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Saving for College Through Qualified Tuition (Section 529) Programs

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Saving for College Through Qualified Tuition (Section 529) Programs

Summary

Congress has tried to make higher education more affordable through favorable tax treatment of qualified tuition programs (QTPs) at Section 529 of the Internal Revenue Code. QTPs allow individuals to save for qualified higher education expenses at eligible institutions. One type of QTP — prepaid tuition plans — enables account owners (e.g., parents) to make payments on behalf of beneficiaries (e.g., their children) for a specified number of academic periods or course units at current prices. Prepaid tuition programs thus provide a hedge against tuition inflation. Only states had been permitted to sponsor tax-exempt prepaid tuition plans until P.L. 107-16 extended sponsorship to private institutions effective in 2002. States remain the sole tax-exempt sponsor of the other type of QTP, college savings plans. Generally, funds in college savings plans can be used toward a variety of qualified expenses at any eligible institution regardless of which state sponsors the plan or where the contributor resides. In contrast, funds in state-sponsored prepaid plans typically are meant to cover tuition and fees at public postsecondary schools within the state. Also unlike prepaid plans, in which the intent is that pooled contributions are invested to at least match the increase in tuition, each owner of a college savings account usually can select one of a number of investment strategies (e.g., aggressive growth) in which to place contributions. Consequently, college savings plans offer the possibility of greater returns than prepaid tuition plans, but they also could prove more risky.

Both types of QTPs have several features in common. Contributions are not deductible on federal tax returns. Earnings accumulate tax-deferred until withdrawn. If they are used to pay college expenses, the earnings are tax-free effective 2002 for state programs and 2004 for private programs. Before those dates, earnings withdrawn to pay college expenses are taxable income to beneficiaries. Withdrawn earnings that are not used toward qualified expenses (e.g., the beneficiary does not attend college) are taxable to the distributee (e.g., account owner) and are subject to a penalty. Account owners can escape the tax and penalty if they designate a new beneficiary who is related to the original beneficiary. Although neither account owners nor beneficiaries were allowed to direct the investment of QTP contributions and earnings, that restriction — considered a major drawback of the plans — was loosened recently. QTP contributors, rather than beneficiaries, maintain control over the invested funds. Nonetheless, payments to the plans are considered completed gifts, which generally are removed from the contributor's estate. In addition, a special gifting provision allows a contributor to make 5 years worth of tax-free gifts in 1 year to a QTP beneficiary.

Saving for college, through Section 529 plans or other vehicles, may adversely affect eligibility for federal student aid. This is unlikely to affect the decision of higher income families to use QTPs because their offspring are less likely than those of other families to qualify for aid. The lack of income limits on QTP contributors combined with the greater propensity of higher income families to save, their higher marginal income tax rates, and the estate/gift tax treatment of QTP contributions increase the likelihood that wealthy families will be relatively frequent users of Section 529 plans.

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Saving for College Through Qualified Tuition (Section 529) Programs

Since the late 1980s, an oft-voiced concern has been that the nation's educational and training institutions may not be supplying enough persons with the reportedly heightened skill levels demanded by businesses. Indeed, the demand for workers with at least some postsecondary education has been growing and is projected to continue growing at a more rapid rate than the demand for individuals with, at most, a high school degree.[1]

At the same time, the cost of higher education has been rising to a greater extent than family income. The average cost to students of tuition and fees between the 1989-1990 and 2001-2002 academic years increased by 8% per year at 4-year private colleges, by 10% per year at 4-year public colleges, and by 9% per year at 2-year public colleges.[2] In contrast, average family income rose by 5% annually between 1989 and 2000, according to data from the U.S. Bureau of the Census.

In response to these trends, Congress has enacted a panoply of tax benefits meant to encourage human capital development by increasing the affordability of postsecondary school attendance. Among the tax incentives to promote higher education initiated or amended by such legislation as the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), the Taxpayer Relief Act of 1997 (P.L. 105-34) and the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) is the qualified tuition program (QTP) or Section 529 plan, named for its section in the Internal Revenue Code.

This report provides an overview of Section 529 provisions. It includes a discussion of the interaction of QTPs with other tax incentives for postsecondary education and with financial aid for students.[3] The relationship between tax-based measures to make higher education more affordable and the traditional student aid system could well be considered during reauthorization of the Higher Education Act in the next Congress.

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[1]See, for example, CRS Report 97-764, *The Skill (Education) Distribution of Jobs: How Is It Changing?*, by Linda Levine.

[2]The College Board. *Trends in College Pricing 2001.*

[3]Information on other tax benefits available to persons pursuing education beyond K-12 can be found in the following products: CRS Report RL31129, *Higher Education Tax Credits and Deduction: An Overview of the Benefits and Their Relationship to Traditional Student Aid*, by James Stedman and Adam Stoll; and CRS Report 97-915, *Tax Benefits for Education in the Taxpayer Relief Act of 1997: New Legislative Developments*; CRS Report 97-243, *Employer Education Assistance: Overview of Tax Status in 2001*; and CRS Report 89-570, *Education Savings Bonds: Eligibility for Tax Exclusion*, all by Bob Lyke.

An Overview of Section 529 Provisions

A few states sponsored QTPs several years before the Small Business Job Protection Act of 1996 (P.L. 104-188) clarified their federal tax treatment at Section 529 in the Internal Revenue Code. Most recently, the tax-advantaged college savings vehicle was substantially amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). In order to comply with the Congressional Budget Act of 1974, however, P.L. 107-16's amendments to Section 529 and many other provisions in the Code sunset for tax years beginning after December 31, 2010. The sunset provision introduces an element of uncertainty for individuals considering whether to contribute to a QTP on behalf of persons who will be attending postsecondary institutions in 2011 or thereafter. Absent congressional action, Section 529 will revert to its pre-P.L. 107-16 version in tax years starting on or after January 1, 2011. For this reason, the following overview of Section 529 covers its pre- and post-P.L. 107-16 provisions.

What Is a QTP?

States, their agencies or instrumentalities can establish and maintain tax-exempt programs

> (1) that permit individuals to purchase tuition credits or certificates for use at eligible institutions of higher education[4] on behalf of a designated beneficiary which entitles the beneficiary to the waiver or payment of qualified higher education expenses; or
> (2) that permit individuals to contribute to an account for the purpose of paying a beneficiary's qualified higher education expenses (QHEEs).[5]

One type of QTP is commonly known as a *prepaid tuition plan*. It enables a contributor (e.g., parent, grandparent, and interested non-relative) to make lump-sum or periodic cash payments[6] for a specified number of academic periods or course units at current prices. Prepaid tuition programs thus provide a hedge against tuition

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[4]Eligible institutions of higher education generally are those accredited public and private non-profit postsecondary schools that offer a bachelor's, associate's, graduate or professional degree, or another recognized postsecondary credential as well as certain proprietary and vocational schools. The institutions also must be eligible to participate in student aid programs of the U.S. Department of Education.

