

**With more states offering new and improved 529 savings plans, there's never been a better—or more confusing—time to save for your kids' education. Here's what you need to know.**

# RELIABLE

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**BY PENELOPE WANG**

Additional reporting by Tara Kalwarski, Derek Manson and Cara Moultrup

At long last, parents struggling to save for their children's college education have received a much needed break: a tax-free way to save for college. The new tax law allows you to make withdrawals from state college savings plans, also known as 529s, completely free of federal taxes if the money is used to pay college expenses. (Previously, 529 savings plans were only tax deferred.) That change gives parents a fighting chance to make a dent in those scary, six-figure tuition bills. Little wonder that the 529, named for the section of the tax code that governs it, is fast becoming the leading college savings plan. Last year, assets in these accounts surged from \$1.5 billion to \$10 billion. And Financial Research Corp., a Boston financial services consulting firm, predicts that those assets will balloon to \$100 billion by 2006, a tenfold increase.

Before you join the stampede to 529s, though, you need to understand what you're getting into—these plans still have major drawbacks, as we will explain. Perhaps the biggest problem of all is that 529 plans are absurdly complicated, which can make shopping for a plan somewhat daunting. Each of the dozens of plans available has its own set of rules, investment options and tax treatment. No single plan is right for everyone.

But let's start with the good stuff. Unlike older prepaid state tuition plans (also called 529s), these savings plans allow you to invest in one or more stock or bond funds, somewhat like a 401(k). Anyone, regardless of income level, can open an account, and you may contribute enough to pay for an Ivy League education plus law school. You can also tuck away tiny amounts, as little as \$25 a month. The money can be used at any college in the country, and you maintain control of the

account until the money is withdrawn to pay the bills. Most states offer additional tax breaks of their own. (One caveat: Three states still tax the earnings on money withdrawn from their 529 plans, and 14 tax withdrawals on out-of-state plans. But the taxes are generally paid at the student's low state tax rate—typically just 1% or 2%.)

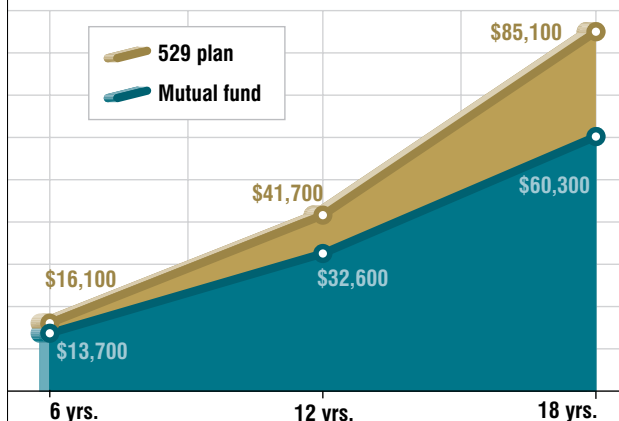
When it comes to selecting a 529, there's no shortage of choices. Almost all states permit nonresidents to put money into their plans—and many are actively marketing their plans nationally. At last count, 43 states were offering 529 savings plans (eight sponsor more than one program), and six more were set to launch this year. Most have hired well-known investment firms to manage their 529 assets. TIAA-CREF leads the pack with contracts for 14 state plans; other money managers operating multiple plans: Fidelity (three), Merrill Lynch (three) and Strong (three). A growing number of states sponsor plans with investment options from a variety of fund families. And 22 states are now marketing their 529 plans through advisers as well as directly.

"There's an arms race among the state plans to add investment options in order to attract investors," says Lisa Baird, a consultant at Cerulli Associates in Boston. "And because broker-sold plans are building assets so quickly, many states are adding those plans on top of their no-load offerings." Even no-load firm TIAA-CREF is considering adding a load share class to its 529 offerings to be sold through advisers.

Now for those drawbacks. For starters, despite the tempting tax breaks, 529 savings plans are *not* the best choice for every family. As we will explain in detail, these plans remain best suited to high-tax-bracket investors who are certain that their family will not qualify for financial aid, since money in 529s can reduce any award. You also need to be aware that a 529 can lose money. The stock-heavy portfolios in these plans have suffered badly in the recent bear market along with most other equity funds, posting double-digit losses.

## THE MAGIC OF TAX-FREE SAVING

The more time you have before your child goes to college, the more you'll feel the impact of a 529's tax advantage.



**Notes:** Assumes an investment of \$2,000 a year in a 529 plan that offers state tax deductions vs. the same investment in an identical mutual fund after taxes. Also assumes 35% federal and 6.85% state tax brackets, annual expense ratios of 0.65% and probable returns based on historical averages for both accounts. **Source:** TIAA-CREF.

In addition, your investment flexibility can be limited in a 529 because most still offer only a handful of funds. An Internal Revenue Service rule change now allows you to switch your investment choice once a year; until this year, you had to follow a cumbersome rollover procedure. But you still lack the investment control available in 401(k) plans, where you can usually make daily trades. You also need to be aware that the tax-free savings break is set to expire by the end of 2010. Unless Congress renews the law, 529s will revert to their old tax-deferred treatment starting in 2011, which means that earnings will be federally taxed at the student's rate, typically 15%, at withdrawal. Most financial advisers expect that the tax break will be extended, but there's no way to predict with certainty what Washington will do.

Given the complexity of 529s and the confusing number of options, more investors are turning to advisers to guide them

through the maze. If you take that route, be sure your adviser is well versed in all plans, not just the one he or she is being paid to sell you. And remember that you'll be paying a sales charge or higher annual expenses or possibly both. These programs are also popping up in the workplace as an employee benefit, but the 529 that your company offers isn't necessarily the best option for you.

