

**SB**

**186**

# FISCAL NOTE

**STATE OF ALASKA  
2000 LEGISLATIVE SESSION**

**BILL NO. SSSB 186**

Revision Date/Time (Note if correction) _____	Dept. Affected _____	Revenue _____
Title <u>College Tuition Savings Plan</u>	BRU	<u>Revenue Operations</u>
	Component _____	<u>Treasury Management</u>
Sponsor <u>Senator Tim Kelly</u>		
Requester <u>Senate Health, Education and Social Services</u>	Component No. _____	

**Expenditures/Revenues (Thousands of Dollars)**

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services	61.6	63.2	64.8	66.4	68.0	69.6
Travel						
Contractual	32.1	32.2	32.2	32.2	32.4	32.4
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>93.7</b>	<b>95.4</b>	<b>97.0</b>	<b>98.6</b>	<b>100.4</b>	<b>102.0</b>

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ( )						
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**FUND SOURCE (Thousands of Dollars)**

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Interagency Receipts)	93.7	95.4	97.0	98.6	100.4	102.0
<b>TOTAL</b>	<b>93.7</b>	<b>95.4</b>	<b>97.0</b>	<b>98.6</b>	<b>100.4</b>	<b>102.0</b>

Estimate of any current year (FY2000) cost: 0.0

**POSITIONS**

Full-time	1.0	1.0	1.0	1.0	1.0	1.0
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

- \* Includes only asset custody and accounting costs under SSSB 186 (1-LS1084H) Sec. 14.40.802 (4) (B).
- \* Estimates based on an initial balance of \$10 million with net contributions averaging \$1.5 million/year.
- \* Asset allocation will be well-diversified to meet Trust objectives; uses six custodial (bank) accounts.
- \* One new Accountant III will be needed for accounting / reporting (Range 18).
- \* Includes annual independent audit costs.
- \* Revenue source is plan participants (via I/A receipts) per Sec. 14.40.802 (5).
- \* No immediate anticipated impact on local government or state's economy.
- \* Computations available from the Department of Revenue.

DOES  
THIS GO  
AWAY WITH  
YES

Prepared by: T. Davenport, Asst. Comptroller  
 Division: Treasury Division  
 Approved by: Commissioner Wilson Condon  
 Agency: Revenue

Phone: 465-3751  
 Date/Time: 1/21/00 4:35 PM  
 Date: 01/21/2000

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# FISCAL NOTE

**STATE OF ALASKA  
2000 LEGISLATIVE SESSION**

**BILL NO. SSSB 186**

Revision Date/Time (Note if correction) _____	Dept. Affected _____	Revenue _____
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	Component _____	<u>Treasury Management</u>
Sponsor <u>Senator Tim Kelly</u>		
Requester <u>Senate Health, Education and Social Services</u>	Component No. _____	

**Expenditures/Revenues (Thousands of Dollars)**

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services	61.6	63.2	64.8	66.4	68.0	69.6
Travel						
Contractual	32.1	32.2	32.2	32.2	32.4	32.4
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>93.7</b>	<b>95.4</b>	<b>97.0</b>	<b>98.6</b>	<b>100.4</b>	<b>102.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE (Thousands of Dollars)**

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Interagency Receipts)	93.7	95.4	97.0	98.6	100.4	102.0
<b>TOTAL</b>	<b>93.7</b>	<b>95.4</b>	<b>97.0</b>	<b>98.6</b>	<b>100.4</b>	<b>102.0</b>

Estimate of any current year (FY2000) cost: 0.0

**POSITIONS**

Full-time	1.0	1.0	1.0	1.0	1.0	1.0
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

- \* Includes only asset custody and accounting costs under SSSB 186 (1-LS1084H) Sec. 14.40.802 (4) (B).
- \* Estimates based on an initial balance of \$10 million with net contributions averaging \$1.5 million/year.
- \* Asset allocation will be well-diversified to meet Trust objectives; uses six custodial (bank) accounts.
- \* One new Accountant III will be needed for accounting / reporting (Range 18).
- \* Includes annual independent audit costs.
- \* Revenue source is plan participants (via I/A receipts) per Sec. 14.40.802 (5).
- \* No immediate anticipated impact on local government or state's economy.
- \* Computations available from the Department of Revenue.

Prepared by: T. Davenport, Asst. Comptroller  
 Division: Treasury Division  
 Approved by: Commissioner Wilson Condon  
 Agency: Revenue

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 Date: 01/21/2000

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# FISCAL NOTE

STATE OF ALASKA

BILL NO. SB 186

**2000 LEGISLATIVE SESSION**

Revision Date (Note if correction) _____	Dept. Affected _____	University of Alaska _____
Title <u>An Act relating to the Alaska Higher Education</u>	BRU _____	Statewide _____
Savings Trust and the Alaska Advance College Tuition Savings Fund	Component _____	_____
Sponsor <u>Senator Tim Kelly</u>	_____	_____
Requester _____	Component Serial No. _____	_____

**Expenditures/Revenues**

OPERATING EXPENDITURES	FY 01	FY 02	FY 03	FY 04	FY 05
Personal Services	50.0	50.0	50.0	50.0	50.0
Travel	10.0	5.0	5.0	5.0	5.0
Contractual	90.0	20.0	20.0	20.0	20.0
Supplies	30.0	25.0	25.0	25.0	25.0
Equipment	20.0				
Land & Structures					
Grants & Claims					
Miscellaneous					
<b>TOTAL OPERATING</b>	<b>200.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<b>CAPITAL EXPENDITURES</b>					
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<b>CHANGE IN REVENUES ( ) ( )</b>	<b>60.0</b>	<b>70.0</b>	<b>80.0</b>	<b>90.0</b>	<b>100.0</b>
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**FUND SOURCE**

1002 Federal Receipts					
1003 GF Match					
1004 GF					
1005 GF/Program Receipts					
1037 GF/Mental Health					
1048 University Receipts	200.0	100.0	100.0	100.0	100.0
<b>TOTAL</b>	<b>200.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Estimate of any current year (FY00) cost:

none

**POSITIONS**

Full-time	1	1	1	1	1
Part-time					
Temporary					

**ANALYSIS:** *(Attach a separate page if necessary)*

At this time there are many uncertainties about how the program can be best implemented. However, many of these cost will otherwise have to be incurred by the Advance College Tuition Program without regard to creation of the Alaska Higher Education Trust in order to meet participants needs for higher earning options. The Advance College Tuition program continues to have an important role in financing education, but changes in the federal tax and other laws currently favor more aggressive savings programs.

Prepared by	<u>Jim Lynch, Interim Vice President for Finance</u>	Phone _____
Division	<u>Statewide Finance</u>	Date <u>1/20/00</u>
Approved by Commission	<u>Jim Lynch, Interim Vice President for Finance</u>	Date _____
Agency	<u>Statewide Finance</u>	

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# SENATE COMMITTEE REPORT

## First Committee of Referral

DATE: 1/10/00

FURTHER: Finance

Date of 5-Day Notice: 1/19/2000  
(in accordance with Uniform Rule 23)

DATE TURNED  
IN TO OFFICE: 1-24-00

HESS Committee considered      SPONSOR SUBSTITUTE FOR SENATE BILL NO. 186

"An Act relating to the Alaska Higher Education Savings Trust; and providing for an effective date."

and recommends:

- be replaced with CS SSSB 186 ( HES )
- adopt previous CS (          )
- attached amendment(s)
- adopt Letter of Intent by                                  Committee
- further referral to the                                  Committee

- Senate Bill:
- same title
  - new title
- House Bill:
- same title
  - technical title
  - new: SCR#

SIGNING <u>DO</u> PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>	✓	<i>[Signature]</i>	✓		
		<i>[Signature]</i>	✓		
CHAIR: <i>[Signature]</i>	✓	CHAIR: <u>                                </u>			

**NEW FISCAL NOTE(S):**

Department	Date	Zero	Fiscal
DOR	1/21/00		93.7
UofA	1/29/00		200.0

Orig #1  
#2 to CS

**PREVIOUS FISCAL NOTE(S):\***

Department	Date	Zero	Fiscal

APPROPRIATION -- no fiscal note

\*include fiscal notes accompanying Governor's bill

# FISCAL NOTE

STATE OF ALASKA  
2000 LEGISLATIVE SESSION

BILL NO. SB 186

Revision Date (Note if correction) _____	Dept. Affected <u>University of Alaska</u>	
Title <u>An Act relating to the Alaska Higher Education</u>	BRU <u>Statewide</u>	
Savings Trust and the Alaska Advance College Tuition Savings Fund	Component _____	
Sponsor <u>Senator Tim Kelly</u>		
Requester _____	Component Serial No. _____	

**Expenditures/Revenues**

OPERATING EXPENDITURES	FY 01	FY 02	FY 03	FY 04	FY 05
Personal Services	50.0	50.0	50.0	50.0	50.0
Travel	10.0	5.0	5.0	5.0	5.0
Contractual	90.0	20.0	20.0	20.0	20.0
Supplies	30.0	25.0	25.0	25.0	25.0
Equipment	20.0				
Land & Structures					
Grants & Claims					
Miscellaneous					
<b>TOTAL OPERATING</b>	<b>200.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<b>CAPITAL EXPENDITURES</b>					
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<b>CHANGE IN REVENUES ( )</b>	( )	60.0	70.0	80.0	90.0	100.0
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**FUND SOURCE**

1002 Federal Receipts					
1003 GF Match					
1004 GF					
1005 GF/Program Receipts					
1037 GF/Mental Health					
1048 University Receipts	200.0	100.0	100.0	100.0	100.0
<b>TOTAL</b>	<b>200.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Estimate of any current year (FY00) cost: \_\_\_\_\_

none

**POSITIONS**

Full-time	1	1	1	1	1
Part-time					
Temporary					

**ANALYSIS:** *(Attach a separate page if necessary)*

At this time there are many uncertainties about how the program can be best implemented. However, many of these cost will otherwise have to be incurred by the Advance College Tuition Program without regard to creation of the Alaska Higher Education Trust in order to meet participants needs for higher earning options. The Advance College Tuition program continues to have an important role in financing education, but changes in the federal tax and other laws currently favor more aggressive savings programs.

Prepared by	<u>Jim Lynch, Interim Vice President for Finance</u>	Phone _____
Division	<u>Statewide Finance</u>	Date <u>11/20/00</u>
Approved by Commission	<u>Jim Lynch, Interim Vice President for Finance</u>	Date _____
Agency	<u>Statewide Finance</u>	

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1-LS1084M

Ford

1/22/00

## CS FOR SPONSOR SUBSTITUTE FOR SENATE BILL NO. 186( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIRST LEGISLATURE - SECOND SESSION

BY

Offered:  
Referred:

Sponsor(s): SENATOR TIM KELLY

## A BILL

## FOR AN ACT ENTITLED

1 "An Act relating to a University of Alaska postsecondary education savings  
2 program, to the Alaska Higher Education Savings Trust, and to the Alaska  
3 advance college tuition savings fund; and providing for an effective date."

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

5 \* Section 1. AS 09.25.120(a)(7) is amended to read:

6 (7) names, addresses, and other information identifying a person as a  
7 participant in the Alaska Higher Education Savings Trust under AS 14.40.802 or  
8 the advance college tuition savings [PAYMENT] program under AS 14.40.803 -  
9 14.40.817;

10 \* Sec. 2. AS 09.38.015(a)(9) is amended to read:

11 (9) tuition credit or savings accounts [CREDITS] under a higher  
12 education savings account established under AS 14.40.802 or an advance college  
13 tuition savings [PAYMENT] contract authorized under AS 14.40.809(a);

14 \* Sec. 3. AS 14.40.170(a) is amended by adding a new paragraph to read:

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(10) administer, manage, market, and promote a postsecondary education savings program; the program must include the Alaska Higher Education Savings Trust under AS 14.40.802 and the Alaska advance college tuition savings fund under AS 14.40.803 - 14.40.817.

\* Sec. 4. AS 14.40 is amended by adding a new section to article 6 to read:

**Sec. 14.40.802. Alaska Higher Education Savings Trust.** (a) The Alaska Higher Education Savings Trust is established in the University of Alaska. The purpose of this trust is to secure obligations to participants and beneficiaries under a postsecondary education savings program operated by the University of Alaska and to provide participants a convenient method of saving for college or other postsecondary education. The Board of Regents of the University of Alaska shall

(1) adopt policies that provide for the administration, management, promotion, and marketing of the trust;

(2) maintain the trust in compliance with requirements of 26 U.S.C. (Internal Revenue Code) for a qualified state tuition program as defined in 26 U.S.C. 529;

(3) coordinate savings options established under the trust and the administration of the trust with the Alaska advance college tuition savings fund (AS 14.40.803), including the creation of common administrative and record-keeping systems, marketing programs, and operating reserves;

(4) establish participation agreements, including application, savings options, and withdrawal procedures;

(5) enter into participation agreements with participants for the  
(A) accumulation, investment, and distribution of funds;  
(B) payment or reimbursement of qualified higher education expenses; and

(C) benefit of a beneficiary;

(6) enter into contracts with one or more contractors, including investment managers; in determining the persons to act as investment managers, consideration must be given to the qualifications of the contractor, including the contractor's ability to

- 1 (A) administer financial programs with individual account  
2 maintenance and reporting;
- 3 (B) develop, market, and administer investment options  
4 appropriate for the trust; and
- 5 (C) augment the savings program with other beneficial products  
6 and services;
- 7 (7) allow both residents and nonresidents to participate in the trust;
- 8 (8) allow the transfer or rollover of funds from the Alaska advance  
9 college tuition savings fund and other qualified state tuition programs under 26 U.S.C.  
10 529 and the participation agreement;
- 11 (9) allow withdrawals from the trust to be used for qualified higher  
12 education expenses, including room and board as allowed by 26 U.S.C. 529;
- 13 (10) establish penalties for withdrawals from the trust for nonqualified  
14 expenses and other distributions as required under 26 U.S.C. 529 or as provided in the  
15 participation agreement;
- 16 (11) engage an independent firm of certified public accountants to audit  
17 the financial position of the trust.
- 18 (b) The board may
- 19 (1) divide the trust into multiple investment portfolios;
- 20 (2) commingle amounts credited to some or all accounts for investment  
21 purposes;
- 22 (3) establish trusts and accounts as the board considers appropriate  
23 under 26 U.S.C. 529;
- 24 (4) require trust participants to pay administrative fees;
- 25 (5) establish earnings reserves as provided in the participation  
26 agreement, including reserves for the payment of administrative costs.
- 27 (c) The University of Alaska, the board, the state, or an agency of the state is  
28 not liable for a loss of funds that are invested under a participation agreement or for  
29 the denial of a perceived tax or other benefit. The board shall provide written notice  
30 to each applicant that there is no guarantee of any rate of return or benefit and that any  
31 risk of loss in account value or other benefit rests exclusively with the participant and

1 the beneficiary.