[5]QHEEs are tuition, fees, books, supplies and equipment required for enrollment or attendance at an eligible institution as well as room and board for students attending school at least half-time. Note: P.L. 107-16 further expanded the definition of qualified expenses to cover the cost of special needs services for special needs beneficiaries. The legislation also raised the potential level of room and board expenses for students who attend eligible institutions at least half-time, thus enabling QTPs to pay for more of this qualified expense. Both these expansions are effective in tax year beginning after December 31, 2001.

[6]For both types of Section 529 plans, payments cannot be made in the form of securities or other property.

inflation in the approximately 22 states that sponsor them.[7] If the beneficiary of a prepaid tuition contract (e.g., child, grandchild or someone not related to the contributor) elects to attend an in-state private college or an out-of-state college, the program typically will pay the student's chosen institution the tuition it would have paid an in-state public college — which may be less than the chosen institution's tuition. The specifics of prepaid tuition plans vary greatly from one state to another (e.g., as to a residency requirement, age limitation on beneficiaries, minimum and maximum investments, fees charged, state guarantee of rate of return and principal, and refund policy). (See **Appendix Table 1** for a summary of some prepaid tuition programs by state.)

The other type of QTP is commonly known as a *college savings plan*. Generally, the beneficiary can use funds in this newer option toward the full range of QHEEs at any eligible institution regardless of which state sponsors the plan or where the contributor resides. In part for these reasons, college savings programs have become more popular than prepaid tuition plans with about 46 states offering them.[8] It also has been suggested that state officials regard college savings plans as a way to offer people a benefit with little cost to the state. In contrast, if a state guarantees its prepaid tuition plan, it assumes the risk that earnings on the plan's pooled contributions will not match tuition inflation, in which case, the state must use other resources to satisfy the plan's obligations.[9] From the contributors' perspective, some of the popularity of college savings plans may result from the possibility of greater returns than produced by the usually conservative investment strategy of prepaid tuition programs. Mutual fund companies typically manage college savings plans for states, and each state's plan generally offers more than one investment option (e.g., a portfolio of stocks and bonds whose percent composition changes automatically as the beneficiary ages, a portfolio with fixed shares of stocks and bonds, or with a guaranteed minimum rate of return). As the value of each savings account is based on the performance of the particular investment strategy chosen by the contributor, however, college savings plans could prove more risky than prepaid tuition plans. Indeed, the depressed value of some college savings accounts in 2001 — a likely reflection of losses in the stock market — could partly explain the greater number of families who established prepaid tuition plans in the first half of 2001 compared to all of 2000.[10] (See **Appendix Table 2** for a summary of some college savings programs by state.)

The two types of QTPs have some common elements. A contributor may establish multiple accounts for the same beneficiary in different states, but the contributor cannot participate in a state-sponsored QTP if he/she sets up a prepaid

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[7]Bell, Julie Davis and Demaree K. Michelau. Making College Affordable. *State Legislatures*, October 1, 2001. (Hereafter cited as Bell and Michelau, *Making College Affordable*.)

[8]Bell and Michelau, *Making College Affordable*.

[9]Roth, Andrew P. Who Benefits from States' College-Savings Plans? *Chronicle of Higher Education*, January 1, 2001. (Hereafter cited as Roth, *Who Benefits from States' College-Savings Plans?*)

[10]Dugas, Christine. Market Woes Boost Prepaid Plans. *USA Today*, November 6, 2001.

tuition program with an eligible private institution (see following paragraph). A student or potential student also may be a designated beneficiary of multiple accounts (e.g., one originated by a parent and another by a grandparent). In addition, states may establish restrictions that are not mandated either by Section 529 of the Code or the proposed regulations issued in 1998. There generally are no income caps on contributors, unlike the limits that apply to taxpayers who want to claim the higher education tax deduction or Hope Scholarship and Lifetime Learning tax credits, or who want to use education individual retirement accounts (now called Coverdell education savings accounts). The absence of an income limit on contributors likely makes Section 529 plans particularly attractive to higher income families, who also are likely to make above-average use of the savings plans because persons with more income have a greater propensity to save.

Effective for tax years beginning after December 31, 2001 and before January 1, 2011, P.L. 107-16 declared that one or more eligible higher education institutions — including *private institutions* — may establish and maintain prepaid tuition programs accorded the same federal tax treatment as state-sponsored prepaid tuition plans. At this point in time, states remain the sole tax-exempt sponsors of college savings plans.

More than 200 private colleges have said they will initiate a national prepaid tuition program. Members of the Tuition Plan Consortium reportedly range from Ivy League schools to large private institutions to small liberal arts colleges. Contributors will be able to buy "tuition shares" for use at any member school regardless of its location.[11] Some believe the expansion of Section 529 plans to include private institutions might help the schools recruit students who would otherwise have been deterred from attending due to their comparatively high tuition. It also has been suggested that the plans of private institutions might appeal to alumni who could "boast they've not only enrolled their [offspring] in their alma mater at birth, [but] they've already paid the tuition."[12]

Tax Treatment of QTP Contributions and Earnings

There is no federal income tax deduction for contributions to QTPs. As of early 2001, about 17 states allow residents who participate in their own state's plan to claim a partial or total state income tax deduction on contributions.[13]

Earnings on contributions to Section 529 plans accumulate tax-deferred until withdrawn. The deferral confers greater benefits on families with relatively high

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[11]Schmidt, Peter. Bush Tax Cut Gives New Clout to States' College-Savings Plans. *The Chronicle of Higher Education*, June 22, 2001. (Hereafter cited as Schmidt, *Bush Tax Cut Gives New Clout to States' College-Savings Plans*.)

[12]Wuorio, Jeff. Prepaying Tuition Offers Peace of Mind at a Price. Available at [http://moneycentral.msn.com/articles/family/college/1462.asp].

[13]Cropper, Carol Marie, and Anne Tergesen. College Savings Plans Come of Age. *Business Week*, March 12, 2001. (Hereafter cited as Cropper and Tergesen, *College Savings Plans Come of Age*.)

incomes because of their higher marginal tax rates. Simulations that compared potential after-tax accumulations in a college savings plan to those in mutual funds employing the same asset allocation strategies generally found that the higher a household's tax bracket, the greater the advantage of saving through a Section 529 plan.[14] The study concluded that other factors substantially affect the level of accumulations as well. These factors are the investment expenses that alternative savings vehicles charge and the value of a state income tax deduction, if any, on contributions to a QTP.

Qualified Earnings Distributions. Earnings withdrawn from Section 529 plans to pay QHEEs are free from federal income tax effective in tax years starting after December 31, 2001 for state-sponsored programs, and starting after December 31, 2003 for programs of private institutions. Until then, QTP beneficiaries continue to pay federal income tax based on annuity taxation rules (Section 72 of the Code) for distributions of qualified earnings; the practice confers a considerable tax benefit on families in which the student's tax bracket (typically 15%) is much lower than the parents' tax bracket. The federal tax-exempt status of earnings withdrawals makes Section 529 plans an even more attractive means of saving for higher education expenses: for example, a student would pay nothing instead of incurring an $18,000 federal tax bill on $120,000 in earnings from contributions of $80,000 to a QTP made since the child was 8 years old.[15] The tax-exemption might especially benefit older students who have relatively high incomes (e.g., a beneficiary employed full-time, or with a spouse employed full-time, who is pursuing an advanced degree or who is taking courses to update the skills used in his/her current occupation or to learn new skills in order to change occupations).

