Education Savings Options

This flyer compares the unique features of the three most popular investment vehicles used to save for a child's education.

529 College Savings Plans

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Few investments are more important to a child's future than an education. *To save for your child's or grandchild's education, there are several investment vehicles available: a 529 College Savings Plan, a Coverdell Education Savings Account (formerly Education IRA), and a custodial account under Uniform Gift To Minors Act (UGMA) or the Uniform Transfer To Minors Act (UTMA). Each of these education savings options has its own unique benefits.*

Baird can help you choose the right education savings option to meet your goals.

529 COLLEGE SAVINGS PLANS

This popular savings plan makes use of Internal Revenue Code Section 529 to combine tax advantages with professional portfolio management. It offers a wide range of advantages not available with other education savings options.

- No income or age restrictions for participation in 529 plans.
- The investment is professionally managed, and earnings grow and compound federal income tax-deferred.
- Withdrawal of assets for qualified higher educational expenses is federal tax-free. The earnings portion of any withdrawal not used for qualified higher education expenses (or not made on account of death, disability or receipt of college scholarship of the beneficiary) is subject to a 10% penalty and is included in the account owner's income.
- Qualified expenses include tuition, fees, supplies and equipment, books, room, board, and computers, computer equipment, internet services and software. Also up to $10,000 annually for tuition at public, private and religious K-12[1]
- The contribution is a completed gift from the donor, reducing his or her taxable estate.
- The account owner, not the beneficiary, maintains discretionary control of the assets.
- The account owner can designate a new beneficiary who is a relative of the original beneficiary, without incurring taxes or penalties in most cases.
- No tax reporting unless there is a distribution.
- High contribution limits, which are set by the individual state plan.
- Five-year gift-averaging rule allows married couples to contribute up to $150,000 per beneficiary in a single year. Single account holders may fund up to $75,000. The "accelerated contribution" is prorated over five years for gift tax purposes, and no gift tax bill is incurred.
- 529s restrict the change of investment strategy to twice annually.

[1] Your state of residence may not conform to this federal change. Check with the 529 Program Manager or your tax advisor prior to taking a distribution for K-12.

COVERDELL EDUCATION SAVINGS ACCOUNTS (ESA)

This savings account is an incentive to help parents and students save for education. Up to $2,000 may be contributed to a child's Coverdell ESA each year. An ESA is available to contributors whose annual income doesn't exceed specified limits ($110,000 for single filers and $220,000 for joint filers for full participation).

- The beneficiary of the account must be under the age of 18 at the time of the contribution. There is no requirement that the beneficiary be your child or have any other particular relationship.
- Contributions can be made to both a 529 and a Coverdell ESA in the same year.
- Earnings accrue tax-deferred and withdrawals are tax-free if the money is used for qualified education expenses.
- Distributions can be used at qualified elementary, secondary and post-secondary educational institutions (private or public).
- Qualified expenses include tuition, fees, academic tutoring, special needs services, supplies and equipment, books, room, board, uniforms, transportation, computer equipment and other technology.[2]
- The account must be depleted by the time the beneficiary turns age 30.
- The beneficiary can be changed to another member of the family without triggering income tax and penalty provided the new beneficiary is under the age of 30.
- Withdrawals are paid to the beneficiary, and are not refunded to the parent or other person who establishes the account. The earnings portion of any withdrawal not used for qualified education expenses (or not made on account of death, disability or receipt of scholarship of the beneficiary) is subject to a 10% penalty and is included in the beneficiary's income.
- ESAs offer flexibility of shifting investment strategies at any time, allowing you to take advantage of bull markets and weather bear markets.

[2] Services must be required or provided by such school in connection with attendance or enrollment. Computer technology and equipment is defined in Internal Revenue Code 170(e)(6)(i). Computer software does not include software involving sports games, or hobbies, unless it is educational in nature.

CUSTODIAL ACCOUNTS (UGMA/UTMA)

Under the Uniform Gift to Minors Act (UGMA) or the Uniform Transfer to Minors Act (UTMA), you can open an account in a child's name and contribute as much as $15,000 in any year without incurring a gift tax.

- As trustee of the account, you direct the investment until the child reaches the age of termination of the custodianship. At that time, the child can use the money for whatever he or she chooses.
- Earnings are subject to annual capital gains and income taxes at the new trust tax rates, and the kiddie tax rules may apply to children under age 19, and dependent and full-time students under 24 for all unearned income.
- The assets can be used for anything that benefits the child.
- The assets of a custodial account are owned by the child and are an irrevocable gift.
- In the event of the minor's death, the assets in the custodial account become property of the minor's estate.
- The assets of a custodial account will be included in the custodian's gross estate for estate tax purposes should he or she die while serving as the custodian.
- Assets from a custodial account can be moved into a 529 or an ESA, but the assets continue to be owned by the child. The custodian cannot transfer the assets to another family member. If the assets are transferred from the custodial account to a 529 or ESA, the custodian must complete a disclosure form provided by the Baird Financial Advisor.

