An Investor's Guide to 529 Education Savings Plans

A 529 education savings plan, created by Section 529(b) of the Internal Revenue Code, is designed to help save for education expenses of your child or another beneficiary.

A 529 education savings plan (529 plan) is a state-sponsored education savings vehicle that offers account owner tax advantages, flexibility and control when saving for elementary, secondary and/or higher education expenses of the account beneficiary. Each state can sponsor its own plan or plans, and typically you don't have to be a resident to contribute. If your state sponsors a 529 plan, you may be eligible for additional state benefits, including state tax benefits, if you participate in that plan.

Numerous 529 plans are available for your consideration through Edward Jones. Choosing between an in-state and out-of-state 529 plan can be complicated. We recommend you discuss complex tax issues related to 529 plans with a tax professional.

Types of 529 Plans

Education Savings Plan – Most states offer an education savings plan. Contributions can be made to any of the 529 investment options offered by the plan, and the amount of money available for withdrawal will depend on the performance of those investments. In the case of a 529 education savings plan, the investor takes on the investment risk.

Prepaid Tuition Plan – This type of plan allows individuals to purchase units of tuition/credits at today's prices for a student's college attendance sometime in the future. Contributions are limited to amounts needed to pay the beneficiary's eligible higher education expenses, often limited to tuition and fees. Many prepaid tuition programs are sponsored by the specific state's government and may have residency requirements. In the case of a 529 prepaid contract, the investment risk is the burden of the state agency investing the money.

Details about a 529 plan's investment options, share classes, fees, expenses, risks and other important information can be found in each plan's program description or offering statement. Read it carefully before making any investment decisions.

Contributions

Contributions are made with after-tax dollars and accumulate income tax free.[1] Other rules and restrictions on 529 plan contributions include the following:

- There are no age or income limitations for either the account owner or the beneficiary.
- Contributions must be made in cash. If assets are sold to make these contributions, tax must be paid on any gains generated from the sale.
- Anyone can contribute to any beneficiary's 529 plan. You do not have to be the parent or even a relative of the beneficiary to make contributions.
- Contributions are considered completed gifts to the beneficiary and not part of the donor's estate.

Currently, you may contribute up to $15,000 per year per beneficiary without exceeding the annual gift tax exclusion (less any other gifts made that year). All 529 plans prohibit contributions once the account balance for the beneficiary reaches a certain point, which is generally in excess of $235,000, but can vary depending on the plan. In addition, the owner of the 529 plan may make an election that allows the owner to contribute up to five times the annual exclusion amount ($75,000 in 2018) per contributor, per beneficiary in a single year.[2] The election allows the gift to be considered prorated over five years. For example, a married couple with two children can contribute $150,000 to each child in one year.

As a result, you can contribute a much larger sum than the annual gift exclusion, meaning a larger amount may begin to accumulate tax-free earnings. In addition, not only is the amount contributed potentially removed from the donor's gross estate, but the future earnings that the gift may ultimately generate are as well.[2] As this election accelerates the annual exclusions over the five-year period, any additional nonexcludable gifts from that donor to the same beneficiary within that period would be taxable (which may be offset by one's lifetime exclusion amount).

Distributions

Any distribution is a proportionate amount of contributions and earnings within the plan. Distributions, if used for qualified higher education expenses at an eligible institution, are federally tax free.

Qualified Postsecondary School Expenses – For postsecondary education, qualified higher education expenses include:

- Tuition and fees
- Books and supplies
- Room and board, if the beneficiary is considered at least a half-time student (including off-campus housing – the equivalent of what it costs to live on campus)
- Computers and related equipment (such as printers), internet access and educational computer software used primarily by the beneficiary of the 529 plan
- Other equipment or expenses required for enrollment

Eligible higher education institutions include:

- Any college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education
- Certain foreign institutions participating in federal student aid programs administered by the U.S. Department of Education

To determine whether a foreign or domestic institution is eligible, visit www.fafsa.ed.gov.

Qualified Elementary and Secondary School Expenses – Effective Jan. 1, 2018, what is considered a qualified withdrawal of funds from a 529 plan, for federal tax purposes, has been expanded to include up to $10,000 of tuition expenses per year per beneficiary in connection with enrollment or attendance at public, private or religious elementary or secondary schools.