As of early 2001, about 26 states provided residents a tax break on earnings distributions from their state's Section 529 plans used to pay an in-state eligible institution's QHEEs. Some have speculated that the new federal tax exemption could spur additional states to do the same for their residents. Only a few states extend the tax exemption on qualified earnings to residents that invest in other states' QTPs.[16]

Non-Qualified Earnings Distributions. Plans must impose a "more than de minimis penalty" on the earnings portion of distributions that exceed or are not used for QHEEs (e.g., the beneficiary does not attend college). Effective for tax years beginning after December 31, 2003, withdrawals of excess earnings continue to be taxable income to the distributee (e.g., account owner) and subject to an additional

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[14]Davenport, Keith R., with Douglas Fore, and Jennifer Ma. Miracle Growth? *Investment Advisor*, September 2001.

[15]Hurley, Joseph F. Planning Strategies Under the Education Provisions of the New Tax Act. *Journal of Financial Planning*, September 2001.

[16]Cropper and Tergesen, *College Savings Plans Come of Age*.

tax of 10%, absent certain circumstances.[17] The 10% tax penalty is the same as that which applies to Coverdell education savings accounts.

After the additional 10% tax penalty goes into effect, plans still may collect for themselves the penalty that prior federal law required. However, some observers have commented that the modest revenue the penalties have afforded states is outweighed by their administrative burden. In addition, the practice would create a competitive disadvantage unless all states continued it.

Investment Control and the Tax Consequences of Transferring Funds Between Section 529 Plans

Neither account owners nor beneficiaries have been allowed to direct the investment of contributions to, or associated earnings from, a Section 529 plan. According to the proposed regulations published on August 24, 1998 in the *Federal Register* (63 F.R. 45019), contributors are permitted — at the time they establish an account — to choose between a prepaid tuition and a college savings program, and if they select the latter, to choose among its investment options. The restriction on investment control had been considered a major drawback of QTPs, but it recently was significantly loosened.

On September 7, 2001 (Cumulative Bulletin Notice 2001-55), the Internal Revenue Service issued a special rule that provides considerably more control to owners of college savings accounts. Effective immediately, a college savings program can permit current contributors to move balances — without incurring taxes and without changing beneficiaries — from one investment strategy to another within the state's offerings (e.g., into a less aggressive portfolio if market circumstances have significantly worsened over time) once per calendar year. Account owners also can, on a tax-free basis, move balances among a state's investment offerings if they change beneficiaries (e.g., into a more aggressive portfolio if the new beneficiary's matriculation date is later than the original beneficiary's).

Changing Beneficiaries. Section 529 of the Code allows QTP distributions to occur without tax consequences if the funds are transferred to the account of a new beneficiary who is a family member of the old beneficiary. In order to receive this tax treatment, the new beneficiary must be one of the following family members:

(1) the spouse of the designated beneficiary;
(2) a son or daughter, or their descendants;
(3) stepchildren;
(4) a brother, sister, stepbrother, or stepsister;
(5) a father or mother, or their ancestors;
(6) a stepfather or stepmother;
(7) a niece or nephew;

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[17]The conditions under which an account owner is not subject to a penalty on a refund of excess earnings are the beneficiary's death or disability, or the beneficiary's receipt of a scholarship, veterans educational assistance allowance or other nontaxable payment for educational purposes (excluding a gift or inheritance).

(8) an aunt or uncle;
(9) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law;
(10) the spouse of an individual referenced in (2) - (9); or
(11) any first cousin of the designated beneficiary.

First cousins are covered by the definition in tax years starting after December 31, 2001. The expansion to first cousins makes QTPs "more attractive to grandparents [who] can transfer an account between cousins [that is, between their grandchildren, and thereby avoid paying federal income tax and a penalty on non-qualified distributions] if, say, the original beneficiary decides not to go to college."[18]

Same-Beneficiary Rollovers. P.L. 107-16 permits tax-free transfers from one QTP to another for the same beneficiary once in any 12-month period effective in tax years starting after December 31, 2001. The report accompanying the legislation provided examples of the amendment's intended purpose: the same-beneficiary rollover permits contributors to make tax-free transfers between a prepaid tuition plan and a college savings plan offered by the same state, and between a state and a private prepaid tuition plan.

Perhaps more importantly according to some observers, the amendment provides an account owner with the opportunity for greater control over the investment of his/her funds without changing beneficiaries. An account owner could, for example, make a same-beneficiary rollover into the program of another state with an investment strategy the contributor prefers to those offered by the original state's program.[19]

Coordination of Contributions with Estate, Gift, and Generation-Skipping Transfer Taxes

Contributors to Section 529 plans — rather than beneficiaries — maintain control over the accounts. In other words, contributors can change the beneficiary or have the plan balance refunded to them. This feature has been touted as a significant advantage of saving for college through a QTP as opposed to a custodial account opened under the Uniform Gifts to Minors Act (UGMA), for example. The custodial account actually is owned by the child who, upon gaining control of the funds, can use them for whatever purpose they chose.[20]

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[18]AuWerter, Stephanie. The 529 Basics. SmartMoney.com, June 8, 2001. Available at [http://www.smartmoney.com/consumer/index.cfm?Story=200106083].

[19]See, for example, Davis, Kristin. Miracle Grow. *Kiplinger's Personal Finance*, September 2001, and [http://www.savingforcollege.com].

[20]About 32 states allow parents to fund QTPs with money from custodial accounts. "Custodial" 529 plans retain some features of UGMA accounts, and there are tax consequences to funding QTPs in this manner. For more information see: Wang, Penelope. Education: Yes, There's Still College. *Money*, December 2001. (Hereafter cited as Wang, *Education: Yes, There's Still College*.)

Nonetheless, the Taxpayer Relief Act of 1997 (P.L. 105-34) declared that payments to Section 529 plans made after August 1997 are completed gifts of present interest from the contributor to the beneficiary. As a result, an individual can contribute up to $10,000 annually (subject to indexation) as a tax-free gift per QTP beneficiary.

A special gifting provision for contributions to Section 529 plans could make them of interest to individuals with substantial resources and to families with children who will be attending college in the not-too-distant future. QTP contributors may make an excludable gift of up to $50,000 in a single year by treating the payment as if it were made over 5 years. Thus, for example, each grandparent could contribute $50,000 (for a total of $100,000) to each grandchild's QTP in tax year 1999, which potentially would allow more earnings to accumulate than if each had contributed $10,000 annually from 1999 to 2003. In this instance, the two grandparents could not make another excludable gift to those account beneficiaries until 2004.

By making QTP contributions completed gifts, the Taxpayer Relief Act also generally removed the value of the payments from the contributor's taxable estate. An exception occurs, however, if a contributor who selected the 5-year advance exclusion option dies within the period.

Interaction with Other Higher Education Tax Incentives

P.L. 107-16 permits contributions to a QTP and to a Coverdell education savings account in the same year for the same beneficiary, effective for tax years starting after December 31, 2001.[21] For the 2001 tax year, then, same-year contributions to a QTP and Coverdell account on behalf of the same beneficiary in the same year it will be considered an excess payment to the latter, and therefore, subject to income tax and a penalty.