COLLEGE SAVINGS PLAN COMPARISON

Feature	529 College Savings Plan	Coverdell Education Savings Account (Formerly Education IRA)	Custodial Accounts (UTMA/UGMA)
Income Limits for Contribution Eligibility	None	Yes	None
Contribution Limits	Program specific, but most are over $400,000	$2,000 per year	Restricted only by impact of gift tax ($15,000 annual exemption)
Control of Assets	Owner of the account	Responsible individual, as named in application, until beneficiary reaches age of majority	Custodian (until the beneficiary reaches the age of termination)
Change of Beneficiary	Yes	Yes	No
Self-Directed Investment	No	Yes	Yes
Requirement to Deplete the Account	No	Yes	No
Qualified Distributions	Higher education expenses Limited K-12 tuition	Elementary, Secondary and Higher education expenses	Any expenses benefiting the beneficiary
Taxation of Withdrawals	Federally tax-free and penalty-free if the money is used for qualified higher education and limited K-12 tuition[3]	Tax and penalty-free if the money is used for qualified education[3]	Subject to mix of ordinary income and capital gains taxes
Effect on Federal Financial Aid	LESS. The account is the asset of the owner, and may be considered available	LESS. Considered the asset of the account custodian	MOST. Considered the student's assets, which may lower financial aid eligibility by as much as 20%

[3] The earnings portion of any withdrawal not used for qualified education expenses (or not made on account of death, disability or receipt. of college scholarship of the beneficiary) is subject to a 10% penalty and income tax.

FINANCIAL AID CONSIDERATIONS

Financial aid is money provided by the federal and state government, as well as educational institutions, to assist students with paying for higher education. The amount of financial aid that a student receives depends on one of two things: the student's financial need and the student's merit.

When applying for federal financial aid, assets belonging to the student will have a greater negative impact on financial aid than parental assets. At most 5.6% of the parents' assets compared to 20% of the student's assets are considered available for funding college. Coverdell Education Savings Accounts (ESA) and 529 College Savings Plans receive equal treatment in the calculation of federal financial aid. ESAs and 529s will be treated as parental assets on the Free Application for Federal Student Aid (FAFSA) form if the account is owned by the parent, by a dependent student or by a custodian for the student. The value of a 529 account owned by a grandparent or other non-parent is not included on the FAFSA form. However, if a grandparent (or other non-parent) provides any type of financial support to the student, that support is reportable as student income on the following year's FAFSA.

Distributions from ESA and 529 College Savings Plans used for qualified educational expenses are not counted as parent or student income in the determination of federal financial aid eligibility and therefore do not reduce financial aid eligibility. On the other hand, custodial accounts (UGMA/UTMA) are assets of the student, which are included when determining a student's financial aid eligibility.[4]

[4] Please refer to the U.S. Department of Education Financial Aid Handbook at www.ifap.ed.gov for more information.

QUALIFYING FOR FINANCIAL AID

Investors saving for college often wonder what effect saving may have on a student's chances of qualifying for financial aid. There are several types of financial aid (federal, state and institutional), but federal aid is the most widely dispersed, and a family seeking any financial aid must complete the Free Application for Federal Student Aid (FAFSA).

The chart below shows the ranges of parent, student and grandparent income and assets used to calculate an annual Expected Family Contribution (EFC) for a student. Once EFC is determined, an institution's financial aid officer subtracts it from the institution's cost of attendance to determine annual financial need. The chart below shows income is more heavily factored than assets.

	PARENT	STUDENT	NON-PARENT
INCOME	22% - 47% of available income	50% of student income (after certain allowances)	Not included
ASSETS	**0% of assets** • Retirement Accounts such as IRAs[4] or 401(k) • Equity in your primary home, a family-owned business, insurance policies and annuities **0% - 5.6% of assets** • 529 savings plan (where parent is owner)[6] • Prepaid tuition plans (where parent is owner) • Coverdell ESA (where parent is owner)[6] • Securities • Mutual Funds • Bank accounts, CDs	**0% of assets** • Retirement Accounts such as IRAs[4] or 401(k) **0% - 5.6% of assets** • 529 savings plan (student owned 529 where student is a dependent)[6] • UTMA-529 (where student is a beneficiary)[6] • Coverdell ESA (where student is owner)[6] **20% of assets held in student's name** • 529 savings plan (student owned 529 where student is an independent)[6] • UGMA/UTMA accounts • Minor trusts • Savings bonds (in student's name) • Money, investments, business interests and real estate	**0% of assets** • Retirement Accounts such as IRAs[1] or 401(k) • 529 savings plan (where non-parent is owner) *Simply owning a 529 account for a child will not affect that child's financial aid eligibility*[7] • Coverdell ESA (where non-parent is owner) **Word of caution:** Financial aid offices are required to treat distributions from non-parent owned 529s as aid to the student that will count as income for the year the withdraw was taken (remember 50% of a student's income counts towards the EFC). Therefore when the non-parent takes a distribution to pay for higher education it may negatively affect the beneficiary's financial aid eligibility when they apply for Financial Aid in the future.

[5] Though the tax law now permits penalty-free withdrawals from traditional or Roth IRAs to pay for qualified college costs, doing so could jeopardize financial aid in the following year. The entire withdrawal, principal and earnings, counts as income on the following year's aid application.

[6] Withdrawals from a 529 plan and an ESA are treated advantageously. Such withdrawals when used for college are excluded from your federal income tax return, and according to the U.S. Department of Education are not required to be "added back" when reporting your family income on the student's FAFSA.

[7] Financial aid offices are required to treat distributions from grandparent-owned and other non-parent owned 529s as aid to the student, even when the distributions are not reportable for federal income taxes (i.e. they are tax-free). The distribution will be included as income to the student in the following year.

Note that some colleges will calculate financial need using a different formula when offering their own grants and tuition discounts. The "institutional methodology" used by many of these colleges may count home equity, sibling assets, and certain investment accounts in a manner that differs from the federal methodology.

Investors should consider the investment objectives, risks, charges and expenses associated with a 529 Plan before investing. This and other information is available in a Plan's official statement. The official statement should be read carefully before investing.

Depending on your state of residence, there may be an in-state plan that provides tax and other benefits such as financial aid, scholarships and creditor protection that are not available through an out-of-state plan. Before investing in any state's 529 plan, you should consult your tax advisor.