Virginia Prepaid Education Program℠

DISCLOSURE STATEMENT

As of December 1, 2006

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This Disclosure Statement and the other documents included in your Enrollment Kit contain important information you should review before participating in the Virginia Prepaid Education Program℠ (VPEP). Please read it carefully and save it for future reference. Potential Account Owners should rely only on the information contained in this Disclosure Statement, the Master Agreement and other documents contained in the Enrollment Kit. No one is authorized to provide information that is different from information contained in these documents. If you speak with an interpreter provided by the Virginia College Savings Plan, please be advised that the Virginia College Savings Plan is not responsible for any miscommunication of facts concerning VPEP during such conversations. Information in this Disclosure Statement is believed to be accurate as of the date of its printing and is subject to change without notice. Please see the Master Agreement (enclosed with this Disclosure Statement) for the definitions of capitalized terms. VPEP has been designed to comply with all requirements for treatment as a qualified tuition program under Section 529 of the Internal Revenue Code. As of the date of this printing, the Internal Revenue Service has not yet issued final regulations concerning the application of Section 529 to qualified tuition programs. Final regulations, changes to the Internal Revenue Code or to the *Code of Virginia* could affect the tax consequences of participation in a qualified tuition program like VPEP. The Board may modify VPEP as necessary in the future to comply with any such changes in order to preserve, if possible, favorable tax treatment.

Virginia Prepaid Education Program Summary of Key Features

Program Administrator: The Virginia College Savings Plan (VCSP) is the Administrator and sponsor of VPEP. VCSP is governed by an eight-member Board, consisting of four members who sit on the Board by virtue of the state offices they hold and four citizen members appointed by the Governor of Virginia. In addition to VPEP, VCSP administers the Virginia Education Savings Trust (VEST), a direct offered college savings option, CollegeAmerica,® a college savings option available only through financial advisers, and CollegeWealth, available through participating banks starting in 2007.

Investment Managers: Upon consultation with its investment consulting firm, VCSP's Board selects the team of firms and mutual funds that professionally manage the stock and fixed income securities within VPEP. The investment managers are listed on page 4.

Federal Tax Treatment: Earnings on withdrawals used to pay qualified higher education expenses may be excluded from income for federal tax purposes. Earnings can grow tax-deferred while invested in a VPEP account.

State Tax Treatment: Virginia taxpayers who are VPEP Account Owners may take a state income tax deduction for VPEP payments. There is also a state tax exemption, and all earnings are state tax deferred while invested in a VPEP account and are exempt from state income tax when used for qualified higher education expenses. Other states may offer residents and taxpayers additional tax or other benefits if they invest in their own state plan. Consult your tax adviser for more information.

Limitations on Participation or Benefits: Either the Account Owner or the Beneficiary must be a Virginia resident in order to participate in VPEP. Account Owners and Beneficiaries must be U.S. citizens or legal residents of the U.S. Beneficiaries must have been born at the time the account is opened, and may not have completed the ninth grade. There are no income restrictions on participation in VPEP. There can be only one Account Owner per account, but more than one person may contribute to an account. Payments from non-Account Owners will be deemed to have been made by the Account Owner for VPEP record-keeping purposes.

Limitations on Contributions, Distributions and Transfers: The total value of all accounts for a single Beneficiary in all Section 529 plans administered by the VCSP (VPEP, VEST CollegeAmerica and CollegeWealth) is limited to $250,000. Multiple accounts for the same Beneficiary will be combined to determine if the maximum account value has been reached. Once the aggregate balance on all accounts for the same Beneficiary reaches $250,000 (including any earnings), VCSP will not accept additional deposits or rollovers. Earnings on distributions not used for qualified higher education expenses will be subject to federal and state income tax and a federal penalty tax of 10% of the earnings. Transfers to other qualified tuition programs may be made once every 12 months for the same Beneficiary, and at any time if the Beneficiary is changed.

Risk Factors: Your investment in VPEP is guaranteed by VPEP and earnings on its assets. State law provides that a line of credit must be included by the Governor in each year's state budget to cover VPEP's contractual obligations in the event of a funding shortfall. This provision can only be changed through the annual appropriations process, which would require action by the Virginia General Assembly, subject to the Governor's veto, and the General Assembly's ability to override a veto. It is possible that Congress, the Treasury Department, the IRS, the Commonwealth of Virginia and other taxing authorities or the courts may take actions that will adversely affect VPEP and that such adverse effects may be retroactive. A VPEP Contract may affect a Beneficiary's ability to qualify for federal need-based financial aid as it is included as an asset of the Account Owner. Accounts owned by dependent students are not counted as an asset for federal financial aid purposes. VPEP Contracts should not affect a Beneficiary's eligibility for either a merit-based scholarship or for a Virginia Tuition Assistance Grant for Virginia students who attend eligible private, nonprofit institutions of higher education in Virginia.

