MFS Heritage Planning®
Helping Yourself. Helping Your Parents. Helping Your Children.®

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EDUCATION PLANNING

By the numbers

- All states and the District of Columbia now offer 529 plans.[1]
- Coverdell Education Savings Accounts allow you to invest up to $2,000 per year.[1]
- Depending on your state, 529 college savings plans can allow you to invest over $300,000 over the life of the account.[2]

[1] www.finaid.org.
[2] www.savingforcollege.com, 2014.

This material should be used as helpful hints only. Each person's situation is different. You should consult your investment professional or other relevant professional before making any decisions.

UNDERSTANDING YOUR COLLEGE SAVINGS OPTIONS

Parents today have more choices than ever for college savings. While that variety gives families greater flexibility, it also means parents need to do more research to find the strategy that is right for them.

Choosing the right savings approach

For most parents, paying for their children's college education will be one of their greatest financial challenges. While financial aid is available for many students, there are different types of aid, some of which must be repaid. In 2013–2014, undergraduate students received 54% of their aid in the form of grants, 37% as loans and 9% in a combination of tax credits or deductions and Federal Work-Study.[3] However, parents can reduce the burden of student loans for their children by saving wisely for college expenses. In addition to traditional saving and investment accounts, parents can choose from a number of different educational savings vehicles designed to help families meet their goals. While each of these options offers certain features and advantages, you will need to answer the following questions carefully when choosing one or more of these plans.

- Does the money potentially grow tax deferred? Are earnings taxed when withdrawn?
- Is there flexibility in how the funds may be used?
- Is a parent or child the account owner? How will this affect financial aid?
- Can you change investments? How often?

[3] Source: Trends in Student Aid 2014, College Board.

Key points

Coverdell ESAs
- Qualified uses include K–12 costs, as well as college expenses.
- Earnings are tax deferred, and withdrawals are tax free if used for qualified educational expenses.

529 plans
- Prepaid tuition plans can help in keeping pace with inflation.
- Earnings are tax deferred, and withdrawals are tax free if used for qualified educational expenses.

Custodial accounts
- Unlimited investment amounts are allowed.
- Earnings over $2,000 are taxed at the parent's income tax rate.

continued on page 2

continued from page 1

- Are there contribution limits per year? For the life of the fund?
- Can you change beneficiaries?
- Are there penalties on nonqualified withdrawals?

The savings options you choose can have a significant impact on your family's eligibility for federal financial aid, depending on whether you or your child is considered the account owner.

Generally, up to 5.6% of parental assets can be factored into the financial aid equation, in contrast to the 20% of student assets that can be applied. As a result, assets owned by the child can have the effect of reducing substantially the amount of need-based financial aid a student may receive.

The following is an overview of three kinds of college savings accounts: 529 plans, Coverdell ESAs and UGMA/UTMA custodial accounts. Each of these accounts has its advantages and disadvantages, and all are governed by a complex set of tax laws. That is why it is important to consult with your financial or tax advisor before choosing one or more of these options.

529 plans

Named for the section of the Internal Revenue Code that governs them, 529 plans come in two varieties — prepaid tuition plans and college savings plans — and generally are state sponsored. Like ESAs, both types of plans allow deferral of annual taxes on account earnings, and earnings on withdrawals used for qualified higher education expenses are tax free.

529 prepaid tuition plans

Prepaid tuition plans offer protection against tuition increases by letting parents buy tuition credits for the future at today's prices. As most prepaid tuition plans are operated by state governments, the projected tuition is generally based on in-state public college tuition rates. In the event the student decides to attend a private or out-of-state institution, typically the plan will pay an amount equal to public in-state rates and the family will pay the difference.

The features of prepaid plans, including fees, contribution limits and maximum account balances, can vary significantly from state to state, although prepaid plans usually cover up to five years of college expenses. Although there is no risk to principal, it is important to note that the returns on most — but not all — prepaid plans are guaranteed by their respective states.

529 college savings plans

College savings plans, unlike some prepaid plans, provide no guarantees on investment returns. As with an IRA or 401(k), they allow the account owners to choose their investment strategies from among the options offered under the particular plan.

This offers parents the potential to earn returns above the yearly tuition inflation rate a prepaid plan offers but also may involve greater risks. You should consider your financial needs, goals and risk tolerance prior to investing.

