529 Plans Demystified

CollegeAccess529
invest in your children

www.collegeaccess529.com

A lack of familiarity with how 529 plans work may deter investors from exploring this college savings vehicle. That's why we have created this 529 plan primer to demystify what many college savings experts believe is "the best way to save for college today."[1]

General

Q. What is a 529 plan?
A. Like 401(k) accounts, which millions of Americans use for their retirement savings, 529 plans are tax-advantaged savings accounts named after a section of the Internal Revenue Code. Unlike 401(k)s, however, 529s are an after-tax contribution, intended for qualified education expenses only.

Q. What do the states have to do with 529 plans?
A. Section 529 of the Internal Revenue Code enabled each state to create its own 529 savings plan "mandate." While the federal tax code stipulates how investors are treated from a federal tax standpoint, how they are treated from a state tax standpoint is up to each individual state.

Furthermore, the federal code merely creates a suggested framework for 529 plans, leaving many of the decisions to the states. This is why each plan looks different—with different minimums, maximums, age restrictions, etc.

Q. Can I open more than one account?
A. Yes. Except in limited circumstances (e.g., where the second account is a custodial account), you may open only one account for each Designated Beneficiary per state plan. You may, however, open another account for the same Designated Beneficiary in another state plan (so long as the combined savings do not significantly exceed the projected educational cost needs of the Beneficiary).

Q. Who can I designate as a Designated Beneficiary?
A. You can open an account for the benefit of an individual person of any age who is either a U.S. citizen (residing in the U.S. or abroad) or a legal U.S. resident (a "resident alien") with a valid Tax ID Number (TIN).

The Designated Beneficiary may be your child, your grandchild, or another relative, such as a niece or nephew, your spouse, or even someone unrelated to you. You can open an account for yourself.

Some plans may require the Designated Beneficiary to be a resident of the state sponsoring such plan.

Q. Can others open an account for the same Beneficiary I have designated?
A. Yes. Other people may also open their own account(s) for the same Designated Beneficiary—in either the same state or a different state.

Q. What if my child (the Designated Beneficiary) cannot use the assets for educational purposes, or if the account assets exceed my child's education expenses?
A. You have several options: a) use the funds for the Designated Beneficiary's graduate or professional school expenses; b) designate a new beneficiary who is a member of the Designated Beneficiary's family; c) close the account by withdrawing all the funds (withdrawals are subject to federal income tax and a 10% penalty); or d) leave the account open indefinitely, until you, as account owner, determine the proper course of action.

[1]Source: SavingforCollege.com; January 2009.

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Q. What expenses are involved?
A. Generally, there are two levels of expenses that apply to 529 contributions.

1) The program manager assesses certain fees that may include a fixed annual account fee (sometimes waived if the account reaches a certain minimum, or if the account owner makes regular monthly contributions), and a program management fee, based on asset value.

2) The mutual funds in which the portfolio invests each have operating expenses that are reflected in the underlying fund's Net Asset Value (NAV)—or daily share price.

If you purchase your plan through a financial professional, your contribution may be subject to: a sales charge, and/or servicing and/or distribution fees, which will vary based on the Class you select (Class A v. Class C etc.).

Taxes

Q. Do I have to pay tax on the earnings in a 529 plan account?
A. Earnings on the money you invest in your account are not subject to federal or state taxes before they are distributed. Withdrawals from a 529 plan for qualified expenses are free from federal and state income tax.

Q. Can I claim a deduction on my federal and state tax filing if I make a contribution to a 529 plan?
A. There is no federal tax deduction for contributions to 529 plans, though some states offer tax incentives.

Because each state has created their 529 plan independently, residents of certain states may be entitled to a state tax deduction or credit—ranging from $250 to an unlimited deduction—while a number of states offer no deduction at all.

Q. What are the gift tax advantages of an account?
A. Normally, a gift of more than $15,000 to a single person in one year is subject to federal gift tax. With most 529 plans, an individual can contribute up to $75,000 (and married couples can potentially contribute up to a total of $150,000) to an account for a particular Designated Beneficiary in one year without triggering the tax. To do this, the contributor must elect to treat the entire gift as a series of five equal annual gifts, and must file a gift tax return (IRS Form 709) for the year in which the entire gift is made. If the contributor dies before the start of the fifth year, a portion of the contribution must be added back to the contributor's estate for purposes of determining the taxable estate.