P.L. 107-16 also allows Hope Scholarship and Lifetime Learning credits to be claimed in the same year that tax-free distributions are made from a Section 529 plan or a Coverdell account, provided that the distributions are not used toward the same QHEEs for which the credits are claimed. If distributions are taken from a Section 529 plan and a Coverdell account on behalf of the same student, the Act further requires that QHEEs remaining after reduction for the education tax credits must be allocated between the two savings vehicles. These provisions are effective for tax years beginning after December 31, 2001. Withdrawals from QTPs before that date still can be used to pay for the same expenses for which Hope Scholarship or Lifetime Learning credits are claimed, but also under prior law, those withdrawals are taxable to the beneficiary.

P.L. 107-16 initiated an above-the-line income tax deduction for QHEEs, effective in tax years starting after December 31, 2001 and ending before January 1, 2006. The deduction cannot be taken for qualified expenses paid with tax-free

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[21]Same-year contributions to a QTP and a Coverdell account for the same beneficiary could have gift-tax consequences if the payment to the two savings vehicles exceeds $10,000 in 1 year or $50,000 if the 5-year option is chosen.

withdrawals from a Section 529 program, Coverdell account, or certain U.S. savings bonds.

The Relationship Between QTPs and Student Financial Aid

Saving for college, through a Section 529 plan or other vehicle, may adversely affect eligibility for and the amount of need-based student financial aid. The degree to which this occurs depends on the type of QTP and on a family's financial resources.

The "federal need analysis system" defines a student's financial need for federal student aid programs (other than Pell Grants) to be the gap between a school's cost of attendance (COA) and the student's expected family contribution (EFC) plus other estimated financial assistance.[22] A statutory formula determines the EFC based on data submitted by students to the U.S. Department of Education on the Free Application for Federal Student Aid (FAFSA).

As prescribed by Section 480(j) of the Higher Education Act (as revised by the Higher Education Amendments of 1992), the Department's formula treats qualified distributions from prepaid tuition plans (both contributions and earnings) as reducing the student's COA on a dollar-for-dollar basis. The sharp reduction in the student's COA — and therefore in financial need — occurs regardless of who is the account owner (e.g., a parent, aunt or non-relative).

The Department has more latitude regarding the treatment of college savings plans in financial need analysis. It decided that, because the account owner can change the beneficiary or close the account at will, this type of Section 529 plan is an asset of the parent. As the Department's formula counts a maximum of 5.6% of the account's value toward the EFC, the treatment is much more favorable to the student than is the case with prepaid tuition plans.

For beneficiaries of college savings plans established by someone other than their parents, the value of the accounts is not reported on the FAFSA, and thus, does not raise the EFC. The exclusion of these assets from financial need analysis may "make eligible for student aid those who by definition are more affluent than others because they have more money to invest."[23] In other words, students in lower income families may be doubly disadvantaged: their families could not afford to take much, if any, advantage of QTPs; they could receive less traditional financial aid because more affluent students have become eligible for some type of assistance.

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[22]The COA includes such items as tuition and fees, room and board, books, supplies, and living expenses. The EFC is the sum that a family can be expected to devote to higher education expenses based on its financial situation.

[23]Roth, *Who Benefits from States' College-Savings Plans?*

The Department's formula applies the same share (50%) of the student's taxable income toward the EFC whether he/she is the beneficiary of a prepaid tuition or college savings plan. According to Section 529 of the Code, earnings distributions for payment of QHEEs through December 31, 2001 are includable as taxable income of the beneficiary (regardless of who is the account owner). The earnings distribution thus may increase the student's EFC and could reduce his/her financial need.

P.L. 107-16 makes qualified distributions of QTP earnings tax-free effective in tax years starting after December 31, 2001 for plans of public institutions and after December 31, 2003 for plans of private institutions. As students will cease having taxable income from QTPs as of those dates, the earnings distributions might no longer raise their EFC. However, the Department might, for example, require a student to include qualified withdrawals as non-taxable income reported on the FAFSA. In addition, some have speculated that as families' accumulate large balances in college savings accounts, the Department might reconsider counting them as parental assets.[24] If the accounts were instead to be deemed a child's asset, for example, a much larger share (35% versus 5.6%) would go toward the EFC, perhaps reducing the amount of federal financial aid for which the student is eligible.

It should be kept in mind that some private postsecondary institutions use other methodologies to determine student eligibility for non-federal student aid. These alternatives to the Department's formula may treat either or both types of QTPs differently when calculating student need. Although some private postsecondary schools attempt "to avoid penalizing students for having such accounts, ... many colleges are moving in the opposite direction, and making sure their aid formulas count" QTPs as resources available to students.[25] In addition, while a few states do not include balances in Section 529 plans when determining state financial aid for students, most do.[26]

Closing Observations

In the last several years, numerous tax-advantaged measures have been enacted to make it easier for individuals to pursue postsecondary education. Some of these benefits are intended to encourage taxpayers to save in advance of students attending institutions of higher education (e.g., QTPs, Coverdell education savings accounts, and EE savings bonds). Other tax incentives do not come into play until students have entered postsecondary school (e.g., the higher education tax deduction, Hope Scholarship credit and Lifetime Learning credit). The variety of higher education provisions in the Code could make it difficult for the typical family to determine the best tax benefit or combination of tax benefits to use. A factor that could further complicate the decision-making process is the interaction between the various tax incentives and eligibility for student financial aid.

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[24]Wang, *Education: Yes, There's Still College*.

[25]Schmidt, *Bush Tax Cut Gives New Clout to States' College-Savings Plans*.

[26]The Big News About College Savings. *Mutual Funds*, June 25, 2001.

Whether to establish a QTP, and then of which type, could prove to be a difficult decision in and of itself. Families presumably would want to study the differences between each state's prepaid tuition plan, each private institution's or group of institutions' prepaid tuition plan, and each state's college savings plan.

To some degree, the financial situation of a family could make it easier for some to say "yea" or "nay" to QTPs. There are some low-income families who cannot afford to put current earnings toward saving, for college or other purposes. Some other low-income families might be able to save for college, but by doing so, they could reduce the amount of financial aid for which their children could well qualify. Of course, these relatively low-income families would have to be aware of the potentially adverse effect on student aid of Section 529 plans generally, and of prepaid tuition plans particularly, in order to factor it into their decision-making process.

The decision to save for higher education expenses through a QTP also could be less difficult for high-income families. First, because of their relatively high marginal tax rate, higher income families stand to gain more than lower income families from the tax-advantaged treatment of Section 529 plans. Second, the offspring of high-income families are less likely to be eligible for need-based student aid. As a result, these families are unlikely to be swayed by whether a QTP offsets financial need dollar-for-dollar as in the case of prepaid tuition programs, or to a much lesser extent as in the case of college savings accounts, when considering which type of plan to setup. In addition, the estate and gift tax treatment of Section 529 plans could make them useful as estate-planning tools for wealthy families.

