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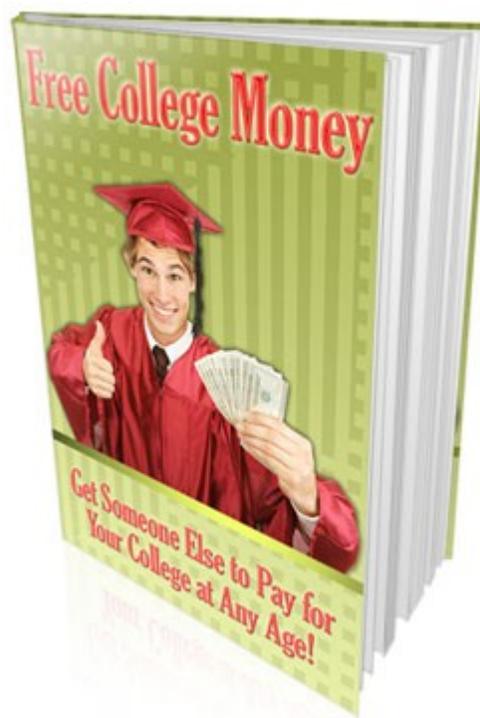
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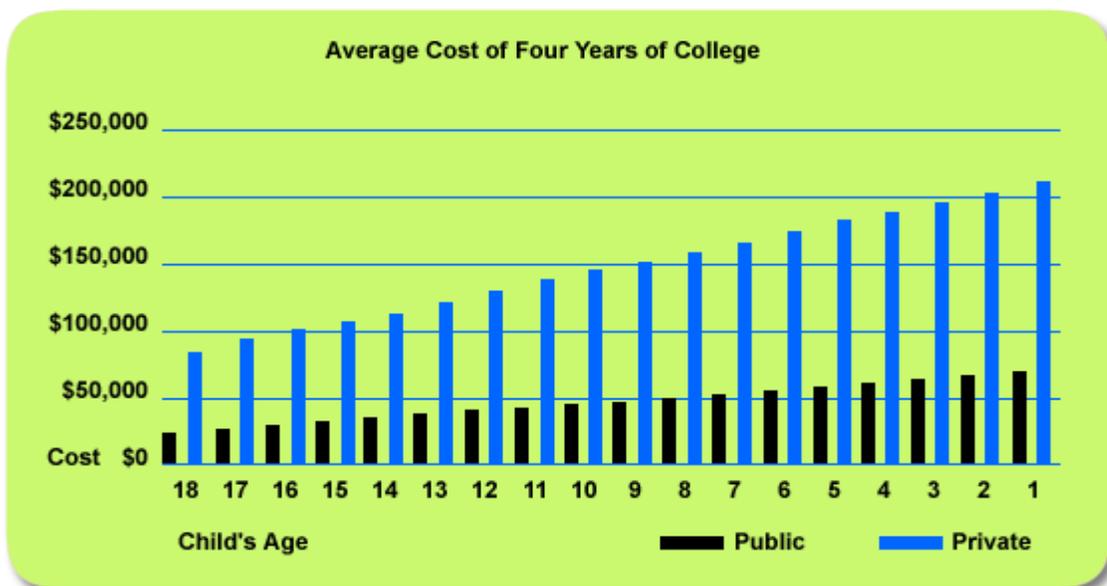
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## Chapter 1 - Introduction to 529 plans

Based upon the statistics from the United States Bureau of Labor Statistics, it shows that employers show favor to applicants with a college degree over another candidate with only a high school diploma. College graduates may even receive a higher salary than those with job related experience, but who have never been to college. This can prove to be discouraging for some and stressful for others. Unfortunately, knowing that college is one path to success is not productive unless one can actually attend and graduate from one.

*Below is a graph showing the increase of college costs over a four year span.<sup>1</sup>*



<sup>1</sup>Source: *Trends in College Pricing 2005*, The College Board®. Assumes a 5% increase in college costs each year and a child entering college at age 18.

The continuing increase in price for college tuition and related educational expenses may cause alarm for some who have not taken the time to financially prepare to send a loved one off to school. Years of strict budgeting and knowledge of savings plans are usually needed in times like this, but sometimes the decision to go to school is not made in enough time to take the proper course of action. Section 529 plans were devised in 1996 to offer families a tax-advantaged medium for college expenses. Using this plan can help aid in a successful journey to college for the beneficiary, but there is key information to take into consideration when making a decision to invest in a Section 529 plan.