General Information

This Disclosure Statement provides details concerning the purchase of prepaid college tuition Contracts from the Virginia College Savings Plan, an independent agency of the Commonwealth of Virginia, authorized by Chapter 4.9 of Title 23 of the *Code of Virginia* (1950), as amended (Sections 23-38.75 through 23-38.87). In order to purchase a Virginia Prepaid Education Program Contract for the 2006-2007 enrollment period, you must submit an Application between December 1, 2006 and February 28, 2007. The Board may, in its sole discretion, accept Applications at other times or during special promotions. Applications for the purchase of a Contract are available at the office of the Virginia College Savings Plan, James Monroe Building, 5th Floor, 101 North 14th Street, Richmond, Virginia, 23219 or may be obtained by calling, toll free, 1-888-567-0540. You may also apply online at **www.Virginia529.com**. The application for, purchase, and ownership of a Contract are governed by the terms of the Contract, the Plan's enabling legislation, Section 529 of the Internal Revenue Code (26 U.S.C. Section 529), and any applicable rules and regulations.

The purchase of a prepaid tuition Contract should be viewed as a long-term financial commitment because generally no distributions are made until a Beneficiary enrolls in an institution of higher education. Contracts are for the specific purpose of prepaying in-state rates of undergraduate tuition and mandatory fees for the normal, full-time course load at two- and four-year public institutions of higher education in Virginia ("Virginia Public Institutions"), and for application toward payment of tuition and fees at other public or accredited, nonprofit, independent institutions of higher education and certain private career schools (eligible educational institutions), and should not be regarded as an investment to be used for any other purpose.

The terms and features of VPEP in subsequent enrollment periods may differ from the terms and features described in this Disclosure Statement. No representation is made or assurance given that there will be additional enrollment periods, or that enrollment periods will take place annually. The Board may limit the number of Contracts that may be purchased in any given enrollment period, although there are currently no plans for any such limits.

VPEP provides no assistance to a Beneficiary with respect to admission to, continuation at, or graduation from a college or university other than the payment of tuition and mandatory fees as described in the Contract. The purchase of a Contract does not guarantee that a student will qualify for acceptance or in-state tuition rates at a particular Virginia Public Institution or any other institution of higher education. For need-based financial aid, the receipt of VPEP Contract Benefits may preclude a Beneficiary from qualifying for some amount of need-based federal financial aid as the refund value of the Contract is included as an asset of the Account Owner. The receipt of Contract Benefits should not affect the Beneficiary's receipt of merit-based financial aid (academic or athletic scholarships, for example). If a student receives a full or partial athletic scholarship that is governed by NCAA or ACC regulations, a payment from VPEP may affect that scholarship. Ownership of a VPEP Contract will not be taken into account when determining a student's eligibility for Virginia financial aid. VPEP Benefits do not affect a student's eligibility for a Virginia Tuition Assistance Grant for Virginia residents who attend an eligible, independent, nonprofit institution of higher education in Virginia. The best resource for more detailed information is the financial aid office of your local community college or university. VPEP Contracts may also affect the Beneficiary's or Account Owner's qualification for certain federal or state need-based benefit programs, such as Medicaid.

The Virginia College Savings Plan

The Virginia General Assembly created the VCSP at its 1994 session and its enabling legislation is codified at Sections 23-38.75 through 23-38.87 of the *Code of Virginia*. The General Assembly may amend the legislation during any regular or special session of the legislature, subject to the Governor's approval and the General Assembly's ability to override a veto. The Contracts create an obligation to pay a Contract Beneficiary's in-state, undergraduate tuition for the normal full-time course load for students enrolled in a general course of study at any Virginia Public Institution and all mandatory fees required as a condition of enrollment of all students for the specified number of academic terms purchased under either the university plan or the community college plan. Contract Benefits may also be applied toward the cost of tuition and fees at other public or independent, nonprofit, accredited institutions of higher education and at certain private career schools, as well as toward the cost of graduate-level tuition, but does not guarantee payment in full of tuition and mandatory fees at any institution of higher education other than a Virginia Public Institution, as described above. Contract Benefits are guaranteed by VPEP and earnings on its assets. In addition, state legislation provides that a line of credit must be included by the Governor in each year's state budget to cover VPEP's contractual obligations in the event of a funding shortfall.

The VCSP is administered by an eight-member Board, consisting of four members who sit on the Board by virtue of the state offices they hold and four citizen members appointed by the Governor. The ex-officio members are the Executive Director of the State

Council of Higher Education for Virginia; the Chancellor of the Virginia Community College System; the State Treasurer; and the State Comptroller. State law mandates that the four citizen members have significant experience in finance, accounting, or investment management. Members of the Board receive no compensation, but are reimbursed for actual expenses incurred in the performance of their duties. The Plan's Executive Director is Diana F. Cantor. Ms. Cantor, an attorney, certified public accountant, and former investment banker, oversees the daily administration and operations of the VCSP.