Middle-income taxpayers could well have the greatest problem figuring out whether Section 529 should be part of their college financing plan and which type of QTP to fund. If, for example, a family suffers a reversal of fortune brought about by extended unemployment, very high medical bills or some other unanticipated event (e.g., birth of twins) after having established a QTP, it is more likely that a middle-income compared to high-income family will need the plan's savings for current consumption. As previously noted, however, account owners must pay income tax and penalties on refunds from either type of QTP. In addition, prepaid tuition plans typically return relatively little if any earnings compared to college savings accounts. Thus, for some middle-income families, saving for college through a vehicle not dedicated to a single purpose might be a more prudent choice.

The interaction of Section 529 plans with need-based student aid also is likely to pose more of a dilemma for middle- than high-income families. If middle-income parents want to save via a QTP and think their child will be eligible for some assistance, then a college savings account seemingly would be the superior option given its comparatively less adverse treatment in the Department of Education's financial need analysis. Indeed, some private colleges reportedly are not immediately starting up prepaid tuition programs because they do not feel comfortable recommending this type of Section 529 plan to a family "if there is any chance at all that they would be eligible for financial aid."[27] Alternatively, prepaid tuition programs

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[27] AuWerter, Stephanie. Prepaid Tuition Plans. SmartMoney.com, June 8, 2001. Available (continued...)

generally are a lower risk investment than college savings accounts and as such, prepaid plans might be a more comfortable choice for middle- compared to high-income taxpayers.

[27](...continued)
at [http://www.smartmoney.com/consumer/index.cfm?Story=20010681]. Note: As previously discussed, private educational institutions recently were extended the right to sponsor prepaid tuition plans. In order to "level the playing field" in financial need analysis between prepaid tuition and college savings plans, they among others (e.g., the College Savings Plans Network which is an affiliate of the National Association of State Treasurers) might attempt to have Congress amend the Higher Education Act. For more information see: Thomas, Georgie A. A Better Way to Plan for College. *State Government News*, September 1, 2001.

APPENDIX

Appendix Table 1. Comparison of State-Sponsored Prepaid Tuition Programs

(as of August 1, 2001)

State and program name	Date of operation and enrollment period	Age restriction	What is covered	Tuition discount?	Value if used for private or out-of-state public institutions	Refund policy	Comments
Alabama (Prepaid Affordable College Tuition)	1990 (September)	Beneficiary 9th grade or younger	4 years of undergraduate tuition and fees at state public institutions	As much as 30% for newborns	Weighted average of in-state tuition and fees	Only contract payments refundable, less $150 cancellation fee	$75 to enroll, benefits must be used within 10 years after the projected college entrance date, earnings exempt from state tax, one price fits all
Alaska (Advance College Tuition Payment Program)	1991 (anytime)	No	Credits can be used on tuition, fees, books, supplies and equipment	No	Principal + earnings (usually money market rate)	Penalty is between 7.5% and 12.5 % of account value	2-year waiting period,[a] plan purchasers get full value of the earnings, benefits must be used within 15 years of the projected college entrance date, guaranteed tuition
Colorado (Colorado Prepaid Tuition Fund)	1997 (fall)	No	Units can be used towards tuition, fees, books, supplies and equipment	8% discount for an 18-year contract	Average in-state tuition and fees	Binding contract, no refund before the end of the term	$50 to enroll, no residency required, 10% penalty on earnings for non-qualified withdrawals,[b] earnings exempt from state tax
Florida (Florida Prepaid College Program)	1988 (October–January)	11th grade or younger	Up to 4 years of undergraduate tuition and fees at state public or private higher institutions	3% for newborns for a 4-year university plan	The lesser of (1) in-state public tuition (2) principal + 5% annual compound interest	Only contributions refunded, $50 fee for contracts less than 2 years	$42 to enroll, benefits must be used within 10 years of the projected college entrance date, guaranteed

State and program name	Date of operation and enrollment period	Age restriction	What is covered	Tuition discount?	Value if used for private or out-of-state public institutions	Refund policy	Comments
Illinois (College Illinois!)	October 1998 (October–January)	No	Up to nine semesters of tuition and fees at state public higher institutions	15% for newborns for a public university plan	Average mean-weighted in-state public tuition and fees	Contributions + 2% interest refundable after 3 years, $100 fee	$75 to enroll, earnings exempt from state tax, 3-year waiting period, benefits need to be used within 10 years of projected college entrance date, guaranteed
Maryland (Maryland Prepaid College Trust)	April 1998 (November 10–February 29)	10th grade or younger	Up to 5 years of tuition and fees at state public institutions	8% for newborns for a 4-year university contract	Up to the average in-state public tuition and fees	Refundable after 3 years, refund is the lesser of (1) payments plus 50% average earnings (2) lowest in-state public tuition and fees	$75 to enroll, up to $2,500 state tax deductible per year, qualified withdrawals exempt from state tax, benefits must be used within 5 years of projected college entrance date
Massachusetts (U. Plan)	1995 (April–May)	10th grade or younger	Certificates worth up to 4 years of tuition and fees at the highest cost institution among 83 participating institutions	No	Principal + annual compound interest equal to consumer price index	Certificates only redeemable upon maturity (between 5 and 16 years)	Tuition certificates exempt from state tax, no residency required, not a qualified 529 plan, certificates must be redeemed within 6 years of maturity

State and program name	Date of operation and enrollment period	Age restriction	What is covered	Tuition discount?	Value if used for private or out-of-state public institutions	Refund policy	Comments
Michigan (Michigan Education Trust)	1988 (December–January)	8th grade or younger for full benefit contract, 10th grade or younger for limited benefit contract	1 to 4 years of tuition and fees in (1) any state public institution for full benefit plan or (2) institution whose tuition is not more than 105% of the weighted average tuition of all state public 4-year universities	No	Full contract: average 4-year public tuition and fees. Limited contract: lowest tuition of state public 4-year institutions	$200 fee, refund value for full benefit contract is the average tuition of state public 4-year institutions; for limited contract, it's the lowest tuition of state public 4-year institutions	$60 enrollment fee, $25 application fee, contributions state tax deductible, benefits must be used within 9 years of projected college entrance
Mississippi (Prepaid Affordable College Tuition)	1997 (September-November, newborns anytime)	18 years or younger	Up to 4 years of undergraduate tuition and fees at state public institutions	13% for newborns for a 4-year university plan	Up to the average in-state tuition and fees	Up to $150 fee, refund includes contributions and interest earnings	$60 to enroll, contributions state tax deductible, earnings exempt from state tax
Nevada (Prepaid College Tuition Plan Trust Fund)	October 1998 (October-November, newborns anytime)	9th grade or younger	Up to 4 years of tuition at state institutions	Over 20% for newborns	Weighted average tuition and fees at in-state public institutions	Contributions refunded, less administrative fees and up to $150 cancellation fee	$60 to enroll, benefits must be used within 10 years of projected college entrance date or the age of 30
Ohio (Ohio Prepaid Tuition Program)	1989 (October-February, newborns anytime)	No	Up to 2000 units can be purchased with each unit worth 1% of the weighted average tuition in state public universities	No	Full value of the units	No refund for beneficiary under18, refund equals 99% of the current unit value	$10-$50 to enroll, earnings exempt from state tax, in-state tuition guaranteed
Pennsylvania (Tuition Account Program)	1993 (anytime)	No	Tuition credits for the chosen public institution	No	The lesser of: (1) account value; and (2) actual tuition cost	The lesser of: (1) contributions; and (2) 90% of account value	1-year waiting period, must be used within 10 years of projected college entrance date, earnings exempt from state and local taxes