All of this may make you feel that you need a college education in 529s before you choose the right one for your family. That's why we've put together the following crash course. In Part 1, we offer guidelines for deciding whether a 529 plan is really right for you. If your answer is yes, move on to Part 2, which will help you select the best plan for your financial situation. We conclude with advice on how to best manage your 529 investment.

For a quick review of the mechanics of these plans, check out our answers to the 10 most frequently asked questions about



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**STATE BY STATE**

In the following tables, you'll find highlights of 43 states' college savings plans and the status of plans in the other seven (plus the District of Columbia) that are in the works. Look for our four top choices for any investor and the 13 plans that are great for state residents.

-  **Recommended** for residents and national shoppers
-  **Recommended** for state residents buying direct
-  **Caution:** High expenses may apply
-  Plan being **overhauled**
-  Plan **not open** yet

**AGE-BASED ALLOCATIONS**

-  **Single option:** Only one age-based portfolio available
-  **Multiple options:** Shows the most aggressive portfolio offered; arrow in the outer ring shows the fixed-income portion of the most conservative option

	STATE/MANAGER PLAN NAME	MAXIMUM CONTRIB. <sup>1</sup>	STATE TAX BREAKS		AGE-BASED ASSET ALLOCATION EQUITY/FIXED INC.		NON-AGE-BASED FUND OPTIONS			EXPENSES <sup>2</sup>	WEBSITE (WWW.) TELEPHONE
			MAX. ANNUAL DEDUCTION SINGLE/JOINT	TAX-FREE WITHDRAWALS	AT AGE THREE	AT AGE TEN	Equity	Balanced	Fixed Income		
	<b>ALABAMA</b> (Anticipated enrollment June 1) Alabama College Education Savings Program										<i>treasury.state.al.us</i>
	<b>ALASKA</b> <i>T. Rowe Price</i> University of Alaska College Savings Plan	\$250,000	NO STATE INCOME TAX				1	1	2	0.62% to 1.05%	<i>uacollegesavings.com</i> 866-277-1005
	<i>T. Rowe Price</i> T. Rowe Price College Savings Plan						1	1	1	0.85% to 1.05%	<i>troweprice.com/collegesavings</i> 800-369-3641
	<i>T. Rowe Price/Manulife</i> Manulife College Savings Plan						2	-	2	1.30% to 2.06%	<i>manulifecollegesavings.com</i> 866-222-7498
	<b>ARIZONA</b> <i>College Savings Bank</i> Arizona Family College Savings Program	\$177,000	0	✓			-	-	1	None	<i>arizona.collegesavings.com</i> 800-888-2723
	<i>Securities Management &amp; Research</i> Arizona Family College Savings Program						6	1	3	0.49% to 11.53%	<i>smrinvest.com</i> 888-667-3239
	<i>Waddell &amp; Reed</i> Waddell & Reed InvestEd Plan						1	1	1	1.70% to 2.58%	<i>waddell.com</i> 888-923-3355
	<b>ARKANSAS</b> <i>Merrill Lynch</i> GIFT College Investing Plan	\$245,000	0	✓			2	1	1	1.35% to 2.33%	<i>thegiftplan.com</i> 877-615-4116
	<b>CALIFORNIA</b> <i>TIAA-CREF</i> ScholarShare College Savings Trust	\$174,648	0				2	-	1	0.80%	<i>scholarshare.com</i> 877-728-4338
	<b>COLORADO</b> <i>Salomon Smith Barney</i> Scholars Choice College Savings Plan	\$235,000	NO LIMIT	✓			1	1	1	1.09% to 1.75%	<i>scholars-choice.com</i> 888-572-4652
	<b>CONNECTICUT</b> <i>TIAA-CREF</i> Connecticut Higher Education Trust	\$235,000	0	✓			1	-	1	0.76% to 0.79%	<i>aboutchet.com</i> 888-799-2438
	<b>DELAWARE</b> <i>Fidelity</i> Delaware College Investment Plan	\$250,000	0 <sup>4</sup>	✓			2	-	1	0.88% to 1.13%	<i>fidelity.com/delaware</i> 800-544-1655
	<b>DISTRICT OF COLUMBIA</b> (Summer 2002)			✓			2	1	2		202-727-0780
	<b>FLORIDA</b> <i>TIAA-CREF</i> (Summer 2002) Florida College Savings Plan		NO STATE INCOME TAX								<i>floridaprepaidcollege.com</i> 800-552-4723
	<b>GEORGIA</b> <i>TIAA-CREF</i> (April 2002) Georgia Higher Education Savings Plan	\$120,000 <sup>3</sup>	\$2,000 S <sup>5</sup> \$2,000 J <sup>5</sup>	✓						0.85%	<i>gacollegesavings.org</i> <sup>8</sup> 877-424-4377 <sup>8</sup>

**Notes:** <sup>1</sup>Can also reflect account value (including appreciation) at which no further contributions can be made. <sup>2</sup>The range of expense ratios for all fund options plus any management or administrative fees. <sup>3</sup>Legislation pending to raise limit to \$235,000. <sup>4</sup>Deduction legislation pending. <sup>5</sup>Beneficiary must be a dependent. <sup>6</sup>Two age-based options available. <sup>7</sup>Maximum expense ratio reflects two new fund choices; it is expected to be reduced to less than 3% by the end of the year. <sup>8</sup>Not available until launch date. **Sources:** The states, Savingforcollege.com.

529s. Finally, in the comprehensive tables that begin on the facing page, we present a state-by-state rundown of key 529 features and highlight the plans that we think make the grade. Now let's begin.

**LESSON 1: COLLEGE SAVINGS PLANS 101**

Sure, the tax breaks are fabulous, and you can sock away plenty. But to really come out ahead in a 529 plan, you should meet at least one of the following criteria.

