Section 529 Qualified College Savings Plans

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College Tuition Savings Plans, also known as 529 plans after the section of the Internal Revenue Code that authorizes their existence, offer an excellent, and flexible, opportunity to invest on a tax-free basis for the education of your children or grandchildren. Such plans also offer potential estate and gift tax benefits as well as, in the case of at least the Oregon plan, creditor protection benefits.

There are two types of 529 plans. One type is the prepaid tuition plan, and the other is the college savings plan. Because the college savings plan is the more popular of the two alternatives, this article will concentrate on it.

Under a 529 plan any person may contribute funds to an investment plan for the benefit of any individual. The plans are sponsored by the individual states, and every state has at least one. Most state plans accept contributions without regard to where the contributor or beneficiary lives or goes to college. If the individual beneficiary withdraws the invested funds for qualified higher education expenses, the funds are withdrawn free from any tax on the earnings. Qualified higher education expenses include not just tuition, but also room, board, books, supplies and equipment.

Starting a 529 plan is easy. Many brokerage and mutual fund companies, in partnership with one or more states, offer the plans. More information about the Oregon plans is available on the web at http://www.oregon529network.com/.

Contributions to a 529 plan must be made in cash, using after-tax funds. Investment choices are limited to the investment funds offered by each state's plan. Most states offer so-called lifestyle investments with a changing asset allocation as the beneficiary nears college age, or direct investment in specific funds. Changes to the investments may be made only once a year. Distributions from the plan to the beneficiary for qualified higher education expenses are not taxed. The earnings portion of distributions for purposes other than education expenses are subject to tax at the beneficiary's tax rate plus a 10% penalty.

The hallmark of the 529 plan is its remarkable flexibility. The person who sets up and contributes to the plan, called the plan owner, can control many aspects of the investment of and distributions from the plan, change beneficiaries, or even pull the funds back out of the plan for the owner's own benefit. Despite this degree of flexibility, contributions to each plan qualify for the annual exclusion from gift tax, as a gift to the plan's named beneficiary. This means each contributor can deposit up to $12,000 to a plan for each beneficiary each year. Even though the owner can pull the funds out of the plan, the plan funds are not considered part of the owner's taxable estate when the owner dies. Another unique aspect of 529 plans is that a contributor can put as much as five years worth of contributions in the plan in one year, and claim annual exclusions for the gift over the next five years. Thus, one individual can "front load" a 529 plan investment account for one beneficiary with a $55,000 contribution in one year, free of gift taxes.

If the original beneficiary of a 529 plan does not need the funds for college, for instance because he or she receives a scholarship, or does not attend college, then the plan owner can name a different beneficiary and redirect the funds to a loved one who does need the help. As long as the new beneficiary is of the same generation as the original beneficiary, and within the same family, the change of beneficiaries triggers no tax. This additional flexibility makes it easier for a contributor to be assured that the contribution will be used to pay college costs.

Oregon plan owners can take advantage of a unique feature of the Oregon plan which protects plan assets from the claims of creditors of the Oregon plan owner and the Oregon beneficiary, despite the access that each has to the assets. This provision, combined with the ability to put up to $55,000 into a plan tax free for each beneficiary, means that a 529 plan can be a very useful way to set aside money for a loved one, but retain access to the funds for the owner in an emergency.

Finally, a contribution to an Oregon 529 plan by an Oregon resident can result in a deduction from the state income tax of up to $2,000. In 2008, the deduction increases to $4,000 for a married couple. Excess contributions can be carried forward.

Because the plans of each state are different, there are many plan features to choose from. Investment advisors may offer advice as to which state's plan has the most attractive features for each potential plan owner. Web sites also offer comparisons of the features of different states' plans.

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