State and program name	Date of operation and enrollment period	Age restriction	What is covered	Tuition discount?	Value if used for private or out-of-state public institutions	Refund policy	Comments
South Carolina (SC Tuition Prepayment Program)	September 1998 (September–December)	10th grade or younger	2-year or 4-year tuition and fees at state public institutions	13% for newborns for a 4-year university plan	No more than principal + program's rate of return	Contributions less $75 penalty	$65 to enroll, earnings exempt from state tax, benefits must be used before age 30
Tennessee (Tennessee BEST)	1997 (fall)	No	Up to 1500 units, each worth 1% of weighted average tuition and fees at state public institutions	No	Weighted average in-state tuition and fees	Contributions + 50% earnings refunded, no refund before beneficiary is college age	$50 to enroll, 2-year waiting period, may be used for graduate school, earnings exempt from state tax
Texas (Texas Tomorrow Fund)	1996 (October–February)	11th grade or younger	Plans are offered for both public and private colleges	7% for newborns for a 4-year university plan	Average tuition and fees at in-state public or private institutions, depending on the plan purchased	Contributions refunded, less fees. If beneficiary is under 18, interest up to 5% is also refunded	$50 to enroll, must be used within 10 years of projected college entrance date, public tuition guaranteed
Virginia (Prepaid Education Program)	1996 (October 1–February 1)	9th grade or younger	Up to 3 years of tuition and fees at community colleges and up to 5 years at universities	13% for newborns for a 4-year university plan	Contributions and actual earnings up to the highest(average) in-state public tuition and fees for in-state private and out-of-state institutions	Within 3 years, only contributions refunded, less $100 penalty. After that, refund includes contributions plus (rate of return –2%) Earnings	$85 to enroll, contributions up to $2,000/year state tax deductible, may be used for graduate school, qualified withdrawals state tax exempt, must be used within 10 years after high school, one price fits all, guaranteed

State and program name	Date of operation and enrollment period	Age restriction	What is covered	Tuition discount?	Value if used for private or out-of-state public institutions	Refund policy	Comments
West Virginia (WV Prepaid College Plan)	October 1998 (October–December)	9th grade or younger	Up to 5 years of tuition and fees at state institutions	Nearly 20% for newborns for a 4-year university plan	Weighted average tuition and fees at in-state public institutions	$150 fee, contributions refunded. If 4 years or more after the projected entrance date, refund amount is the value of current tuition	$70 to enroll, contributions state tax deductible, not to be used for graduate school, must be used within 10 years of projected college entrance date or age 30
Wyoming (Advanced Payment for Higher Education)	1987-1995	—	—	—	—	—	Program suspended in 1995 due to low enrollment

Source: Reprinted from [http://www.tiaa-crefinstitute.org/Data/statistics/pdfs/jma_prepaid.pdf], which relied on information contained in the web site [http://www.collegesavings.org], various states' web sites, the May 2001 issue of *Money Magazine*, and the book *The Best Way to Save for College*, by Joseph Hurley.

Note: In addition, several states (Iowa, Utah, Kentucky) have endowment funds the earnings of which will be provided to accounts for qualified higher education expenses.

[a] "Waiting period" is defined as the amount of time an account needs to be open before qualified withdrawals can be made without penalty.

[b] Currently, earnings of qualified withdrawals are subject to federal income tax at the beneficiary's rate. Starting January 1, 2002, earnings of qualified withdrawals will be exempt from federal income tax. According to the current law, nonqualified withdrawals are subject to a penalty no less than 10% of the earnings portion of the withdrawal. Unless noted, a 10% penalty on earnings is imposed on non-qualified withdrawals. Any penalty is paid into the program. Starting January 1, 2002, the penalty on non-qualified withdrawals will be replaced by an additional 10% tax on the earnings portion.

Appendix Table 2. Comparison of State-Sponsored College Savings Programs

(as of August 1, 2001)

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Alaska	University of Alaska College Savings Plan	1991, revised May 2001	**Option 1 (enrollment-based):** Eight portfolios shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2 (static portfolios):** 100% equities; 100% fixed-income; or 60% equities + 40% bonds. **Option 3 (advanced college tuition portfolio):** prepaid plan for University of Alaska.	$250,000	$30 + 1.05%	State has no income tax	No expense charges for Option 3. $30 annual fee waived for accounts with automatic payments or a combined balance of at least $25,000 for the same beneficiary.
Arizona	Arizona Family College Savings Program	June 1999	**Option 1:** CollegeSure CDs with at least 4% return and FDIC insured up to $100,000. **Option 2:** 100% equities. **Option 3:** 75% equities + 25% fixed income. **Option 4:** 100% fixed income.	$168,000	No fee for Option 1. For others, $10 to enroll, 1.42% annual fee	Earnings state income tax exempt	Maturity of CollegeSure CDs ranges from 1 to 25 years. CDs must be withdrawn within 30 years.
Arkansas	GIFT College Investing Plan	December 1999	**Option 1(age-tailored):** 90% equities+10% bonds for youngest, 10% equities + 25% bonds + 65% money market for 19 and older. **Option 2 (risk-adjusted):** investors choose among four portfolios.	$175,000	$25 + 1.8%	Earnings state income tax exempt	$25 annual fee waived for state residents and accounts with a balance of at least $25,000.

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
California	Golden State Scholar-Share Trust	October 1999	**Option 1 (age-based):** 80% equities + 20% bonds for youngest, 15% equities + 35% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** 100% Social Choice equities. **Option 4:** guaranteed with at least 3% return.	$165,886	0.80%	No	1-year waiting period[a]. Benefits must be paid out 10 years after a beneficiary turns 35. If a beneficiary is over 35 when designated, then payments within 10 years.
Colorado	Scholars Choice	October 1999	**Option 1 (age-based):** 80% equities + 20% bonds for youngest, 10% equities + 60% bonds + 30% money market for 19 and older. **Option 2 (years-to-enrollment-based):** 60% equities + 40% bonds if more than 10 years from enrollment, 10% equities + 60% bonds + 30% money market if less than 1 year from enrollment. **Option 3 (balanced):** 50% equities + 50% bonds. **Option 4:** 100% equities. **Option 5:** 100% fixed income.	$150,000 (contribution limit)	$30 + 1.29%	All contributions state tax deductible. Earnings state income tax exempt.	$30 annual fee waived for state residents. Option 2 targeted at adult beneficiaries.
Connecticut	Connecticut Higher Education Trust	December 1997	**Option 1 (aged-based):** 80% equities + 20% bonds for youngest, 20% equities + 30% bonds + 50% money market for 17 and older. **Option 2 (high equity):** 80% equities + 20% fixed income. **Option 3 (principal plus interest):** guaranteed with at least 3% return.	$235,000	0.79%	Earnings state income tax exempt	—