**You're in a lofty tax bracket with a long time horizon.** Tax-sheltered compounding really works its magic if you are in a high tax bracket—typically 30% or above—and stay invested for many years, as the chart on page 1 shows. According to calculations by TIAA-CREF, a parent who invests \$2,000 annually for six years in an age-based 529 portfolio will likely come away with \$16,100,

assuming history's average returns on stocks, bonds and cash. That's 17% more than a high-bracket investor would have earned in an identical taxable fund. If you continue investing \$2,000 a year for 18 years, you will end up with \$85,100, or 41% more.

Granted, you can minimize taxes on college savings without locking up your money in a 529 simply by buying and holding individual stocks or investing in tax-efficient mutual funds. That way, you won't incur taxes until you take your money out, and those taxes may be quite low because the long-term capital-gains rate will fall to just 18% in 2006. (Those in the 15% bracket pay only 8% on assets held more than five years.) But keep in mind, you will need to shift from stocks to more stable fixed-income investments as your children reach high school. In a taxable portfolio, interest on those investments is taxed at your regular income rate. But in a 529, income from

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STATE/MANAGER PLAN NAME	MAXIMUM CONTRIB. <sup>1</sup>	STATE TAX BREAKS		AGE-BASED ASSET ALLOCATION		NON-AGE-BASED FUND OPTIONS				EXPENSES <sup>2</sup>	WEBSITE (WWW.) TELEPHONE	
		MAX. ANNUAL DEDUCTION SINGLE/JOINT	TAX-FREE WITH- DRAWALS	EQUITY/FIXED INC.	AT AGE THREE	AT AGE TEN	Equity	Balanced	Fixed- Income			Adviser- Sold
HAWAII												
IDAHO <i>TIAA-CREF</i> Idaho College Savings Program	\$235,000	\$4,000 S \$8,000 J	✓			1	—	1		0.88% to 0.93%	<i>idsaves.org</i> 866-433-2533	
ILLINOIS <i>Salomon Smith Barney</i> Bright Start	\$235,000	NO LIMIT	✓			1	—	2	✓	0.99%	<i>brightstartsavings.com</i> 877-432-8777	
INDIANA <i>One Group</i> CollegeChoice 529 Investment Plan	\$236,750	0	✓			3	1	3	✓	0.50% to 1.92%	<i>collegechoiceplan.com</i> 866-400-7526	
IOWA <i>Vanguard</i> College Savings Iowa	\$146,000	\$2,180 PER ACCOUNT	✓			—	—	—		0.65%	<i>collegesavingsiowa.com</i> 888-672-9116	
KANSAS <i>American Century</i> Learning Quest Education Savings Program	\$235,000	\$2,000 S <sup>10</sup> \$4,000 J <sup>10</sup>	✓			—	—	—	✓	0.91% to 1.34%	<i>learningquestsavings.com</i> 800-579-2203	
KENTUCKY <i>TIAA-CREF</i> Kentucky Education Savings Plan Trust <sup>8</sup>	\$235,000	0	✓			1	—	—		0.80%	<i>kentuckytrust.org</i> 877-598-7878	
LOUISIANA <i>State Treasurer</i> START Saving Program <sup>9</sup>	\$173,065	\$2,400 <sup>11</sup> PER ACCOUNT				✓	—	—	1	None	<i>osfa.state.la.us</i> 800-259-5626, ext. 1012	
MAINE <i>Merrill Lynch</i> NextGen College Investing Plan	\$235,000	0	✓			8	1	2	✓	1.32% to 2.50%	<i>nextgenplan.com</i> 877-463-9843	
MARYLAND <i>T. Rowe Price</i> Maryland College Investment Plan	\$175,000	\$2,500 <sup>12</sup> PER ACCOUNT	✓			1	1	1		1.08% to 1.14%	<i>collegesavingsmd.org</i> 888-463-4723	
MASSACHUSETTS <i>Fidelity</i> U. Fund College Investing Plan	\$230,000	0				2	—	1		0.88% to 1.13%	<i>fidelity.com/ufund</i> 800-544-2776	
MICHIGAN <i>TIAA-CREF</i> Michigan Education Savings Program	\$235,000	\$5,000 S \$10,000 J	✓			1	—	1		0.65%	<i>misaves.com</i> 877-861-6377	
MINNESOTA <i>TIAA-CREF</i> Minnesota College Savings Plan	\$235,000	0	✓			1	—	1		0.65%	<i>mnsaves.org</i> 877-338-4646	
MISSISSIPPI <i>TIAA-CREF</i> Mississippi Affordable College Savings Program	\$235,000	\$10,000 S \$20,000 J	✓			1	—	1		0.88% to 0.94%	<i>collegesavingsms.com</i> 800-486-3670	
MISSOURI <i>TIAA-CREF</i> Missouri Saving for Tuition	\$235,000	\$8,000 PER ACCOUNT	✓			1	—	1		0.65%	<i>missourimost.org</i> 888-414-6678	
MONTANA <i>College Savings Bank</i> Montana Family Education Savings Program	\$177,000	\$3,000 S \$6,000 J	✓			—	—	1		None	<i>montana.collegesavings.com</i> 800-888-2723	
NEBRASKA <i>Union Bank &amp; Trust</i> College Savings Plan of Nebraska	\$250,000	\$1,000 S \$1,000 J <sup>13</sup>	✓			3	—	3	✓	0.83% to 1.68%	<i>planforcollegenow.com</i> 888-993-3746	
<i>Union Bank &amp; Trust</i> TD Waterhouse College Savings						3	—	3	✓	1.08% to 1.93%	<i>tdwaterhouse.com</i> 877-408-4644	
AIM Management AIM College Savings Plan						2	1	—	✓	1.06% to 2.57%	<i>aimfunds.com</i> 877-246-7526	

**Notes:** Per account means maximum annual deduction per account regardless of how many accounts are in the beneficiary's name. <sup>1</sup>Can also reflect account value (including appreciation) at which no further contributions can be made. <sup>2</sup>The range of expense ratios for all fund options plus any management or administrative fees. <sup>3</sup>State residency required. <sup>4</sup>Per beneficiary. <sup>5</sup>Deduction may be carried forward. <sup>6</sup>Deduction may be carried forward up to ten years. <sup>7</sup>\$500 limit for married filing separately. <sup>8</sup>Four age-based options available. <sup>9</sup>Three age-based options available. **Sources:** The states, Savingforcollege.com.