2 (d) Notwithstanding any other provision of law, earnings on funds deposited  
3 with the trust are not subject to taxation by the state or a municipality.

4 (e) Funds on deposit with the trust may not be considered by the University  
5 of Alaska or an agency of the state to limit eligibility for a state-funded scholarship.

6 (f) A participant has the right, as provided in the participation agreement, to

7 (1) change the beneficiary of an account to another individual who is  
8 a member of the family of the former beneficiary; or

9 (2) direct that all or a portion of an account be transferred to an  
10 account with a new beneficiary if the new beneficiary is a member of the family of  
11 the former beneficiary.

12 (g) The right to change the beneficiary or to transfer between accounts  
13 described in (f) of this section may be denied or limited as provided in the  
14 participation agreement, including transfers that would result in contributions or  
15 account balances in excess of allowable limits under the participation agreement.

16 (h) An account established under this section

17 (1) is exempt from a claim by the creditors of a participant or of a  
18 beneficiary;

19 (2) is conclusively presumed to be a spendthrift trust;

20 (3) is not an asset or property of either the participant or the  
21 beneficiary;

22 (4) may not be assigned, pledged, or otherwise used to secure a loan  
23 or other advancement;

24 (5) is not subject to involuntary transfer or alienation.

25 (i) Except as permitted in 26 U.S.C. 529, a participant or beneficiary may not  
26 directly or indirectly direct the investment of an account or earnings on the account.

27 (j) A participant may, as provided in the participation agreement, designate a  
28 person other than the participant as a successor participant. The designation of a  
29 successor participant does not take effect until the participant dies or is declared legally  
30 incompetent. If a participant dies or is declared legally incompetent without having  
31 effectively designated a successor participant, the beneficiary may designate a

1 successor participant in the manner prescribed above if the beneficiary is not the same  
2 person as the successor participant.

3 (k) The trust, a participation agreement, and this section are intended to  
4 comply with the requirements of 26 U.S.C. 529 and shall be interpreted in that manner  
5 to the extent permitted by law.

6 (l) The trust and participation agreements may be modified or amended on a  
7 retroactive basis in order to maintain compliance with 26 U.S.C. (Internal Revenue  
8 Code) and to maintain efficient operation of the trust as determined by the board.

9 (m) A name, address, or other information identifying a person as a participant  
10 or beneficiary in the trust is confidential.

11 (n) In this section,

12 (1) "account" means an individual trust account established under this  
13 section;

14 (2) "beneficiary" means any person designated by a participation  
15 agreement, or by another method of designation authorized in this section, to benefit  
16 from payments for qualified higher education expenses at an eligible educational  
17 institution;

18 (3) "board" means the Board of Regents of the University of Alaska;

19 (4) "member of the family" has the meaning given in 26 U.S.C. 529(e);

20 (5) "participant" means a person who has entered into a participation  
21 agreement or has been appointed as a participant as provided in this section and in the  
22 participation agreement;

23 (6) "participation agreement" means an agreement between a participant  
24 and the board providing for the establishment by the participant of one or more  
25 accounts under this section and for the administration of those accounts for the benefit  
26 of the participant and the beneficiary;

27 (7) "qualified higher education expenses" has the meaning given in  
28 26 U.S.C. 529(e);

29 (8) "trust" means the Alaska Higher Education Savings Trust.

30 \* Sec. 5. AS 14.40.803 is amended to read:

31 **Sec. 14.40.803. Alaska advance college tuition savings [PAYMENT] fund**

1 [ESTABLISHED]. (a) The Alaska advance college tuition savings [PAYMENT]  
2 fund is established as a nonlapsing fund of the University of Alaska. The [FUND IS  
3 ESTABLISHED FOR THE] purpose of the fund is to secure obligations to  
4 participants under a postsecondary education savings program operated by the  
5 University of Alaska and to enhance [ENHANCING] the ability of the university to  
6 provide (1) higher education for the people of the state; (2) wide and affordable access  
7 to higher education for residents and their children; (3) an incentive for residents to  
8 achieve higher academic standards in grades 7 - 12; and (4) an incentive for residents  
9 to continue and complete secondary and postsecondary education. The fund may be  
10 divided into separate accounts for accounting purposes.

11 (b) The fund consists of

12 (1) permanent fund dividend and cash contributions made under  
13 AS 14.40.807 under the terms of an advance college tuition savings [PAYMENT]  
14 contract;

15 (2) appropriations, gifts, bequests, and contributions; and

16 (3) income and earnings of the fund.

17 (c) Assets of the fund shall be expended to make payments to the university  
18 and other eligible educational institutions, including payments for refunds, redemptions,  
19 and awards under a savings [AN ADVANCE TUITION PAYMENT] contract or  
20 scholarships, [A PREPAID TUITION SCHOLARSHIP, AND] costs of administration,  
21 and other obligations of the fund.

22 \* Sec. 6. AS 14.40.807(a) is amended to read:

23 (a) Contributions to the fund under the terms of an advance college tuition  
24 savings [PAYMENT] contract may be made by direct cash payments or by  
25 contributions from the permanent fund dividend. The Department of Revenue shall

26 (1) prepare the permanent fund dividend application to allow an  
27 applicant or a parent, legal guardian, or other authorized representative of an applicant  
28 who is an unemancipated minor to contribute 50 percent of a dividend to the fund  
29 [UNDER THE TERMS OF AN ADVANCE TUITION PAYMENT CONTRACT]; and

30 (2) include with each application for a permanent fund dividend an  
31 explanation of the advance college [ADVANCED] tuition savings [PAYMENT]

1 program, including the right to receive a refund, a disclosure of the potential tax  
2 liability of the fund, and disclosure of the possible general effect of the tax liability on  
3 the advance college tuition savings [PAYMENT] program.

4 \* Sec. 7. AS 14.40.809 is amended to read:

5 **Sec. 14.40.809. Powers and duties of the University of Alaska.** (a) The  
6 Board of Regents of the University of Alaska may contract with a purchaser for the  
7 purchase of advance college tuition credits for the payment of tuition and other  
8 qualified higher education expenses [BY THE PURCHASER] for a beneficiary of any  
9 age to attend a branch of the university or other eligible educational institution to  
10 which the beneficiary is admitted. A purchaser and a beneficiary may be the same  
11 person.

12 (b) The board shall

13 (1) make appropriate arrangements as necessary to fulfill the board's  
14 obligations under an advance college tuition savings [PAYMENT] contract;

15 (2) establish and adopt a formal plan for administration of the advance  
16 college tuition savings [PAYMENT PROGRAM AND PREPAID TUITION  
17 SCHOLARSHIP] program; the terms and conditions of the plan shall be considered  
18 a part of an advance college tuition savings [PAYMENT] contract;

19 (3) establish investment objectives, criteria, and asset allocation  
20 guidelines for the fund based on prudent institutional investor guidelines and actuarial  
21 analysis of the earnings requirements for the advance college tuition savings  
22 [PAYMENT] plan; and

23 (4) enter into contracts or agreements considered necessary for the  
24 investment of the fund, including contracts or agreements with investment  
25 managers, consultants, and other custodians of the fund;

26 (5) engage a financial advisor to annually report on the investment  
27 performance of the fund;

28 (6) engage an independent firm of certified public accountants to  
29 audit the financial position of the fund;

30 (7) do all acts, whether or not expressly authorized, that the board  
31 considers necessary or proper in administering the assets of the fund;

1           (8) enter into reciprocal agreements with Sheldon Jackson College,  
2           Alaska Pacific University, and other eligible educational institutions or state tuition  
3           programs that the board determines to be beneficial to the advance college tuition  
4           savings [PAYMENT] program;

5           (9) coordinate savings options established under the Alaska advance  
6           college tuition savings program and the administration of the fund with the  
7           Alaska Higher Education Savings Trust (AS 14.40.802) including the creation of  
8           common administrative and record-keeping systems, marketing programs, and  
9           operating reserves.

10       \* Sec. 8. AS 14.40.811 is amended to read:

11           Sec. 14.40.811. Advance college tuition savings [PAYMENT] contracts. (a)

12           An advance college tuition savings [PAYMENT] contract must set out or include by  
13           reference to the plan

14                   (1) the name and date of birth of the purchaser and the beneficiary  
15                   under the contract;

16                   (2) the number of advance college [PREPAID] tuition credits  
17                   purchased under the contract;

18                   (3) the terms and conditions under which the contract may be  
19                   terminated and refunds made;

20                   (4) the assumption of a contractual obligation by the board to provide  
21                   funding for specified education benefits for [TO] the beneficiary in accordance with  
22                   the terms of the plan;

23                   (5) the period of time during which the beneficiary may receive the  
24                   benefits of the contract; and

25                   (6) other terms and conditions the board determines to be appropriate  
26                   or that are required under 26 U.S.C. [BY THE UNITED STATES] (Internal Revenue  
27                   Code).

28           (b) An advance college tuition savings [PAYMENT] contract may be  
29           terminated

30                   (1) if the board determines that the number of purchasers is insufficient  
31                   to maintain the fund on an actuarially sound basis; or

1 (2) under other circumstances determined by the board and set out in  
2 the advance tuition savings [PAYMENT] contract or in the plan.

3 \* Sec. 9. AS 14.40.817(1) is amended to read:

4 (1) "advance college tuition savings [PAYMENT] contract" or  
5 "contract" means a contract entered into by the board and a purchaser to provide for  
6 the qualified higher education expenses of a beneficiary;

7 \* Sec. 10. AS 14.40.817(5) is amended to read:

8 (5) "fund" means the Alaska advance college tuition savings  
9 [PAYMENT] fund established under AS 14.40.803;

10 \* Sec. 11. AS 14.40.817(6) is amended to read:

11 (6) "plan" means the formal plan for administration of an advance  
12 college tuition savings [PAYMENT] program [AND PREPAID TUITION  
13 SCHOLARSHIP PROGRAM] adopted by the board under AS 14.40.809(b);

14 \* Sec. 12. AS 14.40.817(7) is amended to read:

15 (7) "purchaser" means the person who is named in the contract and has the  
16 rights conferred upon a purchaser under an advance college tuition savings  
17 [PAYMENT] contract;

18 \* Sec. 13. AS 45.55.990(32) is amended to read:

19 (32) "security" means a note; stock; treasury stock; bond; debenture;  
20 evidence of indebtedness; certificate of interest or participation in any profit-sharing  
21 agreement; limited liability company interest under AS 10.50, notwithstanding the  
22 limitations of AS 45.08.103(c); collateral-trust certificate; preorganization certificate  
23 or subscription; transferable share; investment contract; voting-trust certificate;  
24 certificate of deposit for a security; certificate of interest or participation in an oil, gas,  
25 or mining title or lease or in payments out of production under the title or lease or in  
26 any sale of or indenture or bond or contract for the conveyance of land or any interest  
27 in land; an option on a contract for the future delivery of agricultural or mineral  
28 commodities or any other commodity offered or sold to the public and not regulated  
29 by the Commodity Futures Trading Commission; however, the contract or option is not  
30 subject to the provisions of AS 45.55.070 if it is sold or purchased on the floor of a  
31 bona fide exchange or board of trade and offered or sold to the public by a broker-

1 dealer or agent registered under this chapter; investment of money or money's worth  
2 including goods furnished or services performed in the risk capital of a venture with  
3 the expectation of some benefit to the investor where the investor has no direct control  
4 over the investment or policy decision of the venture; or, in general, any interest or  
5 instrument commonly known as a "security," or any certificate of interest or  
6 participation in, temporary or interim certificate for, receipt for, guarantee of, or  
7 warrant or right to subscribe to or purchase, any of the foregoing; "security" does not  
8 include a participation agreement entered into under AS 14.40.802 or an insurance  
9 or endowment policy or annuity contract under which an insurance company promises  
10 to pay a fixed or variable sum of money either in a lump sum or periodically for life  
11 or for some other specified period;

12 \* Sec. 14. AS 14.40.805 is repealed.

13 \* Sec. 15. This Act takes effect immediately under AS 01.10.070(c).

SPONSOR SUBSTITUTE FOR SENATE BILL NO. 186  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
TWENTY-FIRST LEGISLATURE - SECOND SESSION

BY SENATOR TIM KELLY

Introduced: 1/10/00  
Referred: HES, Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the Alaska Higher Education Savings Trust; and providing  
2 for an effective date."

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 \* Section 1. AS 14.4C is amended by adding a new section to read:

5 Article 5A. Alaska Higher Education Savings Trust.

6 Sec. 14.40.802. Alaska Higher Education Savings Trust. (a) The Alaska  
7 Higher Education Savings Trust is established in the University of Alaska. The Board  
8 of Regents of the University of Alaska shali

9 (1) administer, manage, promote, and market the trust;

10 (2) maintain the trust in compliance with United States Internal  
11 Revenue Service standards for a qualified state tuition program as the term is defined  
12 in 26 U.S.C. 529(b);

13 (3) establish application and withdrawal procedures and a participation  
14 agreement for trust participants;

1 (4) issue requests for proposals for multiple contractors to act as  
2 investment managers; in determining the best qualified persons to act as investment  
3 managers, the board shall consider the ability to

4 (A) administer financial programs with individual account  
5 maintenance and reporting;

6 (B) develop and administer an investment program with similar  
7 objectives to those of the trust; and

8 (C) augment the trust with other programs or services  
9 considered beneficial by the board;

10 (5) require trust participants to pay appropriate fees;

11 (6) operate the trust on a cash only basis, including provisions for  
12 automatic deductions;

13 (7) allow both residents and nonresidents to participate in the trust;

14 (8) allow funds deposited with the trust to be used for any qualified  
15 higher education expenses;

16 (9) establish a penalty on nonqualified withdrawals from the trust; the  
17 penalty established must satisfy the minimum penalty requirements of the United States  
18 Internal Revenue Service for nonqualified withdrawals from a qualified state tuition  
19 program.

