

# Qualified Tuition Plans—Prepaid

(Prepaid Tuition Plans, Prepaid  
State Tuition Plans, 529 Plans)

There are two types of Qualified Tuition Plans: Qualified Prepaid Plans and Qualified Savings Plans. Both types of Qualified Tuition Plans come under the same section in the IRS Tax Code and are also known as 529 Plans. Prepaid Tuition Plans allow you to purchase tuition credits or tuition certificates on behalf of a child. When the child is ready for college, you are guaranteed that the tuition, or a percentage of the tuition, depending upon your original purchase agreement, will be covered. The proceeds in the form of tuition credits or certificates are tax free. Prepaid plans are offered by many states and are designed to prepay the cost of tuition at public colleges and universities within the state. Some private colleges have their own Prepaid Tuition Plans. In 2003, a consortium of more than 220 private colleges created the Independent 529 Plan, a prepaid tuition savings plan that can be used at any of the participating colleges. For more information, see [www.finaid.org/savings/529plans.phtml](http://www.finaid.org/savings/529plans.phtml) and [www.independent529plan.org](http://www.independent529plan.org).

- Savings grow tax free. Distributions made from Prepaid Tuition Plans are exempt from federal income tax, as long as they are used to pay qualified education expenses. Congress made the provision for tax-free distributions permanent. The tax-free feature was due to expire at the end of 2010.
- Some states allow deductions for amounts contributed to the fund.
- Qualified education expenses include tuition and fees, books and equipment, and room and board for students attending at least half-time.
- If you withdraw your money for nonqualified expenses, you may forfeit earnings.
- You may transfer the credits or certificates to another family member if the beneficiary does not use the benefit.

## Coordination with Other Education Tax Incentives

- You can contribute to a Qualified Prepaid Plan and a Coverdell Education Savings Account for the same beneficiary during the same year.
- To claim a tax-free distribution from a Prepaid Plan, qualified education expenses must be reduced by scholarships, amounts used to claim education credits, the excludable amount of a Coverdell Education Savings Account, and the excludable amount for savings bonds.
- An individual cannot use the Prepaid Plan for the same expenses used to claim a Hope or Lifetime Learning Credit in a given year.
- You can redeem Series EE and Series I Bonds tax-free and roll them into 529 Plans if you meet all of the requirements for tax-free redemption.

## Advantages

- Future tuition costs are locked in at current rates. You are guaranteed that your contributions will keep pace with inflation in college costs with no investment risk.
- Earnings and payout are tax free.
- The Independent 529 Plan offers an annual discount of at least half of a percentage point off tuition.

**Disadvantages**

- Not as flexible as Qualified Savings Plans, which allow you to apply your savings to any college.
- If you withdraw your money, you may forfeit all of your earnings.
- Some plans are designed to cover tuition only.

**Needs Analysis Implications**

- FM: Distributions are treated as an outside resource, reducing aid eligibility dollar for dollar. The accumulated amount does not count in FM.
- IM: Asset is treated as any other parental asset.

**Best Use for College Savings**

Good plan for those who decide early on to attend a public institution and want to lock in current tuition rates. Parents who are not confident investors can be guaranteed that tuition will be covered.