**INVESTING  
FOR COLLEGE**

bonds and other fixed-income investments can accumulate tax-free, making a 529 an even more tax-advantaged choice for a mixed-allocation portfolio than it is for all-equity accounts. Plus, in a 529 plan you can move your money within the account or switch to a different plan, all without incurring a tax bill.

**You are not relying on financial aid.** A 529 account may count against you more heavily than money held in a taxable account when it comes time to qualify for financial aid. “The decision to choose a 529 plan is basically a trade-off between saving tax dollars now and receiving aid dollars in the future,” says financial adviser Raymond Loewe of College Money in Marlton, N.J. Unfortunately, figuring out whether you will be eligible for aid, and how much you may receive, is a guessing game for middle-income families, particularly parents with young children who are decades away from applying. But if your kids are headed for college in a few years, you can—and should—get an estimate of your aid eligibility by completing the worksheets available in college handbooks or by using online aid calculators such as those at [Finaid.com](http://Finaid.com) or [Collegeboard.com](http://Collegeboard.com).

Here’s how the rules work right now. Under current federal financial aid formulas used by most public colleges, 529s are considered the parent’s asset until the money is withdrawn. Federal aid formulas assess only 5.6% of parents’ assets when

considering how much they should contribute to tuition, compared with 35% of student assets. Any 529 money held in accounts controlled by grandparents or other relatives is not counted at all. Once the money is withdrawn, however, the untaxed earnings from the account are assessed as the student’s income, which reduces any financial aid award by 50¢ on the dollar. As a result, some families who stash substantial amounts in 529s may end up qualifying for less financial aid than if they had saved the same amount in a taxable account.

Be aware too that the financial aid rules governing 529s may change significantly. With the renewal next year of the Reauthorization of the Higher Education Act, which governs federal financial aid policy, the rules for 529 plans will likely be spelled out for the 2004-05 academic year. “The money in 529s will be counted, the question is how much will be counted,” says financial aid expert Kalman Chany, author of *Paying for College Without Going Broke*.

Meanwhile, private colleges are free to consider 529 assets however they wish when it comes to awarding their own aid. Many schools are already asking about 529 accounts owned by parents, grandparents and other relatives. “With endowments shrinking and less money available for aid, it will be hard for private colleges to ignore 529 money,” says Loewe.

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	STATE/MANAGER PLAN NAME	MAXIMUM CONTRIB. <sup>1</sup>	STATE TAX BREAKS		AGE-BASED ASSET ALLOCATION EQUITY/FIXED INC.		NON-AGE-BASED FUND OPTIONS				EXPENSES <sup>2</sup>	WEBSITE (WWW.) TELEPHONE
			MAX. ANNUAL DEDUCTION SINGLE/JOINT	TAX-FREE WITH- DRAWALS	AT AGE THREE	AT AGE TEN	Equity	Balanced	Fixed- Income	Adviser- Sold		
	<b>NEVADA</b> <i>Strong America's College Savings Plan</i>	\$246,000	NO STATE INCOME TAX				1	1	1		1.30%	<a href="http://americas529plan.com">americas529plan.com</a> 877-529-5295
	<i>Strong/American Skandia American Skandia College Savings Plan</i>						1	1	1	✓	1.61% to 2.52%	<a href="http://americanskandia.com">americanskandia.com</a> 800-752-6342
	<b>NEW HAMPSHIRE</b> <i>Fidelity Unique College Investing Plan</i>	\$233,240	NO STATE INCOME TAX				2	—	1	✓	0.88% to 1.82%	<a href="http://fidelity.com/unique">fidelity.com/unique</a> 800-544-1722
	<b>NEW JERSEY</b> <i>State Treasury New Jersey Better Educational Savings Trust</i>	\$185,000	0	✓			—	—	—		0.50%	<a href="http://besaa.org">besaa.org</a> 877-465-2378
	<b>NEW MEXICO</b> <i>Schoolhouse Capital The Education Plan of New Mexico</i>	\$251,000	NO LIMIT				3	1	4	✓	0.78% to 1.47%	<a href="http://tepm.com">tepm.com</a> 800-499-7581
	<i>Schoolhouse/New York Life Inv. Man. CollegeSense</i>						3	1	4	✓	1.10% to 1.68%	<a href="http://collegesense.com">collegesense.com</a> 866-529-7367
	<i>Schoolhouse/Oppenheimer Scholar'sEdge</i>						3	1	4	✓	1.21% to 1.70%	<a href="http://scholarsedge529.com">scholarsedge529.com</a> 866-529-7283
	<i>Prudential/Sun America/Evergreen Arrive Education Savings Plan</i>						4	—	4	✓	1.38% to 2.09%	<a href="http://arrive529.com">arrive529.com</a> 877-277-4838
	<b>NEW YORK</b> <i>TIAA-CREF New York's College Savings Program</i>	\$235,000 <sup>6</sup>	\$5,000 s \$10,000 J	✓			1	—	1		0.65%	<a href="http://mysaves.org">mysaves.org</a> 877-697-2837
	<b>NORTH CAROLINA</b> <i>College Foundation NC National College Savings Program</i>	\$268,804	0	✓			1	1	1		0.30% to 1.26%	<a href="http://cfnc.org/savings">cfnc.org/savings</a> 800-600-3453
	<i>College Foundation/Seligman Seligman College Horizon Funds</i>						17	—	5	✓	0.83% to 2.41%	<a href="http://seligman529.com">seligman529.com</a> 800-600-3453
	<b>NORTH DAKOTA</b> <i>Morgan Stanley College Save</i>	\$269,000	0				2	2	—	✓	1.17% to 1.71%	<a href="http://collegesave4u.com">collegesave4u.com</a> 866-728-3529
	<b>OHIO</b> <i>Putnam Investments CollegeAdvantage</i>	\$232,000	\$2,000 s <sup>17</sup> \$2,000 J <sup>17</sup>	✓			9	1	3	✓	0.68% to 2.22%	<a href="http://collegeadvantage.com">collegeadvantage.com</a> 800-233-6734
	<b>OKLAHOMA</b> <i>TIAA-CREF Oklahoma College Savings Plan</i>	\$235,000	\$2,500 PER ACCOUNT	✓			1	—	1		0.70% to 0.92%	<a href="http://ok4saving.org">ok4saving.org</a> 877-654-7284
	<b>OREGON</b> <i>Strong Facts 529 Plan</i>	\$250,000	\$2,000 s \$2,000 J <sup>18</sup>	✓			3	1	2	✓	1.00% to 2.28%	<a href="http://529Facts.com">529Facts.com</a> 866-772-8464