The price for a Contract in a particular enrollment period is determined actuarially. The Board has retained Milliman USA, Inc. to provide actuarial services. Based upon the annual actuarial valuation and changes in tuition and mandatory fees at Virginia Public Institutions, the Board may adjust the price of Contracts in subsequent enrollment periods.

No Account Owner or Beneficiary may direct the investment of any contributions to a VPEP Contract or any earnings thereon either directly or indirectly.

Mercer Investment Consulting, Inc., a registered investment adviser, serves as the Board's investment consultant. The Board has selected the following investment managers to assist with the investment of assets: Western Asset Management Company, Tattersall Advisory Group, and Lord Abbett (fixed income); Vanguard Total Bond Market Index Fund and Vanguard Inflation Protected Securities Fund (indexed fixed income); Rothschild Asset Management, Inc., Westfield Capital Management, Donald Smith & Co., Thompson, Siegel & Walmsley, Inc., Century Capital Management, and Pier Capital, LLC (small and midcap equity); Vanguard 500 Index Fund, Vanguard Small Cap Index Fund, and Vanguard Total Stock Market Index Fund (indexed equity); Chase Investment Counsel Corporation, Sands Capital Management, Inc., LSV Asset Management, and NWQ Investment Management Company (large-cap equity); Franklin Templeton and EuroPacific Growth Fund (non-U.S. equity); Vanguard REIT Index Fund (indexed real estate investment trust); and INVESCO (stable value).

The Board is required to submit an annual statement of VPEP's receipts, disbursements, and current investments for the preceding year to the Governor, the Senate Committee on Finance, and the House Committees on Appropriations and Finance. The report includes a complete operating and financial statement covering the operation of the VCSP during the year, including a statement of projected receipts, disbursements, investments, and costs for the further operation of the VCSP. The Auditor of Public Accounts, or his legally authorized representatives, audits the VCSP's accounts annually.

Buying A Contract

To purchase a Contract, you must submit an Application or apply online during an enrollment period. The Application must be submitted with a nonrefundable application processing fee of $25. The Board may waive fees on a case-by-case basis and offer special marketing incentives from time to time. Either the Account Owner or the Beneficiary must be a Resident of Virginia at the time the Contract is purchased, and the Beneficiary must not have completed the ninth grade. Account Owners and Beneficiaries must also be U.S. citizens or legal resident aliens. Military personnel stationed in Virginia or who claim Virginia as their domicile may also purchase Contracts. An Account Owner does not have to be related to the Beneficiary. There may only be one Account Owner, who is the owner of the Contract, and only the Account Owner may make changes to or cancel the Contract. The Account Owner may designate on the Application (or at any time in the future by written authorization) other individuals who may have access to account information. Trusts, corporations, partnerships and other persons described in Section 7701(a)(1) of the Internal Revenue Code of 1986, as amended (26 U.S.C. Section 7701(a)(1)), may purchase Contracts for designated Beneficiaries, or for undesignated Beneficiaries as scholarships either directly (if the entity has 501(c)(3) status) or through the VCSP. Information on scholarship accounts is available by calling toll-free 1-888-567-0540.

Depending on the specific state legislation, you may also be able to open a VPEP Contract with Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA) funds, although these types of accounts involve additional restrictions that do not apply to regular VPEP accounts, such as the inability to transfer the VPEP Contract to another Beneficiary. If you are using UGMA or UTMA funds to establish a VPEP Contract, you must indicate that the account is custodial by checking the appropriate box on your Application. The VCSP is not liable for any consequences related to a custodian's improper use, transfer or characterization of custodial funds. UGMA or

UTMA custodians must establish VPEP Contracts in their custodial capacity separate from any Contracts they may hold in their individual capacity in order to contribute UGMA/UTMA assets. If UGMA or UTMA assets are currently invested in securities, these investments must first be liquidated before cash can be used to purchase a VPEP Contract, and any tax liability related to the liquidation will have to be paid. UGMA/UTMA custodians may not change the Beneficiary for custodial Contracts except as may be permitted by applicable law, and must notify the VCSP when the custodianship terminates, at which time the Beneficiary will become the owner of the Contract. Custodians will need to complete an Account Owner Transfer Form to document the termination of the custodianship. Please contact a legal or tax professional to determine how to use an existing UGMA or UTMA account to fund a VPEP Contract, and what the tax implications of such a transfer may be for your specific situation.