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Delaware	Delaware College Investment Plan	July 1998	**Option 1 (age-based):** portfolios shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2:** 100% equities. **Option 3:** 70% equities + 30% bonds. **Option 4:** 20% equities + 40% bonds + 40% money market.	$131,480	$30 + 1.0%	No	$30 annual fee waived for accounts with automatic payments or a balance of at least $25,000.
Idaho	Idaho College Savings Plan	2001	**Option 1 (age-based):** 75% equities + 25% bonds for youngest, 10% equities + 40% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** guaranteed with at least 3% return.	$235,000	0.92%	Up to $4,000 per taxpayer per year state tax deductible	—
Illinois	Bright Start College Savings Plan	March 2000	**Option 1 (age-based):** 90% equities + 10% bonds for youngest, 10% equities + 60% bonds + 30% money market for 18 and older. **Option 2:** 100% fixed income. **Option 3:** 100% equities.	$160,000	0.99%	Earnings state income tax exempt	—
Indiana	Indiana Family College	1997	**Option 1 (age-based):** up to 100% stocks for those under age 11, more conservative for older beneficiaries. **Option 2:** investors choose among four mutual funds.	$114,548 (contribution limit)	$10 to enroll, $25 + 1.06% annual fee	Earnings state income tax exempt.	Withdrawals must be made within 25 years of account opening.
Iowa	College Savings Iowa	September 1998	**Option 1 (age-based):** 80% stocks + 20% bonds for youngest, 80% bonds + 20% stocks for age 16 and older. **Option 2:** six portfolios with 100%, 80%, 60%, 40%, 20%, and 0% equities, respectively.	$140,221	0.79%	Up to $2,112 per taxpayer per year state tax deductible. Earnings exempt from state tax.	Beneficiary under 18 when account opened. Account balance must be paid out within 30 days after a beneficiary turns 30.

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Kansas	Learning Quest Education Savings	July 2000	Three age-based investment tracks (aggressive, moderate, and conservative) available.	$127,000 (contribution limit)	$40 + 1.22%	Up to $2000 per taxpayer per year state tax deductible.	$40 annual fee reduced to $10 for residents or accounts with a balance of at least $100,000.
Kentucky	Education Savings Plan Trust	1990	**Option 1 (age-based):** 75% equities + 25% bonds for youngest, 15% equities + 35% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** guaranteed with at least 3% return.	$235,000	0.80%	Earnings exempt from state tax.	Either the owner or beneficiary needs to have "Kentucky ties."
Louisiana	Louisiana START	July 1997	**Option 1 (growth option):** 85% equities + 15% fixed income. **Option 2 (balanced option):** 60% equities + 40% fixed income.	$281,543	No fee	Up to $2,400 per return per year state tax deductible. Earnings state tax exempt.	Residency required, 12-month waiting period. Up to 14% matching grant available for accounts with at least $100 contributions during the year and family income less than $100K.
Maine	NextGen College Investing Plan	August 1999	**Option 1 (age-based):** 90% equities + 10% bonds for youngest, 5% equities + 15% fixed income + 80% money market for 21 and older. **Option 2:** 100% equities. **Option 3:** 75% equities + 25% fixed income. **Option 4:** 100% fixed income.	$225,000	$50 + 1.85%	Earnings state income tax exempt.	—

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Massachusetts	U. Fund	March 1999	**Option 1 (age-based):** portfolios shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2:** 100% equities. **Option 3:** 70% equities + 30% bonds. **Option 4:** 20% equities + 40% bonds + 40% money market.	$171,125	$30 + 1.00%	No	$30 annual fee waived for accounts with automatic payments or a balance of at least $25,000.
Michigan	Michigan Education Savings Program	2000	**Option 1 (age-based):** 75% equities + 25% bonds for youngest, 15% equities + 35% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** guaranteed with at least 3% return.	$125,000	0.65%	Up to $5,000 per taxpayer per year state tax deductible. Earnings state tax exempt.	One-third matching grant (up to $200) available from the state for new accounts with a state resident beneficiary who is 6 or younger, and whose family income is less than $80,000.
Mississippi	Mississippi Affordable College Savings	Fall 2000	**Option 1 (age-based):** 80% equities + 20% bonds for youngest, 20% equities + 30% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** 100% money market.	$235,000	0.92%	Earnings state tax exempt. Up to $10,000 per taxpayer per year state tax deductible.	—
Missouri	MO$T (Missouri Saving for Tuition Program)	November 1999	**Option 1 (age-based):** 75% equities + 25% bonds for youngest, 10% equities + 40% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** guaranteed with at least 3% return.	$235,000	0.65%	Up to $8,000 per taxpayer per year state tax deductible. Earnings state tax exempt.	12-month waiting period.

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Montana	Montana Family Education Savings Program	1998	CollegeSure CDs issued by College Savings Banks with at least 4% return (maturity of CDs needs to coincide with the expected years of college attendance), FDIC insured up to $100,000 per account.	$168,000 (contribution limit)	None	Up to $3,000 per taxpayer per year state tax deductible.	$100 fee if withdrawals are made within 3 years of account opening. CDs must be withdrawn within 30 years.
Nebraska	Nebraska College Savings Plan	January 2001	**Option 1:** four age-based portfolios that shift away from stocks over time. **Option 2:** six target portfolios with 100%, 80%, 60%, 40%, 20%, and 0% equities, respectively.	$165,000	$24 + 1.0%	Up to $1,000 per tax return per year state tax deductible. Earnings state tax exempt.	—
New Hampshire	Unique College Investing Plan	July 1998	**Option 1 (age-based):** portfolios shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2:** 100% equities. **Option 3:** 70% equities + 30% bonds. **Option 4:** 20% equities + 40% bonds + 40% money market.	$166,600	$30 + 1.00%	No state income tax. Earnings exempt from state interest and dividends tax.	$30 annual fee waived for accounts with automatic payments or a balance of at least $25,000.
New Jersey	New Jersey's Better Educational Savings Trust	August 1998	**Option 1 (age-based):** 80% equities for the youngest, 20% equities + 80% fixed income for 15 and older. **Option 2:** 100% equities. **Option 3:** 75% equities + 25% fixed income. **Option 4:** 100% fixed income.	$150,000	$5 + 0.5%	Earnings exempt from state tax.	Residency required. Between $500 and $1,500 scholarship for college in NJ available for accounts that have been open for more than 4 years and with more than $1,200 contributions.