**Notes:** Per account means maximum annual deduction per account regardless of how many accounts are in the beneficiary's name. <sup>1</sup>Can also reflect account value after appreciation at which no further contributions can be made. <sup>2</sup>The range of expense ratios for all fund options plus any management or administrative fees. <sup>3</sup>\$1,000 is the maximum lifetime contribution that can be made to all accounts for any one beneficiary. <sup>4</sup>Deduction per beneficiary, may be carried forward. <sup>5</sup>\$1,000 limit for married filing separately. <sup>6</sup>Three age-based options. <sup>7</sup>Two age-based options. **Sources:** The states, [Savingforcollege.com](http://Savingforcollege.com).

Given the uncertainties, most advisers recommend that families earning less than \$125,000, who may be eligible for aid, save outside a 529 plan, at least until federal aid rules are made clearer in the next year or so. Families earning \$50,000 or less, who are the best candidates for need-based aid, should steer clear of college savings plans altogether and instead focus on building up their retirement accounts, which are exempt from the aid formulas.

What if you have a 529 plan and your child receives a merit-based scholarship or a need-based award? Your qualified education expenses will be reduced by the amount of financial aid. You can get a refund of your 529 money equal to the amount of the award without incurring the 10% federal penalty for unqualified withdrawals, but depending on your state, you may pay income taxes at your rate on the earnings (some states tax these withdrawals at the student's rate). You can also delay 529 withdrawals until your child's final year of school, when the money will not factor into future awards. Other options: You can transfer the money to another family member or you can leave the money invested for graduate school.

**You live in a high-tax state with generous 529 tax deductions.** If you reside in a high-tax state that offers a serious tax deduction, look closely at its plan even if you are in a low tax

bracket. As our tables show, 23 states offer a tax deduction on 529 contributions, including Idaho (top tax rate: 7.8%; \$4,000 deduction for a single filer), Missouri (6%; \$8,000 deduction per account) and New Mexico (8.29%; unlimited deduction). And 36 states provide a tax exemption on withdrawals. Three states—Arizona, Colorado and New Jersey—exempt withdrawals from out-of-state plans.

**You're a grandparent looking to reduce your estate.** You can contribute up to \$55,000 per beneficiary (\$110,000 for a married couple) to a 529 plan without incurring the federal gift tax. That makes 529s a great way to shift a lot of money out of your estate quickly. The \$55,000 contribution is counted against your \$11,000 annual gift exclusion over five years, so you cannot make another tax-free gift to that child for six years.

**LESSON 2: HONOR ROLL**

So you've decided a 529 savings plan makes sense for you. Your next step is to figure out which plan is best. A quick glance at our state-by-state tables will make it clear that no two programs are alike. Here's how to make your selection.

**Check out your home state.** If you're in a high- or moderately high-tax state, a strong deduction may make it worthwhile to stay in your own backyard, even if the plan has higher fees or