20 (b) The board may

21 (1) divide the trust into multiple investment portfolios;

22 (2) commingle amounts credited to some or all accounts for investment  
23 purposes.

24 (c) The University of Alaska, the state, or an agency of the state is not liable  
25 for a loss of funds that are invested under a participation agreement. The board shall  
26 provide written notice to each applicant that the trust does not guarantee any rate of  
27 return and that any risk of loss in fund value rests with the participants.

28 (d) Notwithstanding any other provision of law, earnings on funds deposited  
29 with the trust are not subject to taxation by the state or a municipality.

30 (e) Funds deposited with the trust or earnings of the trust may not be  
31 considered by the University of Alaska or an agency of the state when determining

1 eligibility for a scholarship.

2 (f) A participant has the right at any time to

3 (1) change the beneficiary of an account to another individual who is  
4 a member of the family of the former beneficiary; or

5 (2) direct that all or a portion of an account be transferred to an  
6 account with a new beneficiary if the new beneficiary is a member of the family of  
7 the former beneficiary.

8 (g) The right to change the beneficiary or to transfer between accounts  
9 described in (f) of this section may be denied if, under regulations adopted by the  
10 board, the exercise of the right would result in either excess contributions to an  
11 account or would constitute an impermissible investment by the participant.

12 (h) An account established under this section

13 (1) is exempt from a claim by the creditors of a participant or of a  
14 beneficiary;

15 (2) is conclusively presumed to be a spendthrift trust;

16 (3) is not an asset or property of either the participant or the  
17 beneficiary;

18 (4) may not be assignable, pledged, or otherwise used to secure a loan  
19 or other advancement;

20 (5) is not subject to involuntarily transfer or alienation.

21 (i) Except as permitted in 26 U.S.C. 529, a participant or beneficiary may not  
22 directly or indirectly direct the investment of an account or earnings on the account.

23 (j) A participant may, at any time, designate a person other than the participant  
24 as a successor participant by executing and dating an instrument of designation and  
25 delivering it to the board. The designation of a successor participant does not take  
26 effect until the participant dies. If a participant dies without having effectively  
27 designated a successor participant, the beneficiary may designate a successor  
28 participant in the manner prescribed above if the beneficiary is not the same person  
29 as the successor participant.

30 (k) In this section,

31 (1) "account" means an individual trust account established under this

1 section;

2 (2) "beneficiary" means any person designated by a participation  
3 agreement, or by another method of designation authorized in this section, to benefit  
4 from payments for qualified higher education expenses at an eligible educational  
5 institution;

6 (3) "board" means the Board of Regents of the University of Alaska;

7 (4) "eligible educational institution" means an institution of higher  
8 education that meets the requirements established by the board consistent with  
9 26 U.S.C. 529(e);

10 (5) "member of the family" has the meaning given in 26 U.S.C. 529(e);

11 (6) "nonqualified withdrawal" means a withdrawal from an account that  
12 is not a

13 (A) qualified withdrawal;

14 (B) withdrawal made as the result of the death or disability of  
15 the designated beneficiary of an account; or

16 (C) withdrawal made as a result of receiving a scholarship;

17 (7) "participant" means a person who has entered into a participation  
18 agreement;

19 (8) "participation agreement" means an agreement between a participant  
20 and the board providing for the establishment by the participant of one or more  
21 accounts under this section and for the administration of those accounts for the benefit  
22 of the participant and the beneficiary;

23 (9) "qualified higher education expenses" has the meaning given in 26  
24 U.S.C. 529(e);

25 (10) "qualified withdrawal" means a withdrawal from an account to pay  
26 the qualified higher education expenses of the designated beneficiary of the account;

27 (11) "trust" means the Alaska Higher Education Savings Trust.

28 \* Sec. 2. AS 45.55.990(32) is amended to read:

29 (32) "security" means a note; stock; treasury stock; bond; debenture;  
30 evidence of indebtedness; certificate of interest or participation in any profit-sharing  
31 agreement; limited liability company interest under AS 10.50, notwithstanding the

1 limitations of AS 45.08.103(c); collateral-trust certificate; preorganization certificate  
2 or subscription; transferable share; investment contract; voting-trust certificate;  
3 certificate of deposit for a security; certificate of interest or participation in an oil, gas,  
4 or mining title or lease or in payments out of production under the title or lease or in  
5 any sale of or indenture or bond or contract for the conveyance of land or any interest  
6 in land; an option on a contract for the future delivery of agricultural or mineral  
7 commodities or any other commodity offered or sold to the public and not regulated  
8 by the Commodity Futures Trading Commission; however, the contract or option is not  
9 subject to the provisions of AS 45.55.070 if it is sold or purchased on the floor of a  
10 bona fide exchange or board of trade and offered or sold to the public by a broker-  
11 dealer or agent registered under this chapter; investment of money or money's worth  
12 including goods furnished or services performed in the risk capital of a venture with  
13 the expectation of some benefit to the investor where the investor has no direct control  
14 over the investment or policy decision of the venture; or, in general, any interest or  
15 instrument commonly known as a "security," or any certificate of interest or  
16 participation in, temporary or interim certificate for, receipt for, guarantee of, or  
17 warrant or right to subscribe to or purchase, any of the foregoing; "security" does not  
18 include a participation agreement entered into under AS 14.40.802 or an insurance  
19 or endowment policy or annuity contract under which an insurance company promises  
20 to pay a fixed or variable sum of money either in a lump sum or periodically for life  
21 or for some other specified period;

22 \* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

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ALASKA STATE SENATE



SENATOR TIM KELLY

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**SPONSOR STATEMENT**

**SSSB 186**

*"An Act relating to the Alaska Higher Education Savings Trust and the Alaska Advanced College Tuition Savings Fund; and providing for an effective date".*

Senate Bill 186 is aimed at authorizing an additional way to save for higher education in Alaska.

Under IRS Code "Section 529", Qualified State Tuition Program, new federal tax rules will now permit individual donors to place funds into a tax-deferred higher education savings account for a beneficiary. In order to take advantage of this federal provision, new state legislation must be created.

This program is available to residents and non-residents alike, and the choice of the accredited college, graduate, professional, or in some cases, vocational school, is up to the beneficiary.

The contributor retains some control of decisions about disbursement. If parents or grandparents disapprove of the beneficiary's study plans; they can transfer the account to another beneficiary. This type of account is especially useful to donors for estate planning purposes, and the money isn't counted in their taxable estate if they die before the funds are used.

Individual donors may contribute up to \$50,000 to a future student, gift-tax free, either in one lump sum or over a five-year period. A married couple may donate up to \$100,000. The donors and beneficiaries need not be related. Earnings grow tax-deferred until they are withdrawn, and are then taxed at the student's rate at the time of withdrawal, typically 15%. Recent action in Washington, D.C., indicates that Congress may soon totally exempt "529" earnings from any taxation at all, if the funds are used for education.

This plan can provide for investors to cash out, if a student wins a scholarship, decides not to attend college, dies or becomes disabled.

The University of Alaska would administer the plan and issue the initial requests for proposals from private sector investment firms to manage the Alaska Higher Education Savings Trust. Administrative fees would pay for the cost of the plan.

More than 40 states have or are planning to offer college savings plans of this type.

###

# New College Savings Plans Gaining Popularity

By Joseph F. Hurley, CPA

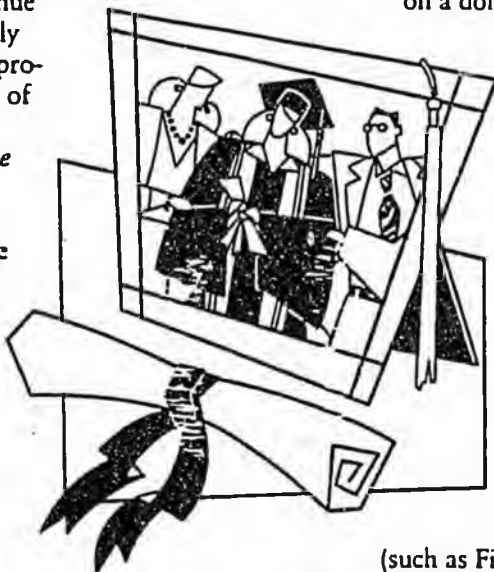
The process of saving for college is being revolutionized by the new tax-advantaged programs being established these days by many of the states under Section 529 of the Internal Revenue Code. These programs, technically known as qualified state tuition programs, have been attracting a lot of attention in recent months with articles in *TIME*, *Newsweek*, *The Wall Street Journal*, *Kiplinger's Personal Finance Magazine* and other national publications. Some of the newest programs, such as those in New York and New Hampshire, have been swamped with new account applications. It is imperative that we as financial planners become familiar with qualified state tuition programs because our clients are going to be coming to us with a lot of questions about them.

For families saving for college, Section 529 allows qualified state tuition programs to offer a host of tax advantages that, in many cases, make them superior to the Education IRA, taxable funds and other investment alternatives. In addition to the income tax advantages, there are some distinct estate and gift tax advantages. For middle- to high-income families who face many obstacles in the tax law, the qualified state tuition program can be a clear winner.

The income tax benefits include deferral of earnings until distributions are made from the plan and taxation of the earnings to the student at (usually) the lowest tax bracket. The estate and gift tax benefits include treatment of a contribution into the plan as a completed gift eligible for the \$10,000 annual exclusion, despite the fact that the donor maintains full control and can later switch beneficiaries or have the account refunded. A donor can contribute \$50,000 at once without gift tax consequences because an election is available to treat the gift as made over a five-year period.

There are two basic kinds of qualified state tuition programs – prepaid tuition plans and savings-type plans. Some of the prepaid tuition plans, such as Florida's, have actually been around for several years and do not have a great reputation as a savings vehicle (deservedly so). They are designed to provide a return that merely keeps up with tuition increases and will often provide a lower return if the child attends a private college or out-of-state institution. Most prepaid tuition plans are restricted to

residents of the state, can only be used for tuition and not the other costs of attending college, and are treated as a financial "resource," which reduces federal financial aid on a dollar-for-dollar basis.



The newer savings-type qualified state tuition programs are a whole different ballgame. Most of the states offering these programs make them available to residents and non-residents alike, and the choice of college makes no difference. In the typical program, over \$100,000 can be contributed for a single beneficiary and is invested on a tax-deferred basis in an age-banded portfolio of mutual funds, which provides a more aggressive asset allocation for younger beneficiaries and then becomes more conservatively invested as the beneficiary nears college age. The state will contract with an investment manager

(such as Fidelity, TIAA or Vanguard) to structure the portfolios and administer the program. Many states offer tax deductions, income exemption or scholarships for residents making contributions to their programs. For federal financial aid purposes, the account is generally considered to be an asset of the parent despite being taxed to the child.

Why should the financial planner be excited about these programs, particularly since none of them (with the exception of Montana) offer commissions to investment advisers? It is because they can be great for your clients, and your clients will definitely need help in sifting through all the special programs now available for higher education (Education IRA, withdrawals from regular and Roth IRA, Series EE bonds). They also need help in developing a strategy for using qualified state tuition programs. There are many different state programs to choose from and each program is different. And because the investment of contributions is directed by the state, not the account owner, your client will need help in properly balancing the asset allocation imposed by the state with his or her other investments.

*Note: Joseph F. Hurley CPA, is a tax partner at Bonadio & Co. LLP in Rochester, N.Y. He has appeared before the IRS and Treasury in hearings on the regulations being developed under IRC Sec. 529 and has written a book, The Best Way To Save For College – A Comprehensive Guide to State-Sponsored College Savings Plans and Prepaid Tuition Contracts. For more information, send e-mail to [jhurley@bonadio.com](mailto:jhurley@bonadio.com) or go to [www.savingforcollege.com](http://www.savingforcollege.com).*

Got any kids or grandkids? Redo your estate plan now!

# The tuition estate trick

By Janet Novack

LAST FALL a 71-year-old midwestern corporate tax lawyer was perusing a Fidelity Investments publication when a new product—a tax-deferred college savings plan that Fidelity runs for New Hampshire—caught his eye.

One detail jumped out: Donors could make tax-free gifts to the plan for children or grandchildren, but still control the account and even take back the money if they wanted to.

It scarcely seemed possible. A basic principle of estate tax law says that assets you control at your death go into your estate.

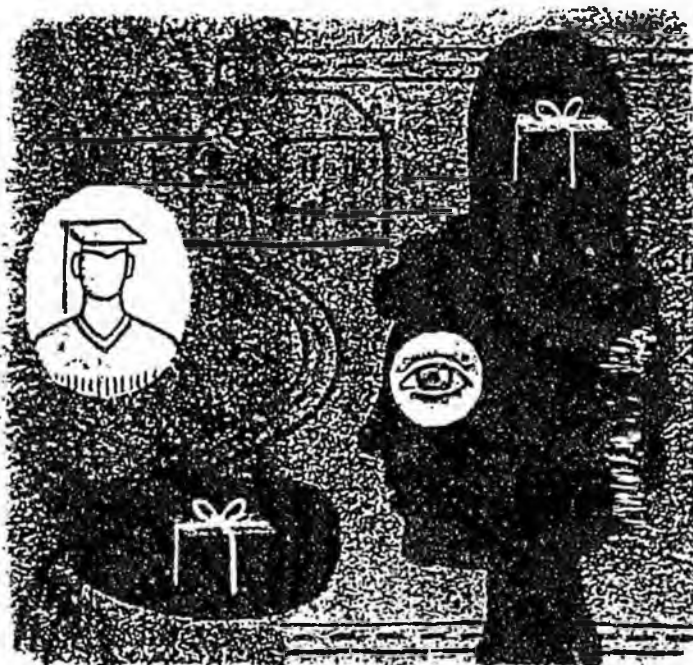
These college plans seemed to fly in the face of that principle. You could get money out of your estate now but change your mind later.

