits on the child's unearned income, taxing most account earnings over a certain limit at the child's lower rate when the child was between 14 and 18 years of age. This tax benefit disappeared in May of 2006 when the Tax Increase Prevention and Reconciliation Act went into effect. Now, while the first \$900 of earnings in a custodial account remains tax free and the next \$900 is taxed at the child's rate, any earnings above that are taxed at the parent's rate until the child reaches age 24, when earnings are taxed at the child's rate. In addition, custodial accounts are considered an asset of the child, which can significantly reduce financial aid.

³ Assumes you live for four years after the year of the gift and filed the appropriate tax form.



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Make educated decisions

College investing programs come in many shapes and sizes today. That’s why the insight and guidance of a financial advisor is so valuable. He or she will not only help you choose the right college plan but also can help you select the investment options that best fit your needs and tolerance for risk.

	529 Plans		Coverdell ESA	Custodial accounts (UGMA/UTMA)	Taxable accounts
	529 savings plans	529 prepaid tuition plans			
Federal taxes	Tax deferred. Earnings on withdrawals tax free if used for qualified expenses.	Tax deferred	Tax deferred. Earnings on withdrawals tax free if used for qualified expenses.	First \$900 of earnings tax free; next \$900 taxed at beneficiary’s rate	Fully taxable
Contribution limits	No annual limit. Account maximum varies by plan; up to \$366,000	Varies by plan. Account maximum generally covers up to five years of college expenses.	\$2,000 per child per year	No limits	No limits
Income limits	No limits		Eligibility phases out for single filers from \$95,000 to \$110,000; for joint filers from \$190,000 to \$220,000	No limits	No limits
Control of assets	Account owner (usually parent)		Account owner (usually parent)	Custodian (usually parent) until child reaches majority, then the child	Account owner
Investment flexibility	Assets may be moved twice a year in 2009 or if changing beneficiaries*	State or sponsor manages investments; offers return tied to tuition inflation rate	Can move assets at any time	Can move assets at any time, but transfer is usually taxable event	Unlimited, but may be taxable
Federal financial aid impact	Considered parental asset; favorable for financial aid		Considered parental asset, favorable for financial aid	Considered student asset; negative impact on financial aid	Considered parental asset; favorable for financial aid
Qualified uses	Post-secondary school expenses, including tuition, fees, and room and board (and graduate school)	Most cover tuition and fees only based on in-state rates; some cover room and board	Post-secondary and K-12 expenses	No restrictions	No restrictions
Changing beneficiaries	Can be transferred to another family member without penalty	Can be transferred to another family member without penalty. Beneficiaries usually restricted to in-state residents.	Can be transferred to another family member without penalty	Beneficiary cannot be changed.	N/A
Federal gift & estate tax	Can gift up to \$65,000 per individual beneficiary per year (\$130,000 per married couple) with no gift tax consequences. ** Assets transferred out of owner’s estate.		\$2,000 yearly limit falls under annual \$13,000 gift tax exclusion. Assets transferred out of owner’s estate.	Standard annual \$13,000 gift tax exclusion	N/A
Penalties on nonqualified withdrawals	Earnings subject to income tax and 10% IRS penalty	Fees or penalties vary by plan. Typically donor gets principal plus modest return.	Earnings subject to income tax and 10% IRS penalty	None	N/A

* After 2009, assets may be moved only once per year.

** Assumes you live for at least four years after the year of the gift and filed the appropriate tax form.



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However, contributions to custodial accounts are unlimited and there is no maximum balance. Custodial accounts do not have the additional plan fee that many 529 plans do, and the parent, as custodian, can select account investments and move assets between various types of investments as they wish. The level of risk depends on the type of investment vehicle chosen.

Custodial accounts also offer parents flexibility in how the money is used — withdrawals are not restricted to educational expenditures but can be spent in any way that benefits the minor. On the other hand, the accounts become the child's asset at either age 18 or 21 (depending on the state). If a child wishes to use the money for a purpose other than college, the parent has no legal right to stop him or her.

No matter which investment option you choose for a child's higher education, it is important to invest early and as often as your investment vehicle allows. As a result of your foresight, your child could avoid being weighed down by large college loan amounts as he or she gets started on a career.

There is a \$25 annual account fee associated with the MFS® 529 Savings Plan. This annual fee is waived for Oregon residents and for those accounts with assets of \$25,000 or more. Investments in 529 plans involve investment risks. You should consider your financial needs, goals, and risk tolerance prior to investing. Clients investing in 529 savings plans should consult a tax advisor or other financial professional to ensure that they obtain the desired tax benefits. Tax benefits of investing in 529 plans depend on meeting distinct requirements such as whether an investor's home state offers state tax or other benefits only available in the home state's 529 college savings plan. Withdrawals of earnings not used to pay for qualified higher education expenses are subject to an additional 10% penalty. State taxes may also apply.

The MFS 529 Savings Plan is a flexible college investing plan sponsored by the state of Oregon, acting by and through the Oregon 529 College Savings Board, and is administered by MFS Investment Management®. Depending on your state of residence and the state of residence of the beneficiary, an investment in the MFS 529 Savings Plan may not afford you or your beneficiary state tax or other benefits only available for investments in such state's qualified tuition program.

Before investing in the MFS 529 Savings Plan, consider the investment objectives, risks, charges, and expenses. For a prospectus containing this and other information, as well as a Participant Agreement, Disclosure Statement, and Expense Supplement, contact your investment professional or view online at mfs.com. Read them carefully.

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