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
New Mexico	Education Plan of New Mexico	October 2000	**Option 1 (age-based):** five portfolios that shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2:** 100% equities. **Option 3:** 100% bonds. **Option 4:** 100% money market.	$160,539 (contribution limit)	$30 + 1.29%	All contributions state tax deductible. Earnings exempt from state tax.	1-year waiting period. $30 annual fee waived for residents, accounts with automatic payments or a balance of at least $10,000.
New York	New York's College Savings Program	September 1998	**Option 1 (age-based managed allocation):** 75% equities + 25% bonds for youngest, 15% equities + 40% bonds + 45% money market for 17 and older. **Option 2 (aggressive managed allocation):** similar to Option 1, with more equities. **Option 3 (high equity):** 75% to 100% equities. **Option 4 (guaranteed):** guaranteed with at least 3% return.	$235,000	0.65%	Up to $5,000 per taxpayer per year state tax deductible. Earnings exempt from state tax.	3-year waiting period.
North Carolina	College Vision Fund	June 1998	**Option 1 (age-based):** 85% equities + 15% bonds for youngest, 15% equities + 25% bonds + 60% money market for 21 and older. **Option 2:** 100% equities. **Option 3 (guaranteed):** 100% fixed income.	$187,500 (contribution limit)	$75 to enroll, 0.5% annual fee	Earnings state income tax exempt.	Residency required, beneficiary less than 11th grade when account opened. Benefits must be paid out before the beneficiary turns 30. A 15% penalty on earnings for non-qualified withdrawals.[b]

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Ohio	Ohio College Advantage Savings Plan	Fall 2000	**Option 1 (age-based):** 85% equities + 15% bonds for youngest, 15% equities + 25% bonds + 60% money market for 21 and older. **Option 2:** 60% equities + 30% bonds + 10% cash. **Option 3:** 85% equities + 15% bonds. Option 4: 100% equities.	$229,000	1.27%	Up to $2,000 per tax return per year state tax deductible. Earnings state tax exempt.	Residency required.
Oklahoma	Oklahoma College Savings Plan	April 2000	**Option 1 (age-based):** 80% equities + 20% bonds for youngest, 20% equities + 30% bonds + 50% money market for 17 and older. **Option 2:** 100% equities. **Option 3:** guaranteed with at least 3% return.	$235,000	0.83%	No	1-year waiting period.
Oregon	Oregon College Savings Plan	January 2001	**Option 1 (age-based):** 90% equities + 10% bonds for youngest, 10% equities + 40% bonds + 50% money market for 18 and older. **Option 2:** 100% equities. **Option 3:** 100% fixed income.	$150,000	2.44%	Up to $2,000 per taxpayer per year state tax deductible.	Residency required.
Rhode Island	RI Higher Education Savings Trust	September 1998	**Option 1 (age-based):** 100% equities for youngest, 25% equities + 40% bonds + 35% money market for 19 and older. **Option 2 (age-based):** similar to Option 1, with more equities. **Option 3:** 100% equities. **Option 4:** 60% equities + 40% fixed income. **Option 5:** 100% bonds.	$246,000	$25 + 1.25%	No	$25 annual fee waived for state residents, accounts with automatic payments or a balance of at least $25,000.
Tennessee	Tennessee BEST Investment Savings Program	March 2000	Age-based managed allocation: 70% equities + 30% bonds for youngest, 5% equities + 40% bonds + 55% money market for 17 and older.	$100,000 (contribution limit)	0.95%	Earnings exempt from state interest and dividends tax.	—

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Utah	Utah Educational Savings Plan Trust	1996	**Option 1:** 100% money market. **Option 2 (age-based):** 95% stocks + 5% bonds for age 3 and younger, 25% stocks + 50% bonds + 25% money market for 17 and older. **Option 3 (age-based):** similar to Option 2, with more equities. **Option 4:** 100% equities.	$160,000 (contribution limit)	No fee for Option 1. For other options, up to $25 + 0.31%	Up to $1,365 per beneficiary per taxpayer per year state tax deductible. Earnings state tax exempt. Account must be opened before the beneficiary turns 19 for these state tax benefits.	100% penalty on earnings if non-qualified withdrawals are made within 2 years of account opening. Benefits need to begin to be paid out before the beneficiary turns 22 years and 4 months (27 upon request).
Vermont	Vermont Higher Education Savings Plan	December 1999	**Option 1 (interest income option):** 100% fixed-income securities. **Option 2 (age-based):** 70% equities + 30% bonds for youngest, 10% equities + 40% bonds + 50% money market for 17 and older.	$100,000 (contribution limit)	0.80% for Option 2. No fee for Option 1.	Earnings exempt from state tax.	"Vermont connection" required, 1-year waiting period.
Virginia	Virginia Education Savings Trust	December 1999	**Option 1 (age-based portfolios):** portfolios shift away from equities and towards fixed income and cash over time. Investors may choose any age-banded portfolio. **Option 2 (all-fixed-income portfolio):** 100% fixed income.	$100,000 (contribution limit)	$85 to enroll. 1.0% annual fee	Up to $2,000 per account per year state tax deductible. Unlimited state tax deduction for owners 70 and older. Earnings state tax exempt.	1-year waiting period. Benefits must be paid out within 10 years after the projected high school graduation date (or, for adults, 10 years after the account is opened).

State	Name of the program	First date of operation	Investment options	Current lifetime account balance limit	Annual expense charges and other fees	State tax advantages	Comments
Wisconsin	EDVEST Wisconsin College Savings Program	1997	**Option 1 (age-based):** 90% equities + 10% bonds if more than 10 years from enrollment, 100% bonds if less than 3 years from enrollment. Investors may choose any age-banded portfolio. **Option 2:** (1) 100% index equities, (2) 100% bonds. **Option 3:** (1) 90% equities + 10% bonds, (2) 70% equities + 30% bonds, (3) 50% equities + 50% bonds. **Option 4 (tuition unit option):** similar to prepaid plans, funds invested in bonds.	$246,000	No fee for tuition unit option. 1.25% annual fee for other options.	Up to $3,000 per beneficiary per year state tax deductible. Earnings state tax exempt.	2 academic-year waiting period before tuition units can be redeemed.
Wyoming	Wyoming College Achievement Plan	May 2000	**Option 1 (age-tailored):** 80% equities + 20% bonds for youngest, 5% equities + 18% bonds + 77% money market for 22 and older. **Option 2:** 100% equities. **Option 3:** 75% equities + 25% fixed income. **Option 4:** 100% fixed-income.	$120,000 (contribution limit)	$50 + 1.57%	No state income tax.	$50 annual fee waived for state residents.

Source: Reprinted from [http://www.tiaa-crefinstitute.org/Data/statistics/pdfs/jma_savings.plans.pdf], which relied on information contained in the web site [http://www.collegesavings.org], various states' web sites, the May 2001 issue of *Money Magazine*, and the book *The Best Way to Save for College*, by Joseph Hurley.

Note: In addition, several states (Iowa, Utah, Kentucky) have endowment funds the earnings of which will be provided to accounts for qualified higher education expenses.

[a] "Waiting period" is defined as the amount of time an account needs to be open before qualified withdrawals can be made without penalty.
[b] Currently, earnings of qualified withdrawals are subject to federal income tax at the beneficiary's rate. Starting January 1, 2002, earnings of qualified withdrawals will be exempt from federal income tax. According to the current law, nonqualified withdrawals are subject to a penalty no less than 10% of the earnings portion of the withdrawal. Unless noted, a 10% penalty on earnings is imposed on non-qualified withdrawals. Any penalty is paid into the program. Starting January 1, 2002, the penalty on non-qualified withdrawals will be replaced by an additional 10% tax on the earnings portion.