There are no annual contribution limits on 529 savings plans, and depending on the state, account balances can accumulate over $300,000. 529 plans also offer special gifting and estate tax benefits. You can gift up to $14,000 per year per beneficiary without federal gift-tax consequences. Under the unique accelerated gifting features of 529 plans, an individual can contribute as much as $70,000 ($140,000 per couple), or the equivalent of five years of gifts, to a 529 plan in one year. You will not incur gift-tax ramifications as long as no additional gifts are made to the beneficiary for four years after you make the five year gift.[4] This feature might be valuable to a grandparent, for example, who wants to help fund a grandchild's education while at the same time reducing the size of his or her estate.[5]

Choosing the right state plan

All states and the District of Columbia offer 529 plans; some offer only college savings plans, while several offer only prepaid tuition plans. While some plans are restricted to in-state residents, many 529 plans are available to residents of any state. About half of the states' plans offer in-state residents additional state income tax benefits. Still, even parents who live in states with tax benefits for residents may want to compare all their options. A college savings plan from another state may offer advantages, such as a wider range of investment options, that could outweigh the tax benefits of participating in an in-state plan. When putting money into any 529 plan, however, parents need to be mindful of the fact that it may have additional plan fees that other investments, such as custodial accounts, do not.

[4] This assumes you live for four years after the year of the gift and file the appropriate tax form.

[5] However, if the account owner elected to treat the gifts as having been made over a five-year period and dies before the end of the five-year period, the portion of the contribution allocable in the remaining years of the five-year period would be includable in computing the account owner's gross estate for federal estate tax purposes. Information is based on 2015 tax rules, which are subject to change.

continued on page 3

continued from page 2

While 529 savings plans have always been considered a parental asset, the treatment of 529 prepaid tuition plans was a different story. 529 prepaid tuition plans were categorized as a student resource that could reduce need-based financial aid awards up to 100%. This changed in 2006, when a law went into effect that made both types of 529 plans parental assets, a clear advantage when applying for financial aid.

Coverdell Education Savings Accounts (ESAs)

Under an ESA, parents and other contributors can make non-deductible contributions of up to $2,000 per child, per year, and investments in an ESA potentially grow tax free as long as withdrawals are used to pay for qualified school expenses. The $2,000 annual limit applies to the total of all contributions made on behalf of the beneficiary for the year, no matter how many separate ESAs or how many separate contributors there are. Because the custodian of an ESA, typically a parent, is considered to be the owner, money accrued in these accounts may allow for a larger grant of financial aid than money saved in a traditional custodial account, where the child is the actual owner.

ESAs have another feature that could prove helpful to many families: Qualified withdrawals cover not only college costs but also expenses for grades K – 12, including equipment such as computers.

Income restrictions apply to any year you contribute to a Coverdell ESA. The top contribution of $2,000 may be reduced for individuals whose modified adjusted gross income falls between $95,000 and $110,000 for single filers or between $190,000 and $220,000 for joint filers. However, if your circumstances change, there is no tax penalty for converting an ESA to a 529 plan — a college savings plan with no income limits and similar tax benefits.

Custodial accounts

These are the old standbys for college savings. They are also known as UGMAs and UTMAs, which are the initials for the state laws that govern them: the Uniform Gifts to Minors Act and the Uniform Transfers to Minors Act.

Custodial accounts do not provide the potential to defer or escape taxes on investment gains. The first $1,000 of earnings in a custodial account remains tax free; the next $1,000 is taxed at the child's rate. Any earnings above that are taxed at the parent's rate until the child reaches age 24, when earnings are taxed at the child's rate. In addition, custodial accounts are considered an asset of the child, which can significantly reduce financial aid.

However, contributions to custodial accounts are unlimited, and there is no maximum balance. Custodial accounts do not have the additional plan fee that many 529 plans do, and the parent, as custodian, can select account investments and move assets between various types of investments as he or she wishes. The level of risk depends on the type of investment vehicle chosen.

Custodial accounts also offer parents flexibility in how the money is used: Withdrawals are not restricted to educational expenditures but can be spent in any way that benefits the minor. On the other hand, the accounts become the child's asset at either age 18 or 21 (depending on the state). If a child wishes to use the money for a purpose other than college, the parent has no legal right to stop him or her.

No matter which savings option you choose for a child's higher education, your foresight could help your child avoid being weighed down by large college loan debts as he or she gets started on a career.

continued on page 4

continued from page 3

Make educated decisions

College investing programs come in many shapes and sizes today. That is why the insight and guidance of a financial advisor is so valuable. He or she will not only help you choose the right college plan but also can help you select the investment options that best fit your needs and tolerance for risk.