The tax lawyer raced to his copy of the Internal Revenue Code. IRC Section 529, and the preliminary IRS regulations clearly permit just what Fidelity was talking about.

In December the attorney and his wife put \$700,000 in New Hampshire tax-deferred college accounts—\$100,000 for each of seven grandchildren, now aged from 1 to 12. Says the attorney, who asked not to be named, "I've done my due diligence, and this is terrific."

Yes, it is. A year ago FORBES labeled the still-incubating state savings plans the sleeper tax-break of the 1997 tax act (FORBES, Feb. 9, 1998). Since then many have hatched, to favorable reviews. But what is still virtually unknown, even among estate-tax experts, is that these plans can provide large estate-tax breaks.

Here's why: Many affluent taxpay-



JUSTUS STEINHLBERG

ers—say, those with net worths between \$1 million and \$4 million—will leave taxable estates at death subject to rates as high as 55%. Often the easiest way for these folks to whittle down their estates is by making annual gifts to each child and grandchild. A single donor can give up to \$10,000 a year and a couple can give up to \$20,000 per year to each beneficiary they choose, tax free.

This exclusion would blow a huge hole in the U.S. estate tax but for one thing: Taxpayers are reluctant to make these gifts. Many fear that they will someday need the money themselves. Others, like the midwestern attorney, worry that if they give money to grandchildren through the Uniform Gift to Minors Act, the kids will blow it on cars instead of college.

New federal tax rules now let college plans address these concerns. When you put \$10,000 into a college savings account for junior, it is a tax-free, completed gift—meaning that if you die, the money in the account isn't

counted in your taxable estate. Yet so long as you remain the account's owner, you can change the beneficiary or even take the money back—if the state plan permits it.

And a lot of state plans do permit it. In a wonderful display of federalism's benefits, the states are falling all over themselves trying to make their plans attractive to their own residents and in some cases, to out-of-staters, too.

In its giant valentine to the education lobby Congress created another goody for affluent taxpayers. Normally, gifts to any one person greater

than the \$10,000 per single/\$20,000 per couple limit eat into the lifetime gift tax and estate tax exemption. (That exemption, currently \$650,000 for you and another \$650,000 for your spouse, is due to rise gradually to \$1 million). In addition, if the gift is to a grandchild, the excess cuts into the \$1-million-per-grandparent lifetime exemption from the generation-skipping tax.

Not here. With college savings plans each grandparent or parent (or aunt or uncle or godmother) can put \$50,000 into a college savings account for a child immediately and have it count as the next five years' \$10,000 gifts. Thus the future appreciation on that amount is out of your estate now.

(If you die within five years, a prorated portion is thrown back into your estate. Noting this, our midwestern attorney put each grandchild's \$100,000 gift in his wife's name, using the gift-splitting technique the IRS allows. As a 69-year-old woman she has a longer life expectancy.)

Once money is in a college savings account, it grows tax-deferred until withdrawn to pay for college tuition, books, room or board. Earnings are then taxed at the student's rate.

What if you decide to yank the money back? You owe income tax on the earnings left after the payment of a penalty. But the IRS has allowed states to set the penalty as low as 10% of earnings, and several have.

That's not steep given the tax deferral, says Bernard Kent, a Detroit partner with PricewaterhouseCoopers. He's right. Assume you are in a 50% tax bracket and destined to earn 8% a

year, all currently taxable, from your investment. Hang in for a mere seven years and the deferral will more than pay for the penalty. If you assume a higher return, or that your tax bracket will fall in future years, the college plan becomes a winner even more quickly. (Try out your own assumptions at [www.forbes.com/college](http://www.forbes.com/college).)

One last, little-known benefit of these accounts: They aren't just for kids. Say you're a 20-something New York single. You can open an account for yourself and claim deductions of \$5,000 on your state income tax return. You can use the money for

graduate school. If you don't go back to school but do start a family, you can name your child as beneficiary.

There are two hitches to state college savings plans. One is that you can't control how the money in the account is invested. But as the number of plans grows, this matters less. The states are getting competitive with their options. Arizona is even awaiting IRS approval of a plan that among other things lets donors choose, when opening an account, specific funds and allocations.

The other drawback is hard to quantify. There is some risk that after you have sunk your money in, Congress

## Roaming

THERE MAY BE a compelling reason to stay close to home when you shop for a tuition savings plan. Some states give a tax deduction for money invested in a plan; others give a break to money on the way out. New York gives both: Couples can deduct contributions of up to \$10,000 per year, and when money is withdrawn for college expenses, it's not taxed by the state. Also check to make sure that your state recognizes the tax deferral of rival states' plans.

But if these inhibitions don't apply, shop around. The eight state plans in this table are happy to take money from out-of-staters. None charges a penalty if your beneficiary attends school in another state. What if a child wins a scholarship, drops out or goes to a cheap school? Take back the cash and pay the taxes and any penalties. (There's no penalty if the money is withdrawn because of a scholarship.) But that puts money back in your estate. You can also change the beneficiary to another child, unless his accounts are already fully funded.

Here it is crucial to read a plan's fine print. Most plans in our table (exceptions: Indiana and Montana)

let you leave money in the account growing tax-deferred, for the same beneficiary, indefinitely. He or she can use it for graduate school. Or the assets can eventually be rolled over to the beneficiary's children—without loss of deferral. This counts as a gift from the first beneficiary to his child, thus no generation-skipping tax.

Another alternative: Six of the eight plans (exceptions: New Hampshire and Delaware) let you transfer ownership of the account to an over-18 beneficiary at your death. As owner, the beneficiary can take money out for any purpose by paying the 10% earnings penalty and taxes on the earnings at his own rate.

What if your plan turns in a disappointing performance or jacks up the fees? It may be possible to switch to another state's plan. First, make sure you have this exit privilege. Next, to avoid federal tax on the rollover, you must change the beneficiary of the account. (Some states are lobbying to get this federal rule changed so you can switch without changing beneficiaries.)

If you can stand the paperwork, diversify. Buy into a few plans. There is now no IRS limit on how much you can contribute using multiple plans. So you can fund graduate school, too, if you care to. —J.N.

## Summa cum laude savings

State	Contribution Limit	Penalty	Rate	Provider	Transferable	Withdrawal Rate
Conn/RI	\$150,000	15% of earnings	1.55%	JP Morgan, Montgomery Asset	yes	60%/40%/0%*
Del/VT	116,120/105,545	10	1.00	Fidelity	yes	62/33.5/4.5*
Indiana	34,405 in first year*	10	1.75	Banc One	not decided	80/20/0*
Iowa	2,000 per year	10	0.31	State treasury*	no	60/40/0*
Montana	176,440	10	none	College Savings Bank	yes	FDIC insured CDs†
New York	100,000	10	0.65	TIAA-CREF	yes	30/70/0*

By the end of the year even more states will be offering competitive plans.

## What about the other breaks for college?

■ A child can't get both a savings plan and education IRA contribution the same year, even if different people contribute. As the annual limit for an education IRA is \$500, a state plan is usually better.

■ If Johnny's tuition is paid from a state plan, his parents can take the \$1,500-a-year Hope or \$1,000-a-year Lifetime Learning tax credits—even if grandma funded the plan. Families earning more than \$100,000 don't qualify for the credits, but a child may be able to claim a credit himself if he isn't his parents' dependent (FORBES, Feb. 9, 1998).

■ It's unclear how college savings plans will be treated in government and private college-aid formulas. As of now, a plan owned by a grandparent isn't counted. An account owned by parents is counted as nonretirement savings. Note: Most colleges don't expect you to dig into your 401(k) or IRA.

College-aid formulas could change to penalize parents who put money in state accounts rather than in fully taxable investments. But if your income is above \$125,000, you probably won't get aid anyway, unless you have several children in expensive colleges.

■ Grandparents can still pay tuition (but not room and board) directly to a school, free of gift tax.

■ You can roll an existing Uniform Gifts to Minors Act account into many state savings plans. —J.N. ■

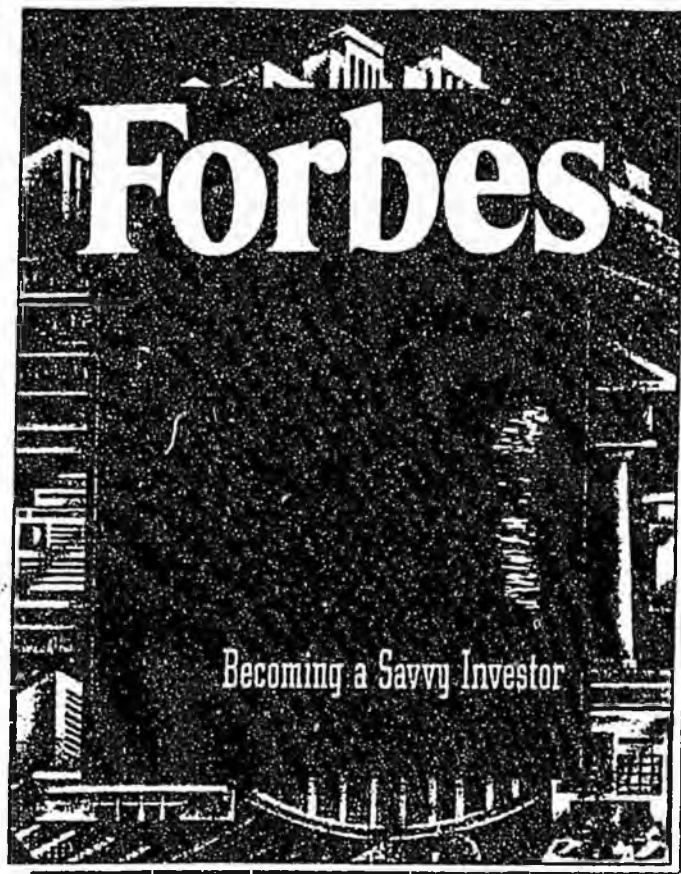
will double-cross you with a change in the tax laws. For example, it could impose an additional federal penalty on withdrawals not used for college.

On the other hand, these plans might get even better; the states are lobbying to make withdrawals for education federally tax exempt.

So despite their complexity, these plans are worth a close look. Fees are in some cases high (in Indiana's case, outlandish), but competition may bring them down. ■

Forbes ■ February 22, 1999

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# States make saving for college easier

By Mike J. Dalessi  
For the Journal

## PERSONAL FINANCE



The ever-rising cost of higher education has many parents wondering, "How will I afford to send my children to college, and what is the best way to save for this important goal?"

If you have begun to explore education-funding possibilities, you have probably found that there is a downside to many traditional savings plans.

For example, if you would like to put the funds for your child's education into a custodial account, you are making an irrevocable gift to your child and giving up control of the money in that account. Upon the age of majority, your child can use the funds for any purpose, and you will have to hope that paying for education is a priority.

Education-specific savings alternatives, such as the Education IRA, do provide tax-free distributions for education expenses. However, parents with relatively high incomes may not be allowed to contribute to these accounts, and those who are able to contribute are limited to \$500 annually.

Other investments, such as U.S. Savings Bonds, a popular gift for children, carry modest invest rates of 4 percent to 5 percent.

Congress has heard the concerns of parents dissatisfied with these conventional savings plans and has passed legislation that gives individual states the authority to establish Qualified State Tuition programs — a boon for anyone interested in saving as much money as possible for a college education.

Recent changes to these programs, also called Section 529 College Savings Plans after the IRS code that establishes them, have allowed individuals to contribute substantially more money toward higher-education expenses while reaping significant tax benefits.

Many states have the new version of these College Savings Plans in place, while others are expected to implement their own plans over the next several months.

Alaska does not have a plan in place, but Alaskans can use Colorado's plan. If Alaska eventually implements a plan, local investors will be able to transfer their accounts from Colorado to

Alaska with no penalties or taxes.

Since these state-sponsored savings plans typically have no income restrictions and allow for relatively large contributions that can exceed six figures in many cases, they can be the answer to the education funding concerns of many middle- and upper-income families.

The funds in College Savings Plans are usually invested in a family of pre-selected portfolios according to the age of the student or the years to enrollment in college.

The contributor has no say in how the funds are invested other



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than a possible choice of a balanced or conservative savings option.

The portfolios typically hold more equities while the account's student beneficiary is young. As the student ages, funds are automatically moved into portfolios with a

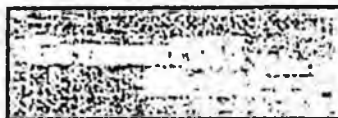
larger portion of fixed-income investments, thus reducing the risk of stock market volatility on funds needed to pay for college expenses in the near future.

The performance of the portfolios depends on market conditions and there is no guarantee

*Continued on Page 18*

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## States' College Savings Plans often the smartest way to put tuition away now

*Continued from Page 5*

that there will be enough money in the account to cover all education expenses.

Those saving for education expenses through College Savings Plans may be able to benefit from the many tax advantages that these accounts provide on the contribution,

growth and distribution levels.

While contributions are not federally tax-deductible, they may be deductible on state or local tax returns. For this reason, investors should look into the programs within their own states to determine if this tax savings makes their state-sponsored plans more attractive than those of other states. Of

course, savings options and fund performance should also be examined.

The assets in a College Savings Plan grow tax-deferred, meaning that any dividends and realized capital gains are not taxed annually. This feature will allow the account to grow larger than an identical taxable account where

earnings are taxed every year.

The earnings on distributions used for qualified education expenses, which include tuition, fees, certain room and board expenses, supplies and equipment, are taxable upon withdrawal at the student's rate.

Since most children do not have earned income, the federal tax rate is usually 15 percent. Qualified distributions may be free of state and local taxes. Penalties apply to non-qualified withdrawals.

Where you live may not be the best place to invest. Several states allow accounts to be opened by and for nonresidents. If your state has a College Savings Plan, you should weigh any local tax benefits against the benefits and conditions of

plans offered by other states.