You should consult with a tax advisor regarding the gift and estate tax consequences of contributing to a 529 plan.

Contributions

Q. How much can I invest in an account?
A. The balance limit of 529 plans varies by state. The maximum of any plan is currently around $500,000.[2] These amounts are adjusted periodically to keep up with the increases in both college tuition and inflation.

Q. How are my contributions invested?
A. Account owners choose from a selection of portfolios offered by the program. Most programs offer one or more of the following types of portfolios: a) "age-based"—a diversified portfolio of mutual funds whose risk/return profile automatically gets more conservative as the child gets closer to college age; b) "static"—a diversified portfolio of mutual funds, which maintains its risk/reward profile, until the account owner exchanges for a different one; and c) "individual investment"—a portfolio invested from among a selection of mutual funds.

Q. Can I direct how my account is invested?
A. For each contribution made to your account, you elect how it is invested.

Q. Can anyone else contribute to my account?
A. Yes—in most states—persons other than the account owner may make contributions to an account. The contribution will be directed in accordance with the account owner's original instructions. Another contributor will not retain any control over, or rights to, his or her contribution (or any other portion of the account), after the contribution is made. The other contributor will not receive any statements or information with respect to the account.

Q. How often can I change how the existing assets in my account are invested?
A. You may reallocate the existing assets in your account twice every calendar year. Alternatively, you may reallocate whenever you change the account's Designated Beneficiary.

Withdrawals

Q. What are "qualified" expenses?
A. You can use the money from your 529 account to pay for "qualified education expenses" of the account's Designated Beneficiary.

Qualified college expenses are defined in the Internal Revenue Code as tuition, room and board, books, equipment, and fees necessary to attend an institution of higher education.

529 Plan account owners can withdrawal assets to pay for K-12 tuition (public, private, or religious) up to $10,000 per year per beneficiary. Always consult a tax professional. K-12 withdrawals may be subject to specific state taxes.

Additionally, on December 20, 2019, the federal Further Consolidated Appropriations Act of 2020 was signed into law. It includes new provisions that allow 529 Plan account owners to withdraw assets to pay for certain apprenticeship programs and to pay principal and interest on qualified higher education loans for the Designated Beneficiary or any of his or her siblings. The loan repayment provisions apply to repayments up to $10,000 per individual. These withdrawals will have no federal impact.

[2]State taxes apply to qualified withdrawals for residents of Alabama participating in another state's plan. Speak to your tax or financial professional.

Q. Can I use my account to pay for any college?
A. Yes. You can get the full benefits from a 529 savings program if your Designated Beneficiary attends any accredited institution of higher education. This might be a college, graduate school, professional school, or a post-secondary vocational or trade school.

The institution may be either private or public, and may be either in your state or out-of-state.

You should be certain that the school is accredited. If you use the money to pay for costs associated with a non-accredited institution, you will not qualify for favorable tax treatment, and the earnings portion of your withdrawal for such purpose will be subject to federal income tax and a 10% penalty.

Visit https://studentaid.gov/ to determine whether or not a particular institution is accredited.

Q. Do I have to send my receipts to the program manager when I make a withdrawal?
A. No. The program manager reports the full distribution to the IRS and the recipient is responsible for the recordkeeping for qualified expenses.

Q. What if I need the money for something else?
A. As account owner, you can withdraw all or any portion of the money in a 529 account at any time, for any purpose. Note, however, that withdrawals for purposes other than paying a Designated Beneficiary's qualified education expenses are deemed to be "non-qualified."

Non-qualified withdrawals are subject to federal income tax and a 10% penalty tax on earnings, with some exceptions, and may also be subject to state tax. Speak to your tax or financial professional.

Rollovers & Transfers

Q. Can I move my child's existing 529 account from one 529 program to another?
A. Yes. The Internal Revenue Code allows you to "rollover" from one plan to another once every 12 months without having to pay federal tax or the 10% penalty associated with non-qualified distributions. State taxes may apply.

Most plans will even take care of the paperwork for you. If you make the liquidation yourself, be sure to make the contribution to the new plan within 60 days, otherwise the tax and penalty will apply.