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STATE/MANAGER PLAN NAME	MAXIMUM CONTRIB. <sup>1</sup>	STATE TAX BREAKS		AGE-BASED ASSET ALLOCATION EQUITY/FIXED INC.		NON-AGE-BASED FUND OPTIONS				EXPENSES <sup>2</sup>	WEBSITE (WWW.) TELEPHONE
		MAX. ANNUAL DEDUCTION SINGLE/JOINT	TAX-FREE WITH- DRAWALS	AT AGE THREE	AT AGE TEN	Equity	Balanced	Fixed- Income	Adviser- Sold		
PENNSYLVANIA (June 2002) TAP 529	\$260,000	0	✓			-	-	1 <sup>27</sup>	✓		patap.org 800-440-4000
RHODE ISLAND <i>Alliance Capital</i> CollegeBoundfund	\$265,620	0	✓			10	1	2	✓	0.68% to 2.67%	collegeboundfund.com 888-324-5057
SOUTH CAROLINA <i>Banc of America Advisors</i> Future Scholar	\$250,000	NO LIMIT	✓			2	-	1	✓	0.40% to 2.63%	futurescholar.com 888-244-5674
SOUTH DAKOTA											
TENNESSEE <i>TIAA-CREF</i> Tennessee's BEST Savings Plan	\$235,000	NO STATE INCOME TAX				1	-	-		0.95%	tnbest.org 888-486-2378
TEXAS											
UTAH <i>Vanguard</i> Utah Educational Savings Plan	\$176,000	\$1,410 PER ACCOUNT				✓	1	1	✓	0.31% to 0.35%	800-418-2551 uesp.org
VERMONT <i>TIAA-CREF</i> Vermont Higher Education Investment Plan	\$240,100	0	✓			1	-	1		0.80%	vsac.org 800-637-5860
VIRGINIA <i>State Board</i> Virginia Education Savings Trust	\$250,000	\$2,000 PER ACCOUNT <sup>22</sup>	✓			2	-	2		0.93% to 0.98%	virginia529.com 888-567-0540
<i>Capital Research/American Funds</i> CollegeAmerica						14	1	6	✓	0.66% to 2.17%	americanfunds.com 800-421-0180
WASHINGTON (October 2002) Washington College Savings Plan <sup>21</sup>	\$250,000 <sup>21</sup>	NO STATE INCOME TAX									
WEST VIRGINIA <i>Hartford Life Insurance</i> Smart 529	\$265,620	NO LIMIT <sup>23</sup>	✓			8	1	2	✓	1.16% to 2.15%	smart529.com 866-574-3542
WISCONSIN <i>Strong</i> Edvest	\$246,000	\$3,000 S <sup>24</sup> \$3,000 J <sup>24</sup>	✓			3	1	2	✓	0.70% to 2.25%	edvest.com 888-338-3789
<i>Strong/American Express</i> Tomorrow's Scholar plans						1	1	1	✓	1.67% to 2.27%	tomorrowsscholar.com 866-677-6933
WYOMING <i>Merrill Lynch</i> The 529 College Achievement Plan	\$245,000	NO STATE INCOME TAX				2	1	1	✓	1.81% to 2.49%	collegeachievementplan.com 877-529-2655

Notes: Per account means maximum annual deduction per account regardless of how many accounts are in the beneficiary's name. <sup>1</sup>Can also reflect account value (including appreciation) at which no further contributions can be made. <sup>2</sup>The range of expense ratios for all fund options plus any management or administrative fees. <sup>3</sup>Not yet finalized. <sup>4</sup>Deduction may be carried forward. <sup>5</sup>Deduction may be carried forward up to five years. <sup>6</sup>Per dependent. <sup>7</sup>Two age-based options. <sup>8</sup>Three age-based options. <sup>9</sup>Ten additional investment options are anticipated. Sources: The states, Savingforcollege.com.

fewer investment choices than the top plans do. One tip: If you work in one state and reside in another, you may qualify for a 529 deduction on the taxes you pay to the state where you work. Check with your accountant. The 13 plans that we have rated best for state residents are marked with a star in the accompanying tables. These are the states that offer hefty tax deductions for 529 contributions and tax-free withdrawals, as well as solid investment choices and relatively low expenses for state residents who buy directly from the plan.

When investigating your state's 529, check to see if more than one plan is available. As we mentioned earlier, eight states now offer two or more separate 529 sav-

ings plans—usually a no-load plan designed chiefly for state residents as well as one or more broker-sold plans. And more states are planning similar moves. You will need to compare carefully to decide which plan, if any, is right for you, since it's not always easy to sort through the multiple options.

For example, New Mexico now offers four 529 savings plans. Our favorite is Education Plan, the lowest-cost option, which is run by Schoolhouse Capital, a subsidiary of State Street Global Advisors. (The plan is also available at a higher cost through advisers or via the Web.) The Education Plan offers portfolios for five age groups consisting of funds from State Street, Janus, Invesco and MFS; you can also hold one of the portfolios as a so-called static investment, which means the fund

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## **MOST FREQUENTLY ASKED QUESTIONS ABOUT 529s**

### **Q. What's new this year?**

**A.** The big news: Thanks to the new tax law, your account grows completely free of federal taxes; withdrawals are also untaxed, as long as you use the money for qualified higher education expenses. There are also a growing number of plans, many of them adviser-sold.

### **Q. Can anyone open a 529 account for any child?**

**A.** Basically, yes. You ("the account holder") can open an account on behalf of nearly any child ("the beneficiary"), regardless of your income. Grandparents, for example, can give money to grandchildren. You can even open an account for an adult who wants to go back to school, although some states require that you use the money by a particular age.

### **Q. Can two people open an account for the same child?**

**A.** You can open more than one account in a single state for the same child. And more than one person can fund a 529 for the same beneficiary. Regardless of the number of accounts, the state's contribution limit still applies, typically \$200,000 or more. In many states, you can no longer contribute once the total value of one or more accounts for the same beneficiary reaches the maximum. States need not count balances in out-of-state accounts in figuring out if you've met your limit, but some are now doing so.

### **Q. What kind of expenses can I use the money for?**

**A.** In all states, tuition qualifies. Most also permit 529 money to be used for room, board, fees and books. If your child has special needs, the new tax law also allows you to use 529 money for special-needs services such as equipment or tutoring. You can use 529 money at any accredited degree-granting school in the country, private, public, undergraduate or graduate.

### **Q. Can I change the beneficiary on the account?**

**A.** Yes, as long as the new beneficiary is a "member of the family"—that is, a close relative such as a son, stepbrother, spouse or aunt. The new tax law just added first cousin to the list. Some plans may charge a fee.

### **Q. What if I need to take out the money in an emergency?**

**A.** Refunds are permitted at any time, but you'll pay taxes plus a 10% penalty on the earnings if the money is not used for qualified education expenses.

### **Q. What if my child doesn't go to college or has money left over?**

**A.** You can always withdraw the money and pay taxes and penalties. Another option is to leave the money in the plan as long as the state allows, in the hope that your child will go to college or graduate school. You can also change beneficiaries and use that extra money for siblings or grandchildren. If your child dies or

becomes disabled, most states will waive withdrawal penalties.