Also, if you are already saving within a custodial account, an Education IRA and with U.S. Savings Bonds, you may want to explore the tax-free transfer of these savings to a College Savings Plan. Your financial adviser can provide more information and can help you decide which education-funding strategy may be appropriate in your case.

*Mike J. Dalessi is vice president-investments and branch manager for Smith Barney in Juneau. He can be reached at 1 800-478-0600.*

*Salomon Smith Barney does not provide tax or legal advice. Please contact a tax or legal adviser for guidance.*

*Attention!*

**ALASKA INVENTORS**



## MANAGING YOUR MONEY

## Generous tax savings point many to prepaid tuition plans

By Thomas A. Fogarty  
USA TODAY

Robert and Debra Armstrong of Elmira, N.Y., have been good savers on behalf of their two children.

When the government paid off early a bond they had bought to help finance the kids' college education, the Armstrongs invested the unexpected cash in the New York College Choice Tuition Savings Program, one of the USA's 40 state-sponsored college savings plans.

"My husband read up on it and thought it was a really good deal," Debra says. Particularly attractive, she says, was being able to deduct up to \$10,000 this year on their state income tax for their contribution.

State tuition plans, which offer professional money management and deferral of federal income tax on earnings, have become the rage among college savers (story, 1B). Assets have shot up to \$7.1 billion from about \$5 billion six months ago. Twelve states — Florida, Hawaii, Illinois, Kansas, Minnesota, North Dakota, Oklahoma, Tennessee, Vermont, Oregon, West Virginia and Wyoming — plan savings programs.

Maine and New Mexico are poised to open prepaid plans, which let investors lock in tuition at public universities by prepaying a lower rate.

## Unique benefits

The "529 plans," named after the section of federal tax law that permits them, "combine a menu of benefits that you're just not going to find elsewhere," says Joseph Hurley, a Pittsford, N.Y., accountant who has written a guide to the plans.

Many states hired investment companies to manage the accounts. TIAA-CREF, the company known for managing educators' pensions, has the most state plan contracts (see chart). Fidelity Investments and Salomon Smith Barney have others, and they market some plans nationwide.

All plans provide for investors to cash out if a student wins a scholarship, decides not to attend college, dies or becomes disabled.

Donors and beneficiaries need not be related, and some plans even allow the donor to be the beneficiary.

The federal government has deemed college expenses broadly to include tuition, fees, books, supplies and living expenses.

## The advantages

Among the most frequently cited advantages of the plans:

► **Federal income taxes.** Earnings grow tax-deferred until they are withdrawn. And when the money is spent for education, it's taxed at the student's rate, typically 15%.

► **State income taxes.** All states that have income taxes match the federal deferral of taxes on earnings. Some, like New York with its \$10,000 deduction per couple for contributions, go far beyond. Virginia and Mississippi offer generous tax breaks, such as unlimited deductions or contributions, and tax exemptions for earnings at withdrawal if the money is used for college.

► **Estate planning.** Donors can contribute up to \$50,000 without triggering the federal gift tax that normally kicks in after \$10,000 a year. That special treatment makes state tuition plans especially appealing to high-income grandparents seeking a way to transfer wealth.

► **Control.** The contributor retains control of decisions about disbursement. So if parents or grandparents disapprove of Johnny's plan to study the logistics of rock concert tours at Camp State U, they can transfer the account to another beneficiary.

Rules are drawn to make sure the money goes for college expenses, and penalties apply when it is used for something else. Most states follow federal guidelines for that penalty: 10% of earnings and taxation at the donor's tax rate, which, presumably is higher than the student's.

## Saving for college? Here's how state tuition plans rate

College savers are not limited to their own state in selecting a state tuition plan, so they face an array of choices. Here is a listing of the plans that are now operating. More are on the way. The chart includes the rating given each plan by Joseph Hurley, a certified public accountant who has written a guide to funds called "The Best Way to Save for College." A rating of 5 is best; a 1 is worst. More information can be found on Hurley's Web site [www.savingforcollege.com](http://www.savingforcollege.com), and on the Web site of the College Savings Plan Network, [www.collegesavings.org](http://www.collegesavings.org).

State	Name (phone)	Web site	Hurley's rating	Type of program	Available to non-residents? (Hurley's rating)	Enrollment period	Investments/comments
Ala.	Prepaid Affordable College Tuition (PACT) Program (800-252-7228)	<a href="http://ajunces.state.al.us/trustsur">ajunces.state.al.us/trustsur</a>	2	Prepaid	No	September	Tracks Ala. tuition and fee increases; no interest if canceled
Alaska	Advancia College Tuition (ACT) (in Alaska, 800-478-0003; outside Alaska, 907-474-5671)	<a href="http://www.alaska.edu/swact">www.alaska.edu/swact</a>	1	Combined	No	Open	Money market interest rates
Ariz.	Arizona Family College Savings Plan (602-229-2591)	<a href="http://www.afcp.asu.edu">www.afcp.asu.edu</a>	3	Savings	Yes (3)	Open	CD rates, 4% minimum or four SM&R mutual funds
Ark.	Arkansas Tax-Deferred Tuition Savings Program (877-442-6553)	<a href="http://www.thetdplan.com">www.thetdplan.com</a>	5	Savings	Yes (4)	Open	Nine age-based portfolios
Calif.	Golden State Scholarship Trust College Savings Program (877-728-4338)	<a href="http://www.scholarshipst.com">www.scholarshipst.com</a>	4	Savings	Yes (3)	Open	Age-based portfolios managed by TIAA-CREF
Colo.	Scholars Choice College Savings Program (888-572-4652) Colorado Prepaid Tuition Fund (800-478-5651)	<a href="http://www.scholars-choice.com">www.scholars-choice.com</a> <a href="http://www.prepaidtuition.org">www.prepaidtuition.org</a>	Savings: 5 Prepaid: 2	Both	Savings: Yes (4) Prepaid: Yes (1)	Open	Savings: age-based portfolios using Salomon Smith Barney mutual funds
Conn.	Connecticut Higher Education Trust (CHET) (888-799-2438)	<a href="http://www.aboutchet.com">www.aboutchet.com</a>	3	Savings	Yes (3)	Open	Age-based portfolios; various money managers
Del.	Delaware College Investment Plan (800-544-1655)	<a href="http://www.dcolny.com/delaware">www.dcolny.com/delaware</a>	4	Savings	Yes (4)	Open	Age-based portfolios using Fidelity funds
Fla.	Florida Prepaid Tuition Program (800-552-4723)	<a href="http://www.fsbta.state.fl.us/prepaid">www.fsbta.state.fl.us/prepaid</a>	2	Prepaid	No	October-January	Tracks Fla. tuition increases; no interest if canceled
Ill.	College Illinois (877-877-3724)	<a href="http://www.collegeillinois.com">www.collegeillinois.com</a>	2	Prepaid	No	Oct. 18-Feb. 18	Tracks Ill. tuition and fee increases; heavy cancellation penalties
Ind.	Indiana Family College Savings Plan (888-814-6900)	<a href="http://www.cfs.state.in.us/icsa">www.cfs.state.in.us/icsa</a>	4	Savings	Yes (4)	Open	Many One Group mutual fund options; Vanguard bond fund
Iowa	College Savings Iowa (888-446-6696)	<a href="http://www.collegesavingsiowa.com">www.collegesavingsiowa.com</a>	4	Savings	Yes (3)	Open	One of four Vanguard portfolios
Ky.	Kentucky Education Savings Plan Trust (877-598-7878)	<a href="http://www.kentuckytrust.org">www.kentuckytrust.org</a>	4	Savings	No	Open	Age-based portfolios managed by TIAA-CREF
La.	Louisiana Student Tuition Assistance and Revenue Trust Program (START) (800-259-5626)	<a href="http://www.osts.state.la.us/start.htm">www.osts.state.la.us/start.htm</a>	4	Savings	No	Open; Nov. 1 deadline for matching grant	Government bonds and other fixed-income investments
Maine	NextGen College Investing Plan (877-463-9843)	<a href="http://www.nextgenplan.com">www.nextgenplan.com</a>	5	Savings	Yes (4)	Open	Age-based portfolios using Merrill Lynch mutual funds
Md.	Maryland Prepaid College Trust (888-463-4723)	<a href="http://www.prepaid.usmd.edu">www.prepaid.usmd.edu</a>	2	Prepaid	No	Feb. 10-June 10	Tracks Md. avg. tuition and fees; cannot cancel first three years
Mass.	U. Fund (800-544-2776) U. Plan (800-449-6332)	<a href="http://www.mofa.org">www.mofa.org</a>	Savings: 4 Prepaid: 2	Both	Savings: Yes (4) Prepaid: Yes (1)	Savings: Open Prepaid: May 2000	Savings: age-based portfolios using Fidelity mutual funds
Mich.	Michigan Education Trust (800-638-4543)	<a href="http://www.trust.state.mi.us/college/mem/index.htm">www.trust.state.mi.us/college/mem/index.htm</a>	1	Prepaid	No	Fall/winter	Tracks Mich. tuition and fees; no cancellations
Miss.	Mississippi Prepaid Affordable College Tuition Program (IMPACT) (800-987-4450)	<a href="http://www.treasury.state.ms.us">www.treasury.state.ms.us</a>	3	Prepaid	No	Sept. 1-Nov. 30	Tracks Miss. tuition and fees
Mo.	Missouri Saving for Tuition Program (MOST) (888-414-6678)	<a href="http://www.missourimost.org">www.missourimost.org</a>	5	Savings	Yes (4)	Open	Age-based portfolios or fixed-income, both TIAA-CREF
Mont.	Montana Family Education Savings Program (800-889-2723)	<a href="http://montana.college.savings.com">montana.college.savings.com</a>	4	Savings	Yes (3)	Open	CDs based on avg. college costs, 4% minimum
Nov.	Nevada Prepaid Tuition Program (888-177-2667)	<a href="http://prepaid-tuition.state.nv.us">prepaid-tuition.state.nv.us</a>	3	Prepaid	No	Aug. 30-Nov. 16	Tracks Nevada tuition increases
N.H.	UNIQUE College Investing Plan (800-544-1722)	<a href="http://personal400.fidelity.com/planning/college">personal400.fidelity.com/planning/college</a>	5	Savings	Yes (4)	Open	Age-based portfolios using Fidelity mutual funds
N.J.	New Jersey Better Education Savings Trust (NJBEST) (877-465-2368)	<a href="http://www.state.nj.us/treasury/osa">www.state.nj.us/treasury/osa</a>	3	Savings	No	Open	Invested by state; minimum 60% in bonds
N.Y.	New York's College Savings Program (877-697-2837)	<a href="http://www.nysaves.com">www.nysaves.com</a>	4	Savings	Yes (4)	Open	Age-based portfolios managed by TIAA-CREF
N.C.	College Vision Fund (800-600-3453)	<a href="http://www.collegevisionsfund.org">www.collegevisionsfund.org</a>	2	Savings	No	Open	Fixed-income securities
Ohio	Ohio Prepaid Tuition Program (800-233-6734)	<a href="http://www.ohiocollege.savings.org/">www.ohiocollege.savings.org/</a>	2	Both	No	Open	Tracks Ohio tuition increases
Pa.	Pennsylvania Tuition Account Program (TAP) (800-440-4000)	<a href="http://www.pstap.org">www.pstap.org</a>	2	Prepaid	No	Open	Tracks Pa. tuition increases; no interest if canceled
R.I.	Rhode Island Education Savings Trust (RIHEST) (877-474-4378)	<a href="http://www.rihest.com">www.rihest.com</a>	3	Savings	Yes (3)	Open	Age-based portfolios with various money managers
S.C.	Prepaid Affordable College Education (PACE) (888-772-4723)	<a href="http://www.state.sc.us/tao">www.state.sc.us/tao</a>	2	Prepaid	No	Oct. 1-Jan. 21	Tracks S.C. tuition and fee increases; no interest if canceled
Tenn.	Tennessee Back-to-School Education System Trust (BEST) (888-486-2378)	<a href="http://www.treasury.state.tn.us/best.htm">www.treasury.state.tn.us/best.htm</a>	1	Prepaid	No	Open	Tracks Tenn. tuition and fee increases
Texas	Texas Tomorrow Fund (800-445-4723)	<a href="http://www.texas-tomorrow.fund.com">www.texas-tomorrow.fund.com</a>	2	Prepaid	No	Nov. 1-March 28	Tracks Texas tuition and fee increases
Utah	Utah Educational Savings Plan Trust (UESP) (800-418-2551)	<a href="http://www.uesp.org">www.uesp.org</a>	4	Savings	Yes (4)	Open	Four options, with state-run fixed-income fund and Vanguard stock and bond index funds
Va.	Virginia Education Savings Trust (VEST) Virginia Prepaid Education Program (VPEP) (888-567-0540)	<a href="http://www.vpep.state.va.us">www.vpep.state.va.us</a>	Savings: 5 Prepaid: 3	Both	Savings: Yes (4) Prepaid: No	Savings: Open Prepaid: Dec. 1-Feb. 29	Prepaid: tracks Va. tuition and fee increases; savings: seven age-based portfolios
Wash.	Guaranteed Education Tuition of Washington (GET) (877-438-8848)	<a href="http://www.get.wa.gov">www.get.wa.gov</a>	2	Prepaid	No	Sept. 1-Jan. 15	Tracks Wash. tuition increases
W.Va.	West Virginia Prepaid College Plan (800-307-4701)	<a href="http://www.wvtreasury.com">www.wvtreasury.com</a>	2	Prepaid	No	October-January	Tracks W.Va. tuition and fee increases; no interest if canceled
Wis.	Edvest Wisconsin (888-338-3789)	<a href="http://edvest1.state.wi.us">edvest1.state.wi.us</a>	1	Savings	No	Open	Tuition units similar to U.S. Savings Bonds, now 6% interest

Source: Saving for College, [www.savingforcollege.com](http://www.savingforcollege.com)

## The downside

So, what's not to like?

Kalman Chazy, author of *Playing for College Without Going Broke*, says state officials and companies that manage the plans are only pitching the plans' good points.