Stocks and investment bonds have already been chosen by Section 529 plan sponsors to give contributors an option where to invest their money. Section 529 plans will mandate that you divide your investment contribution geared towards an asset allocation based upon the age of the beneficiary. Basically, the plan will advise for your investment choice to be more aggressive for younger beneficiaries and less aggressive for students nearing entrance into college.

Sponsored by educational facilities, states, and state agencies, there are two plan types available for section 529. They are pre-paid tuition plans and college savings plans. The United States and the District of

Columbia supports the minimum of either one of these plans. Also, there are a number of private universities that sponsor a pre-paid tuition plan as well.

There are also several marketing techniques that were developed for the Section 529 plan where an employer can offer a Section 529 Section plan as a payroll deduction or other options to their employees. They also can offer an affinity rebate program that funds college savings plan accounts from funds rebated by participating merchants from where the investor purchases goods or services.

## **Pre-paid tuition plans**

Generally, pre-paid tuition plans are supported by state agencies and have a residency requirement for the participant and offer a plan guarantee backed by the state. This type of plan allows a person to buy tuition credits, at the current rate, for future use and some can include housing expenses. Eligible public and private universities and colleges will lock in their price to avoid tuition inflation. Some policies are applicable for a two or four year tour of college. It can include a combination of a two year community college and then transferring to a four year university. A few plans can go towards graduate school.

They have an age and a grade limit for the participant and carry limited enrollment periods. Some of these plans also have pre-determined lump sum goals before purchase based upon age of the beneficiary and the amount of time the student plans to attend college. Additional expenses such as housing are not covered, so another savings plan might have to be considered to cover this cost.

The general idea of a pre-paid tuition plan is to hone in on a tuition rate based upon the current rate. This is supposed to create a way to save money in a frugal way. Payments are made in installments over a number of years. There are things to consider such as the added restrictions when choosing a college and strict terms and conditions

to follow for withdrawals. A list of schools is given so that a student will know his or her college choices.

If the beneficiary of the pre-paid tuition plan decides they want to choose another school that is not on the pre-approved list, it can be transferred to another school, but it may reduce the value of the policy. For example, if you have a policy that locked on to a community college's tuition rate, then those rates might be lower compared to another school whose tuition might be higher. Therefore, you still may have to pay out of pocket to make up the difference in tuition rates.

It is possible to transfer a policy to another sibling, if the beneficiary decides to forego college altogether, but age restrictions can complicate matters if there is an older sibling involved. If there is no one to give the pre-paid plan too, the investor can get his or her money back, but only what they contributed and there might be a cancellation fee involved.

Most of the states guarantee funds contributed to the pre-paid tuition plan with the assurance that if the Section 529 plan should find itself in financial distress, the states will give the program what is needed to help them out of distress. Some states will help out financially while others have no formal guarantee, but will make decisions as deemed appropriate to the state's legislature to keep the Section 529

plans flourishing. A select few offer no guarantee whatsoever and will do nothing to intervene if the plan starts to fail financially.

Pre-paid tuition plans have residency requirements and mandates that either the purchaser or the beneficiary reside in the state offering the tuition savings plan. They do not offer year round enrollment, so it is necessary to be aware of application deadlines.

There are no investment options available for pre-paid tuition plans. The price of the policy is calculated before the purchase and depends on the following factors: type of contract, the current age of the beneficiary, current tuition rates, and projected future rates. This money is pooled together and is used for long term investments so the return on investments will meet or exceed the cost for tuition as it increases over time.

## **College savings plans**

Savings plans that are offered differ from pre-paid tuition plans in various ways. They do not guarantee a lock on tuition prices but contributing to a savings plan covers housing, tuition, mandatory fees, and miscellaneous items such as books. They have contribution limits in excess of \$200,000.

They have no state guarantee and most investment choices are prone to market risk. This option may not be profitable and can also decline in value. The plan offers neither age restrictions nor residency requirements for the contributor or the beneficiary of the plan. Out of state residents would possibly have to purchase a college savings plan through a broker or financial adviser, but the plan offers year round enrollment.

Unlike the pre-paid tuition plan, a student is not confined to a list of schools they can attend. Contribution limits vary depending on the state, but there are no household income limits or annual contribution limit. Large annual contributions of \$12,000 or more may require a special tax form to be completed called a federal gift tax form. There are state tax deductions a contributor may be eligible for if they are a resident. Earnings are tax deferred in the Section 529 plans.