### **Q. Can I switch plans if I move to a different state or don't like the plan I'm in?**

**A.** Under the new tax law, you can roll the money over into another state's plan once a year. Many state plans will now arrange for a direct rollover—just ask the new plan for a rollover application form. (If you make a withdrawal, you have 60 days to reinvest the money; otherwise you pay taxes and penalties.) Check to see if there are any fees for switching or if you will pay a deferred sales charge. You can leave your money in a 529 plan if you move, though you may forgo state tax advantages.

### **Q. Can I switch investment options?**

**A.** Yes, the new rules allow you to switch investments without having to roll over into another plan. But you can make a move only once a year, so consider any shift carefully.

### **Q. Can I also use a Coverdell Education Savings Account?**

**A.** You can now put money into a 529 and a Coverdell Education Savings Account (formerly known as an Education IRA) for the same beneficiary in the same year. Both are tax-free, although the Coverdell allows you to put away only \$2,000 annually. If your child has dreams of the Ivy League, you may need to use both.

—P.W.

will not shift allocations as your child ages. But the state also provides three broker-sold plans. Two carry mid-level expenses: CollegeSense, run by Schoolhouse and New York Life, with funds from Mainstay, State Street, J.P. Morgan Capital and Eclipse, and Scholar'sEdge, with Oppenheimer and State Street funds. The latest entry, Arrive Education Savings, which offers portfolios built from Evergreen, Prudential, State Street and SunAmerica funds, levies above-average fees.

**Compare out-of-state plans.** If you live in a state with low or no income tax, then it makes sense to comparison shop. One important point to keep in mind: If you're considering an out-of-state plan and talking to that plan administrator or your adviser, you may not be told about the tax breaks your own state plan offers—you may even be given incorrect information. In a survey, MONEY reporters called seven brokerage firms and two no-load fund companies and asked about investing as New York

residents in an out-of-state 529 plan. Among the brokerage firms, only Salomon Smith Barney's rep stated that New York's 529 plan offered in-state tax deductions, though Fidelity and Morgan Stanley mentioned that residents might get a tax break with their own state plan. By contrast, both the Alliance and Putnam reps said that there were no tax deductions available for 529s. The no-load firms either recommended checking out the state tax benefits (T. Rowe Price) or mentioned that New York's 529 has a tax deduction (Vanguard).

Our four favorite plans—Iowa, the College Savings Plan of Nebraska, New York and Utah—are noted in the tables with an American flag. All four are managed by top investment firms that offer a wide range of portfolios with low expenses. To find the best 529 plan for you, consult the tables with the following guidelines in mind.

**Stick with a solid investment manager.** Don't put too much weight on the performance history of 529 plans. For one thing,

most programs have been around for less than three years, a period dominated by a bear market. Also, while it can be tempting to compare one plan's performance with another, that's almost always an apples-to-oranges situation. The underlying portfolios are different and, as the pie charts in the state-by-state tables show, the asset allocations vary from plan to plan. For example, New Jersey's age-based portfolio for three-year-olds gained 0.1% last year while Maine's option fell 11.4%. But New Jersey's fund holds as little as 60% in equities vs. Maine's allocation of 90%. That's why it makes sense to focus on firms with long-term track records, such as pension plans and retail mutual funds. Among our top picks are Vanguard, Fidelity and TIAA-CREF.

**Keep your expenses low.** As we noted, more states are selling plans through advisers, and that is driving up fees and sales charges. Good investment advice can be worth paying for, but fees for broker-sold 529 plans can be costly and will eat into the total you save. Some funds offered in Alaska's broker-sold plan, for instance, carry hefty expenses of 2%, plus you may pay a front-end load of 3.5%. That may run you twice the cost of Alaska's no-load plan, managed by T. Rowe Price. And Nebraska's AIM money-market fund shares have hefty expense ratios of 1.06% to 1.81% vs. just 0.61% for the typical retail money fund. "For families whose children are close to college and who are keeping most of their money in fixed-income funds," says financial adviser Michael Steiner of Regent Atlantic Capital in Chatham, N.J., "much of your returns can be wiped out by high plan expenses."

Say a family invested \$2,000 in a no-load age-based 529 fund with expenses of 0.65% annually. After 18 years, the account would have grown to \$71,152, assuming historical average returns. By contrast, if the family had invested in an identical fund with a front-end load of 3.5%, the ac-

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## QUESTIONS TO ASK YOUR ADVISER

State 529 savings plans have only recently become widely popular, which means that many advisers are not fully versed in these programs. So before you invest in a plan that an adviser recommends, ask these five questions.

**Q. Do you invest in a 529 plan yourself?**

If the answer is yes, that's a promising sign. The adviser has firsthand familiarity with the ins and outs of at least one 529 and probably did some homework on other plans before investing. (Of course, if your adviser doesn't have children, you shouldn't treat a no as a negative.)

**Q. Can you explain the pros and cons of 529 programs?**

Most advisers will tout the tax advantages and high contribution limits of 529 plans. But only better advisers will compare these plans to other methods of saving for college, such as custodial accounts and Coverdell Education Savings Accounts. And only the best advisers will explain the potential impact of 529s on your eligibility for financial aid, warn you about the sunset on tax-free withdrawals at the end of 2010 and, above all, make sure you are first saving enough for your own retirement.

**Q. Are there advantages to my state's plan?**

This is a real test of objectivity. A responsible adviser will alert you to possible tax deductions or other breaks if you stick to your state's plan, even if he or she does not sell it.