For starters, Chazy says, anyone who invests in a tuition plan before making sure they are getting the maximum employer match to their company's 401(k) plan — if they have one — is making a big mistake. Beyond that, Chazy and others point out several potential pitfalls:

► **Penalties.** Most states are intent on locking participants into the plan. As a result, penalties for canceling an

account can be steep.

► **Lack of investment choice.** Once an account is open, the state — or the investment company acting as the state's agent — takes full control over how the money is invested. In most savings plans, the assets are allocated, according to the beneficiary's age, among stocks, bonds and money market mutual funds.

The younger the beneficiary, the more risk is taken. By the time the student reaches college, most of the account is invested in low-risk bonds and money market mutual funds. Chazy says some plans are too risk-averse. He cites New York's plan, which limits stock investments on behalf of newborns to just 53% of

an account. New Hampshire, by contrast, invests 88% of a newborn's account to stocks.

► **Prepaid plan conversions.** Prepaid tuition contracts let students convert state university tuition credits for use at a private or out-of-state college. Some plans, however, make conversions at a significant discount from public university tuition.

► **Taxes.** Tax payments aren't considered a college expense under IRS rules. So a student must have another source of money to pay taxes on money coming out of the savings plan. As a result, Chazy says parents who expect to invest only modest amounts for their child's education may be better off with a plain vanilla

investment account, which lets a minor withdraw up to \$700 in interest tax-free each year.

► **Impact on financial aid.** Prepaid from a prepaid tuition plan reduce a student's financial need dollar-for-dollar.

By contrast, at least for now, the government has issued an interpretation that gives savings plans relatively favorable treatment in financial aid calculations. As a result, savings accounts have less negative impact on aid than other assets.

But the debate over how savings plans should be viewed in aid calculations is far from settled. A future determination could mean a savings account could cut a student's fi-

nanacial aid substantially.

So how do you pick a plan?

The first decision is between a prepaid and a savings plan.

► **A prepaid plan** is for a conservative investor who wants the assurance that the full cost of college, at least the cost of college at a public university, will be covered.

► **A savings plan** is for those who can live with the idea that their savings may come up short of fully covering tuition.

Once that decision is made, check to see if your own state offers what you want. Many times the state income-tax concessions are so generous that they will eliminate the need to look any further.

## Section 31.8. QUALIFIED STATE TUITION PROGRAMS

The Small Business Job Protection Act of 1996, Pub. L. 104-188, Section 1806(a), added Code Section 529, which grants tax-exempt status to qualified state tuition programs. A qualified state tuition program (QSTP) is a program established and maintained by a state under which a person

(1) may purchase tuition credits or certificates on behalf of a designated beneficiary entitling the beneficiary to the waiver or payment of qualified higher education expenses, or

(2) may make contributions to an account established for the purpose of meeting the qualified higher education expenses of the beneficiary.

The tax on earnings attributable to prepayments or contributions is deferred until the earnings are distributed from the QSTP. The beneficiary includes the earnings in gross income at the time of distribution.

QSTP requirements are discussed in Section 31.9 The tax treatment of QSTPs is discussed in Section 31.10 Coordination of QSTPs with the Hope scholarship and lifetime learning credits and with education IRAs is discussed in Section 31.11 Effective dates are discussed in Section 31.12

<<END OF SECTION>>

## SECTION 529. QUALIFIED STATE TUITION PROGRAMS

## (a) GENERAL RULE

A qualified State tuition program shall be exempt from taxation under this subtitle. Notwithstanding the preceding sentence, such program shall be subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable organizations).

## (b) QUALIFIED STATE TUITION PROGRAM

For purposes of this section--

## (1) IN GENERAL

The term "qualified State tuition program" means a program established and maintained by a State or agency or instrumentality thereof--

## (A) under which a person--

(i) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary, or

(ii) may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account, and

(B) which meets the other requirements of this subsection.

## (2) CASH CONTRIBUTIONS

A program shall not be treated as a qualified State tuition program unless it provides that purchases or contributions may only be made in cash.

## (3) REFUNDS

A program shall not be treated as a qualified State tuition program unless it imposes a more than de minimis penalty on any refund of earnings from the account which are not--

(A) used for qualified higher education expenses of the designated beneficiary,

(B) made on account of the death or disability of the designated

beneficiary, or

(C) made on account of a scholarship (or allowance or payment described in section 135(d)(1) (B) or (C)) received by the designated beneficiary to the extent the amount of the refund does not exceed the amount of the scholarship, allowance, or payment.

(4) SEPARATE ACCOUNTING

A program shall not be treated as a qualified State tuition program unless it provides separate accounting for each designated beneficiary.

(5) NO INVESTMENT DIRECTION

A program shall not be treated as a qualified State tuition program unless it provides that any contributor to, or designated beneficiary under, such program may not directly or indirectly direct the investment of any contributions to the program (or any earnings thereon).

(6) NO PLEDGING OF INTEREST AS SECURITY

A program shall not be treated as a qualified State tuition program if it allows any interest in the program or any portion thereof to be used as security for a loan.

(7) PROHIBITION ON EXCESS CONTRIBUTIONS

A program shall not be treated as a qualified State tuition program unless it provides adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary.

(c) TAX TREATMENT OF DESIGNATED BENEFICIARIES AND CONTRIBUTORS

(1) IN GENERAL

Except as otherwise provided in this subsection, no amount shall be includible in gross income of--

(A) a designated beneficiary under a qualified State tuition program, or

(B) a contributor to such program on behalf of a designated beneficiary, with respect to any distribution or earnings under such program.

## (2) GIFT TAX TREATMENT OF CONTRIBUTIONS

For purposes of chapters 12 and 13--

### (A) IN GENERAL

Any contribution to a qualified tuition program on behalf of any designated beneficiary--

(i) shall be treated as a completed gift to such beneficiary which is not a future interest in property, and

(ii) shall not be treated as a qualified transfer under section 2503(e).

### (B) TREATMENT OF EXCESS CONTRIBUTIONS

If the aggregate amount of contributions described in subparagraph (A) during the calendar year by a donor exceeds the limitation for such year under section 2503(b), such aggregate amount shall, at the election of the donor, be taken into account for purposes of such section ratably over the 5-year period beginning with such calendar year.

## (3) DISTRIBUTIONS

### (A) IN GENERAL

Any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the manner as provided under section 72 to the extent not excluded from gross income under any other provision of this chapter.

### (B) IN-KIND DISTRIBUTIONS

Any benefit furnished to a designated beneficiary under a qualified State tuition program shall be treated as a distribution to the beneficiary.

### (C) CHANGE IN BENEFICIARIES

#### (i) ROLLOVERS

Subparagraph (A) shall not apply to that portion of any distribution which, within 60 days of such distribution, is transferred to the credit of another designated beneficiary under a qualified State tuition program who is a member of the family of the designated beneficiary with respect to which the distribution was made.

(ii) CHANGE IN DESIGNATED BENEFICIARIES

Any change in the designated beneficiary of an interest in a qualified State tuition program shall not be treated as a distribution for purposes of subparagraph (A) if the new beneficiary is a member of the family of the old beneficiary.

(D) OPERATING RULES

For purposes of applying section 72--

(i) to the extent provided by the Secretary, all qualified State tuition programs of which an individual is a designated beneficiary shall be treated as one program,

(ii) all distributions during a taxable year shall be treated as one distribution, and

(iii) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year in which the taxable year begins.

(4) ESTATE TAX TREATMENT

(A) IN GENERAL

No amount shall be includible in the gross estate of any individual for purposes of chapter 11 by reason of an interest in a qualified tuition program.

(B) AMOUNTS INCLUDIBLE IN ESTATE OF DESIGNATED BENEFICIARY IN CERTAIN CASES

Subparagraph (A) shall not apply to amounts distributed on account of the death of a beneficiary.

(C) AMOUNTS INCLUDIBLE IN ESTATE OF DONOR MAKING EXCESS CONTRIBUTIONS

In the case of a donor who makes the election described in paragraph (2) (B) and who dies before the close of the 5-year period referred to in such paragraph, notwithstanding subparagraph (A), the gross estate of the donor shall include the portion of such contributions properly allocable to periods after the date of death of the donor.

(5) OTHER GIFT TAX RULES

For purposes of chapters 12 and 13--

(A) TREATMENT OF DISTRIBUTIONS

Except as provided in subparagraph (B), in no event shall a distribution from a qualified tuition program be treated as a taxable gift.

(B) TREATMENT OF DESIGNATION OF NEW BENEFICIARY

The taxes imposed by chapters 12 and 13 shall apply to a transfer by reason of a change in the designated beneficiary under the program (or a rollover to the account of a new beneficiary) only if the new beneficiary is a generation below the generation of the old beneficiary (determined in accordance with section 2651).

(d) REPORTS

Each officer or employee having control of the qualified State tuition program or their designee shall make such reports regarding such program to the Secretary and to designated beneficiaries with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by the Secretary.

(e) OTHER DEFINITIONS AND SPECIAL RULES

For purposes of this section--

(1) DESIGNATED BENEFICIARY

The term "designated beneficiary" means--

(A) the individual designated at the commencement of participation in the qualified State tuition program as the beneficiary of amounts paid (or to be paid) to the program,

(B) in the case of a change in beneficiaries described in subsection (c)(3)(C), the individual who is the new beneficiary, and

(C) in the case of an interest in a qualified State tuition program purchased by a State or local government (or agency or instrumentality thereof) or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as part of a scholarship program operated by such government or organization, the individual receiving such interest as a

scholarship.

(2) MEMBER OF FAMILY

The term 'member of the family' means, with respect to any designated beneficiary--

(A) the spouse of such beneficiary,

(B) an individual who bears a relationship to such beneficiary which is described in paragraphs (1) through (8) of section 152(a), and

(C) the spouse of any individual described in subparagraph (B).

(3) QUALIFIED HIGHER EDUCATION EXPENSES

(A) IN GENERAL

The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution.

(B) ROOM AND BOARD INCLUDED FOR STUDENTS UNDER GUARANTEED PLANS WHO ARE AT LEAST HALF-TIME

(i) IN GENERAL

In the case of an individual who is an eligible student (as defined in section 25A(b)(3)) for any academic period, such term shall also include reasonable costs for such period (as determined under the qualified State tuition program) incurred by the designated beneficiary for room and board while attending such institution. For purposes of subsection (b)(7), a designated beneficiary shall be treated as meeting the requirements of this clause.

(ii) LIMITATION

The amount treated as qualified higher education expenses by reason of the preceding sentence shall not exceed the minimum amount (applicable to the student) included for room and board for such period in the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 108711, as in effect on the date of the enactment of this paragraph) for the eligible educational institution for such period.

## (4) APPLICATION OF SECTION 514

An interest in a qualified State tuition program shall not be treated as debt for purposes of section 514.

## (5) ELIGIBLE EDUCATIONAL INSTITUTION

The term "eligible educational institution" means an institution--

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this paragraph, and

(B) which is eligible to participate in a program under title IV of such Act.

## &lt;&lt;BACKGROUND/EFFECTIVE DATES&gt;&gt;

## AMENDMENTS

1998

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Subsection (c)(3)(A). -- Pub. L. 105-206, Section 6004(c), struck "section 72(b)" and inserted "section 72" in its place. [Effective as if included in the provisions of Taxpayer Relief Act of 1997]

Subsection (e)(2). -- Pub. L. 105-206, Section 6004(c), amended paragraph (2). [Effective as if included in the provisions of the Taxpayer Relief Act of 1997]

Prior to amendment, paragraph (2) read as follows:

"(2) MEMBER OF FAMILY

"The term "member of the family" means--

"(A) an individual who bears a relationship to another individual which is a relationship described in paragraphs (1) through (8) of section 152(a), and

"(B) the spouse of any individual described in subparagraph (A)."

1997

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Subsection (b)(5). -- Pub. L. 105-34, Section 211(b)(4), inserted 'directly or indirectly' after 'may not'. [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Subsection (c)(2). -- Pub. L. 105-34, Section 211(b)(3)(A)(i), amended subsection (c)(2). [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (c)(2) read as follows:

"(2) CONTRIBUTIONS

In no event shall a contribution to a qualified State tuition program on behalf of a designated beneficiary be treated as a taxable gift for purposes of chapter 12."

Subparagraph (c)(3)(A). -- Pub. L. 105-34, Section 211(d), struck 'section 72' and inserted 'section 72(b)'. [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Subsection (c)(4). -- Pub. L. 105-34, Section 211(b)(3)(B), amended subsection (c)(4). [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (c)(4) read as follows:

"(4) ESTATE TAX INCLUSION

The value of any interest in any qualified State tuition program which is attributable to contributions made by an individual to such program on behalf of any designated beneficiary shall be includible in the gross estate of the contributor for purposes of chapter 11."

Subsection (c)(5). -- Pub. L. 105-34, Section 211(b)(3)(A)(ii), amended subsection (c)(5). [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (c)(5) read as follows:

"(5) SPECIAL RULE FOR APPLYING SECTION 2503(E)

For purposes of section 2503(e), the waiver (or payment to an educational institution) of qualified higher education expenses of a designated beneficiary under a qualified State tuition program shall be treated as a qualified transfer."

Subsection (d). -- Pub. L. 105-34, Section 211(e)(2)(A), amended subsection (d). [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (d) read as follows:

"(d) REPORTING REQUIREMENTS

**(1) IN GENERAL**

If there is a distribution to any individual with respect to an interest in a qualified State tuition program during any calendar year, each officer or employee having control of the qualified State tuition program or their designee shall make such reports as the Secretary may require regarding such distribution to the Secretary and to the designated beneficiary or the individual to whom the distribution was made. Any such report shall include such information as the Secretary may prescribe.

**(2) TIMING OF REPORTS**

Any report required by this subsection--

(A) shall be filed at such time and in such manner as the Secretary prescribes, and

(B) shall be furnished to individuals not later than January 31 of the calendar year following the calendar year to which such report relates."

