July 1, 2002

QUALIFIED TUITION PROGRAMS - "529 PLANS"

If you have a child (or if you'd like to help someone else's child) who is going to attend college in the future, you may be interested to know many states have set up a qualified tuition program which allows prepayment of higher education costs on a tax-favored basis. These programs are sometimes referred to as "529 plans," for the Code section which provides for them.

Under the program, funds that you place in the program are held in a special account to be used to cover the future higher education costs of the child you designate as beneficiary. The earnings on the account aren't taxed while the funds are in the program. Instead, at the time the funds are used for the child's higher education, the earnings (but not the contributions) will be taxed to the child. And since the child is likely to be in a low tax bracket when using the funds, the earnings will be taxed at a favorable rate. Further, there is no tax on distributions to the extent the funds are used to pay qualified expenses. Also, private education institutions will be allowed to establish programs, but distributions from those programs won't be tax-free until 2004.

Tuition, fees, books, supplies, and required equipment can be prepaid through our state's qualified tuition program. What's more, reasonable room and board expenses of a student who is enrolled at least half-time may also be prepaid.

Accredited colleges, junior colleges and area vocational schools are qualified to participate in the tuition program. In addition, accredited post-secondary schools offering credit towards a bachelor's degree, an associate's degree, a graduate or professional degree, or another recognized post-secondary credential, are eligible to participate. Certain proprietary institutions and post-secondary vocational education institutions eligible to participate in Department of Education student-aid programs may also participate in the qualified tuition program.

The contributions you make to the qualified tuition program are not subject to gift tax, except to the extent the contributions exceed $11,000 annually (indexed for inflation). And if your contributions in a year exceed $11,000 (as indexed for inflation), you can elect to take the contributions into account ratably over a five-year period starting with the year of the contributions.

Please note, if a distribution of earnings isn't used for qualified higher education expenses of the beneficiary, a 10% additional tax will be imposed on the distribution. A distribution from a qualified program isn't a gift, but a change in beneficiary or rollover to the account of a new beneficiary is.