Only the federal tax treatment for qualified distributions was changed by the federal tax plan. Some states may require additional legislation to recognize state benefits in accordance with federal tax plan changes. If you live or file income taxes in a state that does not recognize the expanded use of 529 plan funds for elementary and secondary school tuition expenses and will be required to adopt additional legislation regarding its 529 plan and state income tax incentives, and you withdraw funds before those states recognize the use of 529 plan funds for elementary or secondary school tuition, you may risk having to repay a state tax deduction you've already received, may face state taxes on the investment gains in the account and/or may incur additional penalties.

We recommend you consult a qualified tax advisor about your personal situation to understand the state tax consequences of taking distributions during any taxable year to pay expenses for tuition at an elementary or secondary public, private or religious school. Edward Jones, its employees and financial advisors cannot provide tax or legal advice. This content should not be

depended upon for other than broadly informational purposes. Specific questions should be referred to a qualified tax advisor.

Non-Qualified Distributions – If a distribution is taken from a 529 plan but not used for a qualified expense, the portion of the distribution representing earnings is subject to ordinary income tax and a 10% federal penalty. The distribution may also be subject to state income tax recapture, ordinary state taxes and/or state penalties. The 10% federal penalty does not apply to distributions that are:

- Paid to a beneficiary, or the estate of the beneficiary, on or after the death of the beneficiary
- Made because the beneficiary is disabled
- Included in income because the designated beneficiary received a tax-free scholarship or fellowship, veterans educational assistance or employer-provided educational assistance
- Made because of the designated beneficiary's attendance at a U.S. military academy
- Included in income only because the qualified education expenses were taken into account in determining the American Opportunity Tax Credit or Lifetime Learning Credit

Other Distribution Considerations – An educational credit (American Opportunity Tax Credit or Lifetime Learning Credit) or the tuition and fees deduction can be claimed in the same year a beneficiary takes a tax-free distribution from a 529 plan, but the credit or deduction may not be used for the same qualified higher education expenses.

Ownership and Control

The account owner has full control of the account and should name a successor-owner in the event he or she dies or becomes legally incompetent. If these events happen, a child beneficiary may not gain control or ownership until reaching the age of majority. Only the owner can:

- Change the beneficiary to another family member of the original beneficiary
- Request a distribution[3]
- Elect to change investment options[4]

Keep in mind that family members include, but are not limited to, siblings, children, nieces or nephews, parents, and first cousins. Be sure to check your plan's program description or offering statement to review a list of qualified family members. Changing the beneficiary to a family member is income tax- and penalty-free within 60 days of the distribution. Transfer taxes may apply in certain situations.

It's possible to roll the balance of one 529 plan to another; however, steps must be followed exactly to avoid potentially significant tax consequences. Specific circumstances apply if a 529 plan is funded with assets from a custodial account. Also, some plans offer rollovers at Net Asset Value (NAV). Please ask your Edward Jones financial advisor for more information.

Investment Options

Many 529 plans offer a range of professionally managed portfolio options, including the following:

- Individual portfolios invest in a single mutual fund to accommodate your beneficiary without regard to age.
- Fund-of-funds portfolios invest in multiple funds to accommodate your beneficiary without regard to age.
- Age-based portfolios are weighted and invest in several funds that automatically reallocate as your beneficiary ages.
- Some portfolios include guaranteed options or money market funds.
- Changes may be made to current investment options only twice during a calendar year for the same beneficiary.

Risks

All 529 plans are state-sponsored, but the state doesn't guarantee against investment loss. The investments within these education savings plans are subject to market risk and fluctuation. It's important to understand the market risks involved with any investment before the initial purchase. In the case of 529 plans, details about investment options, share classes, fees, expenses, risks and other important information can be found in each plan's program description or offering statement. Read it carefully before making any investment decision.