Subsection (e)(1)(B). -- Pub. L. 105-34, Section 1601(h)(1)(A), struck 'subsection (c)(2)(C)' and inserted 'subsection (c)(3)(C)'. [Effective for provisions of the Small Business Job Protection Act of 1996 to which they relate.]

Subsection (e)(1)(C). -- Pub. L. 105-34, Section 1601(h)(1)(B), inserted '(or agency or instrumentality thereof)' after 'local government'. [Effective for provisions of the Small Business Job Protection Act of 1996 to which they relate.]

Subsection (e)(2). -- Pub. L. 105-34, Section 211(b)(1), amended subsection (e)(2). [Effective for January 1, 1998, for transitional rule see "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (e)(2) read as follows:

**"(2) MEMBER OF FAMILY**

"The term "member of the family" has the same meaning given such term as section 2032A(e)(2)."

Subsection (e)(3). -- Pub. L. 105-34, Section 211(a), amended subsection (e)(3). [See "Effective Date of 1997 Amendments" section below.]

Prior to its amendment, subsection (e)(3) read as follows:

**"(3) QUALIFIED HIGHER EDUCATION EXPENSES**

The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution (as defined in section 135(c)(3))."

Subsection (e)(5). -- Pub. L. 105-34, Section 211(b)(2), added at the end a new paragraph (5) defining an "Eligible Educational Institution". [Effective for distributions after December 31, 1997, with respect to expenses paid after such date (in taxable years ending after such date), for education furnished in academic periods beginning after such date.]

1996  
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Pub. L. 104-188, Section 1806(a), added new section 529, relating to "Qualified State Tuition Programs". [See "Effective Date of 1996 Amendments" section below]

#### EFFECTIVE DATE OF 1997 AMENDMENTS

Pub. L. 105-34, section 211(f)(2) provided the following rules for determining the effective date of amendments made by section 211(a):

"EXPENSES TO INCLUDE ROOM AND BOARD -- The amendment made by subsection (a) shall take effect as if included in the amendments made by section 1806 of the Small Business Job Protection Act of 1996."

"ELIGIBLE EDUCATION INSTITUTION -- The amendment made by subsection (b)(2) shall apply to distributions after December 31, 1997, with respect to expenses paid after such date (in taxable years ending after such date), for education furnished in academic periods beginning after such date."

"GIFT TAX CHANGES -- Paragraphs (2) and (5) of section 529(c) of the Internal Revenue Code of 1986, as amended by this section, shall apply to transfers (including designations of new beneficiaries) made after the date of the enactment of this Act." [August 5, 1997.]

"ESTATE TAX CHANGES -- Paragraph (4) of such section 529(c) shall apply to estates of decedents dying after June 8, 1997."

Pub. L. 105-34, section 211(f)(6) provided the following transitional rules for determining the effective date of amendments made by section 211(b)(1), (b)(3)(A)(i), (b)(3)(A)(ii), (b)(3)(B), (d), (e)(1)(A), (e)(2)(A), (e)(2)(C) and (b)(4):

"TRANSITION RULE FOR PRE-AUGUST 20, 1996 CONTRACTS - In the case of any contract issued prior to August 20, 1996, section 529(c)(3)(C) of the Internal Revenue Code of 1986 shall be applied for taxable years ending after August 20, 1996, without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a

member of the family."

#### EFFECTIVE DATE OF 1996 AMENDMENTS

Pub. L. 104-188, section 1806(c) provided the following rules for determining the effective date of amendments made by section 1806(a):

"(1) In general.--The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

"(2) Transition rule.--If--

"(A) a State or agency or instrumentality thereof maintains, on the date of the enactment of this Act, a program under which persons may purchase tuition credits or certificates on behalf of, or make contributions for education expenses of, a designated beneficiary, and

"(B) such program meets the requirements of a qualified State tuition program before the later of--

"(i) the date which is 1 year after such date of enactment, or

"(ii) the first day of the first calendar quarter after the close of the first regular session of the State legislature that begins after such date of enactment, the amendments made by this section shall apply to contributions (and earnings allocable thereto) made before the date such program meets the requirements of such amendments without regard to whether any requirements of such amendments are met with respect to such contributions and earnings. For purposes of subparagraph (B)(ii), if a State has a 2-year legislative session, each year of such session shall be deemed to be a separate regular session of the State legislature."

#### PUBLIC LAWS AMENDING THIS SECTION

(August 5, 1997, Pub. L. 105-34, title II, section 211, title XVI, Section 1601; July 22, 1998, Pub. L. 105-206, Section 6004.)

## SmartMoney calls UNIQUE "The best college savings plan ever"

The State of New Hampshire has teamed with Fidelity Investments as manager to offer the UNIQUE College Investing Plan (the UNIQUE Plan) - which SmartMoney called in an August 12, 1998 article, "the best college savings plan ever." This new plan, the article states, is better than an Education IRA - and residents of any state can take advantage of it.



### Other plans don't measure up

Soon after 1997 legislation made qualified state tuition programs for higher education more attractive, many state governments began sponsoring them. However, many limit your college choices to in-state schools and invest in historically lower yielding conservative debt investments. The UNIQUE Plan is "much better in almost every respect," according to SmartMoney, and it is available to all U.S. residents.

### Assets grow federal income tax-deferred

According to SmartMoney, the most attractive aspect of the UNIQUE Plan is that assets grow federal income tax-deferred. When assets are withdrawn for qualified higher education, they are taxed to the student, or "beneficiary," whose tax rate will most likely be lower than that of their parents, or the "participants" in the plan. The money can be used at accredited higher education institutions in the U.S. (Eligible expenses include tuition, room, board, and required supplies and equipment.)

### UNIQUE vs. Education IRAs

Since you cannot fund both an Education IRA and the UNIQUE Plan\*, it's important to understand some of the key differences between them.

Education IRA distributions are tax-free when used for qualified higher education expenses, but contributions are limited to \$500 annually. With costs for a four-year private college currently estimated at \$191,000 18 years from now, according to SmartMoney, a couple with an Education IRA may choose to invest other college savings in taxable accounts, and therefore may have to pay taxes on that money over the years.

However, the maximum annual contribution for the UNIQUE Plan is \$100,311 for 1998, and the minimum is \$1,000. SmartMoney points out that a couple could even invest \$100,000 in the UNIQUE Plan and avoid paying Federal gift taxes. Participants can make a gift of up to \$50,000 in a single

year without triggering the Federal gift tax - as long as the participant treats the entire gift as a series of five equal annual gifts.

**Effects of participation on financial aid and scholarships**

Under current Federal law, students must contribute 35% of their total assets to college costs annually before they can qualify for financial aid, and financial aid offices expect any money in a student's name to be used for college expenses. However, current Federal guidelines only require a maximum of up to 5.7% (depending upon the parents' financial situation) of parents' assets to be applied toward tuition before aid can be expected.

So, saving money in your child's name may reduce the chances of the child receiving financial aid. SmartMoney points out, though, if you have substantial assets and a high income, it is not realistic to expect financial aid with or without the plan.

However, if the beneficiary earns a scholarship and doesn't need the money saved in the plan, you can take penalty-free withdrawals up to the amount covered by the scholarship. And if you also qualify for Hope Scholarship and Lifetime Learning Credits, you may use them in conjunction with the UNIQUE Plan.

**Different investors, different choices - SmartMoney's advice**

The UNIQUE Plan's asset allocation is fairly conservative, SmartMoney says. You may prefer to invest on your own and allocate your money more aggressively. If you are confident you would make enough to offset the taxes you may have to pay - or are willing to take a greater investment risk that you wouldn't - you may prefer a taxable account to the UNIQUE Plan.

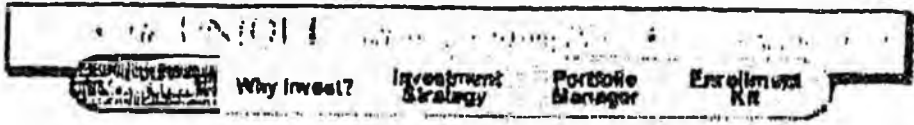
If you have money invested in stocks or a tax-efficient fund and would have to pay significant capital gains taxes to move it to the UNIQUE Plan, you may be better off leaving your money where it is. You should consult a tax advisor regarding your specific situation.

More information about the UNIQUE College Investing Plan.

\*A 6% excess contributions penalty will be applied to an Education IRA when the account owner has also contributed to a tax-deferred tuition savings plan during the same tax year.

*"The Best College Savings Plan Ever" SmartMoney Interactive, August 1996  
Ranking based on SmartMoney's comparison of the UNIQUE Plan's features to those of other types of college savings plans as reported in: "Five TOOLS FOR COLLEGE TOMORROW" SmartMoney Interactive. SmartMoney is a registered trademark of SmartMoney, a joint venture of Dow Jones & Company, Inc. and the Hearst Communications and SmartMoney is not affiliated with Fidelity.*

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### Overview

Each child is unique. A college investing plan should be too. That's why the State of New Hampshire has teamed with Fidelity Investments to offer you the UNIQUE College Investing Plan (the UNIQUE Plan)



*New Hampshire Plan*

The UNIQUE Plan is available to any U.S. resident. However, Fidelity also manages 529 investment plans for Massachusetts and Delaware. If you are a resident of one of those states, you may want to check into your state's plan.

### Investment and Tax Benefits

- ability to give up to \$50,000 federal gift tax free
- tax-advantaged growth of earnings
- a portfolio of Fidelity mutual funds tailored to the student's age

### Portability and Flexibility

- the ability to save for college while retaining control of your assets
- the flexibility to use your investment at any accredited post-secondary school in the U.S.
- a high contribution limit

### Affordability

- a low minimum investment requirement

The UNIQUE Plan is intended for individuals of all income levels with higher education goals for their children or loved ones. Parents, grandparents, other relatives and even family friends can all participate. Whether your beneficiary attends a private college, public university, graduate school, 2-year community college, vocational-technical school in- or out-of-state, the UNIQUE Plan can help you meet the significant financial challenge that lies ahead.

The only requirement for enjoying these unique benefits is that your investment be used to pay for qualified expenses at an accredited institution of higher education that is eligible to participate in certain federal student aid programs.

The UNIQUE Plan does not guarantee a rate of return and may not be right for everyone. However, if you are looking for a new way to invest for a child's higher education, it might be right for you.

**Download an enrollment kit, request one by mail, or call 1-800-644-1722 to speak with a UNIQUE Plan representative at Fidelity.**

### Investment and Tax Benefits

- Professional investment management by Fidelity. The UNIQUE Plan

puts the investment expertise of Fidelity to work for you.<sup>1</sup> You purchase units of one of the UNIQUE Plan portfolios. Balancing investment risks against potential returns can be a difficult task -- especially if you do not have the time or the inclination to do so. Investments in the UNIQUE Plan portfolios are managed by Strategic Advisers, Inc., a Fidelity Investments company. An experienced portfolio manager will automatically determine the portfolio's investment mix and make appropriate adjustments according to your beneficiary's age.

When your beneficiary is ten or more years away from college age, the portfolio will be heavily invested in equity mutual funds for growth of capital. As your beneficiary nears college age, the portfolio will gradually shift emphasis to bond and money market mutual funds to potentially preserve capital that will be readily available for college expenses.

You can learn more about the UNIQUE Plan's asset allocation and investment strategy, and read about the portfolio manager of the plan.

■ **Tax-advantaged earnings.** Earnings in your UNIQUE Plan account grow federal income tax-deferred. When assets are withdrawn for qualified expenses such as tuition, room and board, books, and required supplies, federal income taxes are payable by the beneficiary -- typically at his/her lower rate. For New Hampshire residents, qualified withdrawals are also completely exempt from the New Hampshire interest and dividends tax.<sup>2</sup> Non-residents are not subject to this tax. If you already have money set aside for college in a taxable account (such as a savings account), you may want to consider the tax benefits of moving it to the UNIQUE Plan. Consult your tax advisor for your particular situation.

■ **Flexible investing plans.** Any resident of the U.S. age 18 or over can open an account for their beneficiary. You can get started for as little as \$50 per month with automatic payments. There are no restrictions on participation based on your income. Parents, grandparents, other relatives and even family friends can open up accounts on behalf of the same beneficiary as long as the total amount in all accounts does not exceed the UNIQUE Plan limit of \$100,311 per beneficiary.<sup>3</sup>

Also, a gift of more than \$10,000 to a single person in one year is normally subject to federal gift tax. With the UNIQUE Plan, you can make a gift of up to \$50,000 in one year without triggering the tax. To do this you must elect to treat the entire gift as a series of five equal annual gifts. And no additional gifts can be made over the five year period. Consult your tax adviser for your particular situation.

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### Portability and Flexibility

■ **Portability to any school in the U.S.** Assets in the UNIQUE Plan can be used to pay for qualified higher education expenses at any accredited post-secondary institution in the United States that are eligible to participate in certain federal student aid programs. These include public and private colleges and universities, graduate schools, 2-year community colleges and vocational-technical schools.

■ **Change of beneficiaries.** Participants in the UNIQUE Plan retain control of their assets until account assets are withdrawn for qualified higher education expenses. Participants can change their beneficiary to be another family member of the original beneficiary without paying a penalty.<sup>4</sup>

■ **Withdrawals for non-higher education purposes.** You can take money from your account at any time. If your beneficiary receives a scholarship for higher education expenses, you may withdraw an amount equal to the value of the scholarship from your account without paying a penalty. You may also make penalty-free withdrawals in the event of the death or disability of your beneficiary. Otherwise, earnings on non-qualified withdrawals will be taxed to you as ordinary income at your rate, and a federally mandated penalty equal to 10% of any investment gains distributed will apply.

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### Affordability

■ **Affordable investments.** Investors who sign up for Fidelity's Automatic Account Builder<sup>®</sup> (FAAB) to make automatic payments directly from their bank accounts can open an account with a minimum initial investment of \$50 a month or \$150 per quarter. Otherwise, there is an initial minimum investment requirement of \$1000.

■ **Low fees and expenses.** The UNIQUE Plan charges an annual \$30 maintenance fee per account which is waived if you sign up for FAAB or if the combined value of your account and any other accounts with the same named beneficiary is \$25,000 or more. There is a daily charge at a rate equal to 0.30% (\$3 per \$1,000) of your account assets per year. Each of the mutual funds also has investment management fees and other expenses which vary from fund to fund. There are no sales loads imposed on your UNIQUE Plan purchase.