	529 Plans		Coverdell ESA	Custodial accounts (UGMA/UTMA)	Taxable accounts
	529 savings plans	529 prepaid tuition plans			
Federal taxes	Tax deferred. Earnings on withdrawals tax free if used for qualified expenses.	Tax deferred	Tax deferred. Earnings on withdrawals tax free if used for qualified expenses.	First $1,000 of earnings tax free; next $1,000 taxed at beneficiary's rate. Amounts over $2,000 taxed at parent's rate	Fully taxable
Contribution limits	No annual limit.* Account maximum varies by plan; can be over $300,000.	Varies by plan. Account maximum generally covers up to five years of college expenses.	$2,000 per child per year[5]	No limits	No limits
Income limits	No limits		Eligibility phases out for single filers from $95,000 to $110,000; for joint filers from $190,000 to $220,000.	No limits	No limits
Control of assets	Account owner (usually parent)		Account owner (usually parent)	Custodian (usually parent) until child reaches majority, then the child	Account owner
Investment flexibility	Generally, investments may be changed twice a year or if changing beneficiaries.	State or sponsor manages investments; offers return tied to tuition inflation rate.	Can change investments at any time	Can change investments at any time, but transfer is usually taxable event	Unlimited, but may be taxable
Federal financial aid impact	Considered parental asset; favorable for financial aid		Considered parental asset, favorable for financial aid	Considered student asset; negative impact on financial aid	Considered parental asset; favorable for financial aid
Qualified uses	Post-secondary school expenses, including tuition, fees and room and board (and graduate school)	Most cover tuition and fees only based on in-state rates; some cover room and board.	Post-secondary and K–12 expenses	No restrictions	No restrictions
Changing beneficiaries	Can be transferred to another family member without penalty. Beneficiaries usually restricted to in-state residents.	Can be transferred to another family member without penalty. Beneficiaries usually restricted to in-state residents.	Can be transferred to another family member without penalty	Beneficiary cannot be changed.	N/A
Federal gift and estate tax	Can gift up to $70,000 per individual beneficiary per year ($140,000 per married couple) with no gift tax consequences.** Assets transferred out of owner's estate.		$2,000 yearly limit falls under annual $14,000 gift tax exclusion. Assets transferred out of owner's estate.	Standard annual $14,000 gift tax exclusion	N/A
Penalties on nonqualified withdrawals	Earnings subject to income tax and 10% IRS penalty	Fees or penalties vary by plan. Typically donor gets principal plus modest return.	Earnings subject to income tax and 10% IRS penalty	None	N/A

* See annual gift tax limits.

** This assumes you live for at least four years after the year of the gift and file the appropriate tax form, but see annual gift tax limits.

[5] However, if the account owner elected to treat the gifts as having been made over a five-year period and dies before the end of the five-year period, the portion of the contribution allocable in the remaining years of the five-year period would be includable in computing the account owner's gross estate for federal estate tax purposes. Information is based on 2015 tax rules, which are subject to change.

continued on page 5

continued from page 4

The MFS® 529 Savings Plan is a flexible college investing plan sponsored by the state of Oregon, acting by and through the Oregon 529 College Savings Board, and is part of the Oregon 529 College Savings Network. MFS Fund Distributors, Inc. is the Program Manager. MFS 529 Savings Plan accounts are considered municipal fund securities.

Depending on your state of residence and the state of residence of the beneficiary, an investment in the MFS 529 Savings Plan may not afford you or your beneficiary state tax benefits or other benefits available only for investments in such state's qualified tuition program. See your tax advisor to be sure you understand the tax issues related to a 529 plan. Withdrawals of earnings not used to pay for qualified higher education expenses are subject to an additional 10% federal tax penalty. State taxes may also apply.

There is a $25 annual account fee associated with the MFS 529 Savings Plan. This annual fee is waived for Oregon residents and for those accounts with assets of $25,000 or more. Investments in 529 plans involve investment risks. You should consider your financial needs, goals, and risk tolerance prior to investing.

Before investing in the MFS 529 Savings Plan, consider the investment objectives, risks, charges, and expenses. For a prospectus or summary prospectus containing this and other information, as well as a Participant Agreement, Disclosure Statement, and Expense Supplement, contact your investment professional or view online at **mfs.com**. Read them carefully.

Resources

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