Share Classes, Fees and Expenses

529 plans will have fees and expenses, which vary and will lower the rate of return. 529 plans generally carry sales charges, either front-end or deferred, based on the share class and the amount invested. Further, 529 plans carry built-in operating expenses that affect the fund's return. Examples of operating expenses include distribution and marketing fees (12b-1 fees), management fees, networking fees, annual account maintenance fees and transaction fees. Details on the operating expenses are included in each plan's program description document.

Edward Jones receives a portion of the sales charge on 529 plans purchased through Edward Jones, and your financial advisor receives a percentage of that sales charge as compensation. Further, Edward Jones receives ongoing service fee payments, provided by the 12b-1 fees, and your financial advisor receives a portion of those ongoing service fees. There may be potential to reduce or waive the sales charge, enrollment fee or annual maintenance fees in 529 plans. Please consult the program manager or program description for this information.

Many broker-sold 529 plans offer more than one class of shares, which impose different fees and expenses. Here are some key characteristics of the most common 529 plan share classes:

Class A shares typically carry a front-end sales charge applied to the total amount being invested and can range up to 5.75%. There are discounted sales charges (breakpoints) available at different levels. Breakpoints vary by vendor but are generally reached at the $50,000, $100,000, $250,000, $500,000 and $1 million levels. Class A shares usually do not have a back-end sales charge and typically offer the lowest annual fees.

Class C shares may have front- or back-end sales charges. The sales charges (if any) for Class C shares are typically lower than those on A shares. Annual distribution fees and expenses on Class C shares, however, are usually higher than those on Class A shares, although some 529 plans offer Class C shares that automatically convert to Class A shares after a certain number of years of ownership, at which time annual fees will be reduced.

Convertible Class C shares allow for an investor to purchase with no or low upfront sales charges with higher annual expenses and after a stated holding period automatically converts this share class to a lower annual expense share class. The conversion date typically occurs at a sales charge break-even point as defined in the program description.

Convertible Class C shares are not available in all 529 education savings plans. Important information regarding Convertible Class C shares, including conversion time periods, can be found in each plan's program description or offering statement. Read it carefully before making any investment decision.

Share Class Decision – Before deciding whether to invest in a Class A share, Class C share or Convertible Class C share, you should discuss with your financial advisor the different fee and expense structures of the share classes. You should also consider the holding period (when you anticipate needing funds) and any potential discounted sales charges (breakpoints) for which you may be eligible. These factors will help you determine which available share class makes sense for your situation.

Generally, it is more economical to invest in Class A share units over nonconvertible Class C share units in situations where the time horizon is longer and/or Class A share unit breakpoints can be obtained. Also, if an investor is not certain if the invested funds will be needed prior to when convertible Class C share units are expected to convert to Class A share units, and if the conversion period occurs once a break-even point is reached, generally investing within the convertible Class C share units of the plan would be advisable.

Consider using FINRA's 529 College Savings Plan Expense Analyzer Tool to compare Class A share unit and Class C share unit hypothetical performance from an overall asset growth and total cost incurred perspective when making the share class decision.

To access the FINRA's 529 College Savings Plan Expense Analyzer Tool, visit www.finra.org. Select the Investors link. Under the Tools & Calculators tab, select 529 Expense Analyzer.

Corporate 529 Plans

Some employers may offer a corporate or employer-sponsored 529 plan with sales charge discounts. If your employer offers this benefit, you should compare any potential benefits of that program to those of other 529 plans.

Additional Information

For federal financial aid purposes, a 529 plan is considered an asset of the account owner, generally the parent.[5]

For additional information and resources, please visit www.finra.org, www.msrb.org, www.sec.gov and www.fafsa.ed.gov.

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1 Contributions may be eligible for a state income tax deduction or credit in certain states for those residents.

2 In the event of the grantor's death within the five-year period, the portion of the original gift allocated to years following the year of death will be considered part of the grantor's estate for estate tax purposes.

3 Nonqualified withdrawals are generally taxed as ordinary income to whomever the check is made payable — account owner or beneficiary — and subject to a 10% penalty on earnings.

4 New contributions are not considered changes to investment options.

5 Student and parental assets and income are considered when applying for financial aid. A 529 plan is considered an asset of the parent, which may be an advantage over saving in the student's name. Make sure you discuss potential financial aid impacts with a financial aid professional.

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