Also, find out if the existing plan will treat the transaction as a non-taxable event. Some states treat rollovers as a non-qualified distribution, so state tax would apply to the earnings. And, check to see if the plan imposes any fees.

Q. Can I transfer my existing Coverdell ESA (Education Savings Account) or Series EE and I U.S. Savings Bonds into a 529 plan tax-free?
A. Yes. Most rollovers of this nature are not considered taxable events. But, there may be ownership issues or a "phase-out" of the favorable tax treatment, depending on

your income. You should speak to your financial professional or your tax advisor before taking any action.

Q. Can I transfer my child's existing UGMA (custodial) account into a 529 plan?
A. Yes. Most 529 plans accept funds coming from an existing UGMA (or UTMA) account. However, because these accounts are irrevocable "gifts," any withdrawals from the UGMA/UTMA that is then used to fund a 529 account must be for the benefit of the same minor only. As such, state laws generally prevent you from making any future Designated Beneficiary changes to this "custodial" 529 account. And, the minor will assume ownership of the account when they reach the age of majority (generally dictated by the laws of the state that sponsors your 529 plan). For this reason, parents who are concerned about a child accessing the money in a 529 account should open a second (non-custodial) 529 account—which would remain under their control—for any subsequent contributions.

The transfer of UGMA/UTMA funds into a 529 account can provide all the tax and investment benefits associated with 529 plans, and may be an advantageous move for many investors. Remember, however, that a 529 plan can only accept cash. So, any appreciated securities in the UTMA would first have to be sold, and capital gains would be reportable on the minor's tax return.

Financial Aid and Scholarships

Q. How do 529 savings plans affect my child's chances for financial aid?
A. A 529 savings plan account is treated as an asset of the owner in determining eligibility for federal financial aid. This means that an account owned by a parent or a student reduces the student's eligibility for financial aid by up to 5.64% of the account's balance. A withdrawal from an account owned by grandparents, aunts, uncles, or other relatives reduces a student's financial aid by 50 cents per dollar withdrawn.

Q. What if my child gets a scholarship, or can't use the money because they get hurt and can't attend college?
A. The normal 10% federal penalty is not assessed if you terminate the account because the Beneficiary has died or is disabled, or if you withdraw funds not needed for college because he or she has received a scholarship.

SECURE Act

On December 20, 2019, the federal Further Consolidated Appropriations Act of 2020 was signed into law. It includes new provisions that allow 529 Plan account owners to withdraw assets to pay for certain apprenticeship programs and to pay principal and interest on qualified higher education loans for the beneficiary or any of the beneficiary's siblings. The loan repayment provisions apply to repayments up to $10,000 per individual. These withdrawals will have no federal tax impact.

We encourage account owners to consult a qualified tax advisor about their personal situation. If you have any questions about the CollegeAccess 529 Plan, please contact us at 800-243-4361.

Investors should consider the investment objectives, risks, and charges and expenses of the CollegeAccess 529 plan before investing. This and other important information is in the Plan Disclosure Statement, available at www.CollegeAccess529.com. Read the Plan Disclosure Statement carefully before investing.

Before investing, you should consider whether your state of residency, or your intended beneficiary's state of residency, offers a state tax deduction or any other state benefits such as financial aid, scholarship funds, and protection from creditors that are only available for investments in that state's 529 savings program.

The CollegeAccess 529 Plan is issued by the South Dakota Higher Education Savings Trust. The Program Manager and Underwriter for the CollegeAccess 529 Plan is VP Distributors, LLC, One Financial Plaza, Hartford, CT 06103, 800-243-4361.

Certain of the investment management firms that manage underlying mutual Funds in the Program, including Virtus Investment Advisers, Inc., are affiliated with the Program Manager.

Only South Dakota residents and Account Owners who designate a South Dakota resident as Beneficiary can invest directly in the CollegeAccess 529 Plan. Certain Portfolios are not available to those who invest directly. Residents of states other than South Dakota can invest in the CollegeAccess 529 Plan only through a financial professional. Additional fees apply for investments made through a financial professional. Please see the Plan Disclosure Statement for details. State taxes may apply for residents of states other than South Dakota.

Notice: CollegeAccess 529 Plan accounts are not insured by any state, and neither the principal deposited nor any investment return is guaranteed by any state.

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