**Q. Can you walk me through a comparison of three different 529 plans?**

Beware of anyone who can tell you about only one program—chances are, it's not the right one for you. An adviser who really knows 529s will be able to compare the features of at least three plans, including fund choices, expenses and administrative rules. And if the adviser strongly prefers one plan, he or she should offer clear reasons why it is superior to the alternatives.

**Q. How much will it cost me to invest?**

You should be told about any front-end sales charges, deferred loads and other expenses. If the adviser recommends a particular fund share class, you should understand why you are better off with that pricing structure rather than another. In the end, you should know how much you need to invest to meet your college savings goals, after paying those costs. —P.W.

count would have grown to \$68,662. And if the fund carried an annual expense ratio of 2.3%—standard for many broker-sold funds—that family would have earned only \$60,073, 15.5% less than in the no-load 529 with low expenses.

**Shop for the right asset allocation, not the largest fund menu.** Now that investors can switch 529 funds once a year, states are broadening their investment choices. The typical 529 plan now offers four or five funds, but some states, such as New Mexico, offer 32 options. And some offer more than traditional mutual funds, adding sector funds and guaranteed-return portfolios to the mix.

Still, you shouldn't be overly impressed by a wide array of funds. For most investors, the best choice remains the basic 529 offering: the age-based portfolio that gradually shifts the asset allocation as your child ages. For children under three, for example, some 80% of the portfolio may be stashed in stocks. As your child gets older, the equity portion shrinks, so that by the time he or she is 18, the assets are stashed mainly in fixed-income assets, ensuring that the money will be there to meet the first tuition bill. The good news: Twelve plans now offer two or more age-based allocation choices, ranging from very aggressive to moderate to very conservative. Some, such as Maine and Iowa, offer as many as four choices. States with more than one age-based choice are designated in our state-by-state tables with arrows around the pie charts.

If you are a take-charge investor, a plan with five or more fund choices—including large-cap, small-cap and fixed-income—will make it easier for you to design your own asset allocation and then to move the money yourself as your child ages. The risk is that you won't make the right shifts on time. Says financial planner Brian Orol of Raleigh, N.C.: "The value of the age-based fund is that the asset shifts really do take place." Pop quiz: When was the last time you rebalanced your own 401(k) account? If you can't remember—or if, like most people, you have never rebalanced—you would probably be better off choosing an age-based portfolio.

### **LESSON 3: EXTRA CREDIT**

Once you've committed to a 529 plan, evaluate its growth once a year to make sure you're putting enough away to meet your goals. If you are not investing in an age-based portfolio, don't forget to make those allocation moves. If you procrastinate, you may get caught short in a market downturn. That's happened to a lot of families over the past couple of years.

Remember to monitor your 529 plan for changes as states continue to revamp their plans in order to compete with each other. Among the common reforms are enhancing tax breaks, raising contribution limits and switching or adding investment managers.

Bear in mind that 529 contracts with money-management firms generally last from three to eight years. If a state is not happy with the performance of the manager, or if the plan is not attracting sufficient assets, you can expect some kind of overhaul. North Carolina, for example, recently added more funds as well as an adviser-sold plan run by Seligman. It's worth repeating that moves like this could result in improved fund choices but almost certainly higher fees. "A 529 plan needs to reach a critical mass in assets to break even, and a few states are even getting a share of revenue from these plans," says Joseph Hurley, head of Savingforcollege.com and author of *The Best Way to Save for College*.

When it comes time to make withdrawals from your 529 account, plan ahead. If you qualify for a HOPE tuition credit or lifetime learning credit (fully or partially available to married couples with combined incomes of up to \$102,000) or for a section 222 tuition deduction (incomes up to \$130,000), be aware that you can't double-dip—that is, if you use a particular education expense to claim the credit or deduction, that expense no longer qualifies for a 529 tax-free withdrawal. So unless your education costs are sizable, you may have to forgo the tax break or leave your 529 intact for

future spending. But chances are, given the constant rise in college costs, generating enough bills to pay won't be a problem. **S**

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## **529s AT WORK: THE NEW 401(k)?**

Hoping to do for college savings what the 401(k) has done for retirement planning, big employers such as Raytheon and Ford have launched workplace 529s that allow employees to use payroll deductions to fund their college savings. According to Hewitt Associates, 19% of employers plan to offer 529 payroll deductions for workers in the near future, and an additional 46% are considering such a move.



**of employers surveyed plan to offer a 529 plan through payroll deductions.**

But benefits experts worry that these plans will be offered without sufficient education. With 50-plus plans to choose from, the one or two or even 10 choices a company may offer aren't necessarily the plans with the investment options and tax breaks that work best for all employees. Another recent Hewitt survey shows that only 25% of employers planning to offer 529s are going to educate their employees through written communication. So if you're evaluating a company-sponsored 529, you should use the criteria described throughout this package to make sure the plan makes sense for you. —DEREK MANSON

The information contained in this article was compiled by *Money* magazine. The article does not contain all pertinent information relating to New York's College Savings Program and certain Program details may have changed since the date of the article. To request copies of a Program Brochure, please call 1-877-NYSAVES or visit the web site at [www.nysaves.org](http://www.nysaves.org). The information presented in the chart on page 1 is for illustrative purposes only and does not reflect actual performance, or predict future results, of the Program. New York's College Savings Program is described in the current Program Brochure. Accounts are opened by completing an Enrollment Form and Tuition Savings Agreement. All of these documents should be read carefully before opening an account. The State of New York, its agencies, TIAA and its affiliates do not insure any account or guarantee its principal or investment return (except to the extent of the guarantee by TIAA-CREF Life Insurance Company to the Program Trust under the funding agreement for the Guaranteed Option). Account value will fluctuate based upon a number of factors, including general financial market conditions. Federal, state and local tax benefits are subject to certain limitations. You should consult your tax advisor. Investments are made through Teachers Personal Investors Services, Inc., distributor.