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*Important Point to Consider: Although the UNIQUE Plan has many benefits, it may not be appropriate for all investors. Please review your individual situation to make sure it is right for you.*

**Download an enrollment kit, request one by mail, or call 1-800-544-1722 to speak with a UNIQUE Plan representative at Fidelity.**

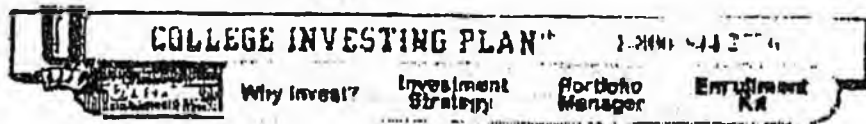
<sup>1</sup> Under federal law you cannot direct your own investments in the UNIQUE Plan.

<sup>2</sup> If you are not a New Hampshire resident, you may want to investigate whether your state offers a plan with alternative tax advantages for its residents.

<sup>3</sup> This contribution limit is for 1998 only and will be adjusted annually to reflect the changing costs of higher education. The limit for 1999 will be \$105,545.

<sup>4</sup> The new Beneficiary must have one of the following relationships to the original Beneficiary: (1) son or daughter, (2) stepson or stepdaughter, (3) brother, sister, stepbrother, or stepsister, (4) father or mother, or an ancestor of either, (5) stepfather or stepmother, (6) son or daughter of a brother or sister, (7) brother or sister of the father or mother, and (8) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law. The spouse of a family member is also considered a family member. However, if the new Beneficiary is a member of a younger generation than the previous Beneficiary, a federal generation-skipping gift tax may apply. The tax will apply in the year in which the money is distributed from an Account.

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**Overview**

To help you provide for the rising costs of higher education, the Massachusetts Educational Financing Authority (MEFA) has teamed with Fidelity Investments to offer you the U Fund<sup>SM</sup> College Investing Plan. The U Fund is flexible and affordable, and it combines significant tax advantages with experienced investment management.



*Massachusetts*

The U Fund is available to residents of all states. However, Fidelity also manages 529 investment plans for New Hampshire and Delaware. If you are a resident of one of those states, you may want to check into your state's plan.

Investment and Tax Benefits

- tax-advantaged growth of earnings
- potential for competitive market returns
- low investment requirement and high contribution limit currently over \$150,000

Flexibility

- the ability to save for college while retaining control of your assets
- use funds at most colleges and universities nationwide
- change of beneficiaries
- use of funds for tuition, fees, room, board, books and supplies

Affordability

- low fees and expenses

The U Fund is intended for individuals of all income levels with higher education goals for their children, grandchildren or other loved ones. Whether your beneficiary attends a private college, public university, graduate school, two-year community college or vocational-technical school, anywhere in the United States, the U Fund can help you meet the significant financial challenge that lies ahead. MEFA also offers the U Plan, a prepaid tuition program.

Although neither the Massachusetts Educational Financing Authority nor Fidelity Investments can guarantee a rate of return on your investments, the U Fund has been designed to be an

attractive and innovative opportunity to invest for higher education.

**Download an enrollment kit, request one by mail, or call 1-800-544-2776 to speak with a U.Fund representative at Fidelity.**

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### Investment and Tax Benefits

- **Tax-advantaged earnings.** Earnings in your U.Fund account grow federal and Massachusetts income tax deferred<sup>1</sup>. When assets are withdrawn for qualified expenses (including tuition, fees, room, board, books, and supplies), federal taxes are payable by the beneficiary, whose tax rate is typically lower.
- **Potential for competitive market returns.** Your contributions will be invested in units of one of the U.Fund portfolios. Strategic Advisers, Inc. (a Fidelity Investments company) will manage the U.Fund portfolios and invest in Fidelity mutual funds.<sup>2</sup> The portfolio manager will automatically adjust the balance of stock, bond, and money market mutual funds in the portfolio according to your beneficiary's age.

For a detailed explanation of the U.Fund's investment strategy, please see the [Investment Strategy](#) section or the [Fact Kit](#).

- **Low investment requirement and high contribution limit.** You can get started for as little as \$50 a month with automatic payments.<sup>3</sup> There are no restrictions on participation based on your income, and individual lump sum contributions of up to \$50,000 per beneficiary are permitted in a single year without there being a taxable gift.<sup>4</sup> Once assets are placed in the U.Fund, they are generally considered to be out of the participant's (the donor's) estate. (Consult your tax advisor for your particular situation.) If the value of all accounts opened on behalf of a single beneficiary exceeds the U.Fund contribution limit (currently over \$150,000<sup>5</sup>), further contributions will not be accepted.

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### Flexibility

- **Withdrawals for non-higher education purposes.** You can take money from your account at any time. However, if the money is not used to pay for qualified higher education expenses, earnings on such withdrawals will be taxed as ordinary income to you at your rate, and a federally mandated penalty equal to 10% of any investment gains distributed will

apply. If your beneficiary receives a scholarship for higher education expenses, you may withdraw an amount equal to the value of the scholarship from your account without paying a penalty. You may also make penalty-free withdrawals (subject to taxation of earnings) in the event of the death or disability of your beneficiary.

■ **Use of funds at schools anywhere in the U.S.** Assets in the U.Fund can be used to pay for qualified higher education expenses at accredited post-secondary institutions anywhere in the United States. These include public and private colleges and universities, graduate schools, two-year community colleges, and vocational-technical schools.

■ **Change of beneficiaries.** The participant (the donor) maintains control until account assets are withdrawn. The participant can change the beneficiary to be another family member of the original beneficiary - including adults returning to school - without paying a penalty.<sup>6</sup>

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### Affordability

■ **Low fees and expenses.** The U.Fund charges an annual \$30 maintenance fee per account, which is waived if you sign up for direct deposit or Fidelity Automatic Account Builder (FAAB) or if the combined value of your account and any other accounts for the same beneficiary is \$25,000 or more. There is a daily charge at a rate equal to 0.30% (\$3 per \$1,000) of your account assets per year. Each of the mutual funds also has investment management fees and other expenses which vary from fund to fund. No sales loads are deducted from your U.Fund purchase. Please see the [Fact Kit](#) for more details.

**Important Point to Consider:** Although the U.Fund has many benefits, it may not be appropriate for all investors. Please review your individual situation to make sure the U.Fund is right for you.

**Download an enrollment kit, request one by mail, or call 1-800-544-2776 to speak with a U.Fund representative at Fidelity.**

<sup>1</sup> Other states may offer plans with state tax advantages for their residents. If you are not a Massachusetts resident, you may want to contact your state to see if it offers a plan.

<sup>2</sup> Under federal law you cannot direct your own investments in the U.Fund.

<sup>3</sup> Periodic investment plans do not assure a profit and do not protect against a loss in a declining market.

<sup>4</sup> To avoid the federal gift tax on a \$50,000 contribution, you must make no further gifts to the beneficiary over the five-year period, and treat the gift as a series of five equal annual gifts. If you prorate a gift of less than \$50,000, you can make

additional gifts without gift tax so long as the total of the prorated gift and the additional gifts do not exceed \$10,000 in any one year. If you decide to prorate a gift of more than \$10,000, a prorated portion of the gift will be included in your estate if you should die before the end of the five-year period.

See the Fact Kit for the exact contribution limit and other details.

Family members include anyone who is related to the beneficiary in one of the following ways: sibling, half-sibling, step-sibling, niece or nephew, parent, step-child, grandparent, aunt or uncle, immediate in-law (mother, father, brother, sister, daughter or son), or the spouse of any family member listed above. However, changing the beneficiary to someone in a younger generation in the family will result in a federal gift tax. Pending clarification of its permissibility under federal tax requirements, the U Fund, at this point, does not permit you to name yourself as a beneficiary.



**Fidelity  
Investments**

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### Overview

Each child is unique. A college investment plan should be too. That's why the State of Delaware has teamed with Fidelity Investments to offer you the Delaware College Investment Plan (the College Plan).

*Delaware*

The College Plan is available to any U.S. resident

#### Investment and Tax Benefits

- tax-advantaged growth of earnings
- a portfolio of Fidelity mutual funds tailored to the student's age

#### Portability and Flexibility

- the ability to save for college while retaining control of your assets
- the flexibility to use your investment at nearly any accredited post-secondary schools anywhere in the U.S.
- a high contribution limit

#### Affordability

- a low minimum investment requirement

The College Plan is intended for individuals of all income levels with higher education goals for their children or loved ones. Parents, grandparents, other relatives, and even family friends can all participate. Whether your beneficiary attends a private college, public university, graduate school, 2-year community college, vocational-technical school, in- or out-of-state, the College Plan can help you meet the significant financial challenge that lies ahead.

The only requirement for enjoying this unique combination of benefits is that your investment be used to pay for qualified expenses at nearly any accredited institution of higher education, that is eligible to participate in certain Federal student aid programs.

The College Plan does not guarantee a rate of return and may not be right for everyone. However, if you are looking for a new way to invest for a child's higher education, it might be right for you.

**Request a free kit with more information on the College Plan or call 1-800-544-1655 to speak with a College Plan representative at Fidelity.**

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#### **Investment and Tax Benefits**

- **Professional investment management by Fidelity.** The College Plan puts the investment expertise of Fidelity to work for you. <sup>1</sup> You purchase units of one of the College Plan portfolios. Strategic Advisers, Inc., a Fidelity Investments company, will manage the College Plan portfolios and invest in

**Fidelity mutual funds.** An experienced portfolio manager will systematically adjust the balance of stock, bond, and money market mutual funds in the portfolio according to your beneficiary's age.

When your beneficiary is ten or more years away from college age, the portfolio will be heavily invested in equity mutual funds for growth of capital. As your beneficiary nears college age, the portfolio will gradually shift emphasis to bond and money market mutual funds to potentially preserve capital that will be readily available for college expenses.

You can learn more about the College Plan's asset allocation and investment strategy, and read about the portfolio manager of the plan.

■ **Tax-advantaged earnings.** Investments to the College Plan are made after tax. Earnings in your College Plan account grow Delaware state and federal income tax-deferred.<sup>2</sup> When assets are withdrawn for qualified expenses, such as tuition, room, board, books, and required supplies, federal income taxes are payable by the beneficiary, who typically will have a lower rate. As a result, if you already have money set aside for college in a taxable account (such as a savings account), you may want to consider the tax benefits of moving it to the College Plan. Consult your tax advisor for your particular situation.

■ **Flexible investment plans.** Any resident of the U.S. age 18 or over can open an account for their beneficiary. You can get started for as little as \$50 per month with automatic payments. There are no restrictions on participation based on your income. Parents, grandparents, other relatives, and even family friends can open up accounts on behalf of the same beneficiary as long as the total amount in all accounts does not exceed the College Plan limit of \$112,950 per beneficiary.<sup>3</sup> Also, a gift of more than \$10,000 to a single person in one year is normally subject to federal gift tax. With the College Plan, you can make a gift of up to \$50,000 in one year without triggering the tax. To do this you must elect to treat the entire gift as a series of five equal annual gifts. Consult your tax advisor for your particular situation.

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### Portability and Flexibility

■ **Portability to any school in the U.S.** Assets in the College Plan can be used to pay for qualified higher education expenses at any accredited post-secondary institution in the United States that are eligible to participate in Federal student aid programs. These include public and private colleges and universities, graduate schools, 2-year community colleges, and vocational-technical schools.

■ **Change of beneficiaries.** Participants retain control of their assets until account assets are withdrawn for qualified higher education expenses. Participants can change their beneficiary to be another family member of the original beneficiary -- including adults returning to school -- without paying a penalty.<sup>4</sup>

■ **Withdrawals for non-higher education purposes.** You can take money from your account at any time. If your beneficiary receives a scholarship for higher education expenses, you may withdraw an amount equal to the value

or the scholarship from your account without paying a penalty. You may also make penalty-free withdrawals in the event of the death or disability of your beneficiary. Otherwise, earnings on non-qualified withdrawals will be taxed to you as ordinary income at your rate, and a federally mandated penalty equal to 15% of any investment gains distributed will apply.

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### Affordability

- **Affordable investments.** Investors who sign up for Fidelity's Automatic Account Builder<sup>1</sup> (FAAB) – automatic payments transferred directly from your bank account – can open an account with a minimum initial investment of \$50 a month or \$150 per quarter. Otherwise, there is an initial minimum investment requirement of \$500.
- **Low fees and expenses.** The College Plan charges an annual \$30 maintenance fee per account which is waived if you sign up for FAAB or if the combined value of your account and any other accounts with the same named beneficiary is \$25,000 or more. There is a daily charge at a rate equal to 0.30% (\$3 per \$1,000) of your account assets on an annual basis. Each of the mutual funds that your portfolio may invest in also has investment management fees and other expenses which vary from fund to fund. No sales loads (charges) are deducted from your College Plan purchase.

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*Important Point to Consider: Although the College Plan has many benefits, it may not be appropriate for all investors. Please review your individual situation to make sure it is right for you.*

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<sup>1</sup>Under federal law you cannot direct your own investments in the College Plan.

<sup>2</sup>If you are not a Delaware resident, you may want to investigate whether your state offers a plan with alternative tax advantages for its residents.

<sup>3</sup>This contribution limit is for 1999 only and will be adjusted annually to reflect the changing costs of higher education. The limit for 1998 will be \$100,000.

<sup>4</sup>The new Beneficiary must have one of the following relationships to the original Beneficiary: (1) son or daughter, (2) stepson or stepdaughter, (3) brother, sister, stepbrother, or stepsister, (4) father or mother, or an ancestor of either, (5) stepfather or stepmother, (6) son or daughter of a brother or sister, (7) brother or sister of the father or mother, and (8) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law. The spouse of a family member is also considered a family member. However, if the new Beneficiary is a member of a younger generation than the previous Beneficiary, a federal generation-skipping gift tax may apply. The tax will apply in the year in which the money is distributed from an Account.



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