Trusts

Trusts are allowed to own VPEP Contracts. Trustees and other fiduciaries are responsible for determining whether the terms of a trust are consistent with the requirements of Section 529 and thus allow ownership of a VPEP Contract. If, after investing in a VPEP Contract, the trustee determines that the trust cannot be administered in a manner consistent with the requirements of Section 529, the trustee may be liable for any tax penalties or other charges imposed in connection with a cancellation. The VCSP will not review trust documents, and the trustee or other fiduciary bears all liability for a determination that a VPEP Contract is an appropriate investment.

Contract Benefits

Please see Articles IV (Prepaid Tuition Contract Benefits) and VI (Use of Prepaid Tuition Contract Benefits) of the Master Agreement for a complete description of VPEP Contract Benefits. The Contract covers undergraduate Tuition at the in-state rate and mandatory fees at any Virginia Public Institution for the number of years purchased under the plan selected (either the university plan or the community college plan, or a combination of years from each plan). Tuition at Virginia Public Institutions is covered for the normal full-time course load for students enrolled in a general course of study. If there are additional charges for a specific course of study, such as nursing or engineering, or for more than a full-time course load, these additional costs are not covered by VPEP. The number of credit hours that constitutes a full-time course load varies by higher education institution. For additional information about the 2006-2007 full-time course load for a specific school, please contact us toll free at 1-888-567-0540 or by email at **vcspinfo@virginia529.com**. Mandatory fees are those fees required as a condition of enrollment for all students. VPEP does not cover any other fees or costs that a Beneficiary is obligated to pay, such as, but not limited to, individual fees related to participation in a particular sport or activity, individual course fees such as lab fees, textbooks, room and board, computers or any fees not listed on the school's invoice. If a student attends summer school or an inter-session, VPEP benefits may be used, but this will result in early depletion of the account.

Benefits may also be applied at any eligible educational institution as defined in section 529 of the Internal Revenue Code. Generally, these are accredited institutions of higher education that are eligible to participate in federal student financial aid programs. Eligible educational institutions include independent, nonprofit, accredited institutions of higher education in Virginia ("Virginia Private Institutions"), accredited out-of-state or foreign public or independent, nonprofit institutions of higher education ("Out-of- State Institutions"), and certain accredited for-profit vocational, private career or technical schools or colleges ("Proprietary Institutions") that are eligible to participate in federal student financial aid programs. VPEP does not guarantee payment of Tuition at any institution of higher education other than a Virginia Public Institution. If a Beneficiary attends a Virginia Private Institution or a Virginia Proprietary Institution, VPEP will pay to the Virginia private college or career school the **lesser** of 1) the payments made on the Contract plus the actual rate of return earned by VPEP on the invested funds, compounded annually, or 2) the highest in-state undergraduate Tuition at a Virginia public school in the same academic year the benefits are used.

If a Beneficiary attends an Out-of-State Institution or out-of-state Proprietary Institution, VPEP will pay to the institution the **lesser** of 1) the payments made on the contract plus interest at the composite reasonable rate of return, compounded annually, or 2) the average in-state undergraduate Tuition at Virginia public schools for the same academic year the benefits are used.

Unused Benefits may be applied toward graduate or professional school tuition in the same amount the Beneficiary would have received if enrolled as an undergraduate at the same institution in the same academic year. A Beneficiary is responsible for any costs in excess of the amount payable under the Contract. A Beneficiary who attends a Virginia Public Institution but who does not qualify for the in-state tuition rate is responsible for paying the amount by which the tuition and mandatory fees of that institution exceeds the amount payable under the Contract for that Beneficiary. All payments are made directly to the institution each academic term.

Substitution, Assignment, Transfer And Rollover

An Account Owner may designate a substitute Beneficiary who is a "Member of the Family," as defined in Article II of the Master Agreement, convert a Contract from one plan to another, transfer ownership of the Contract to another Account Owner, and roll over an account to another qualified tuition program upon written request. Please see Articles VI (Use of Prepaid Tuition Contract Benefits) and VIII (Substitution, Assignment, Transfer and Rollover) of the Master Agreement for more detailed information.

Funding And Actuarial Assumptions

VPEP's funding is derived entirely from Payments received from Contracts and the investment income earned thereon. State legislation requires that each year the Governor must include in his budget proposal a line of credit to cover VPEP's contractual obligations in the event of a funding shortfall. This provision can only be changed through the annual appropriations process, which would require action by the Virginia General Assembly, subject to the Governor's veto, and the General Assembly's ability to override a veto. The Board is authorized to obtain actuarial assistance in order to perform an actuarial valuation of its assets each year, as well as to establish Contract prices. Based on information and data provided by its actuarial consultant, the Board determines the purchase price of Contracts offered during an enrollment period. Investment return and the projected rate of increase in college tuition and fees are significant factors in the pricing of the Contracts. A Beneficiary's age or grade is also a material factor in determining pricing for Contracts. Under state legislation, any moneys remaining in VPEP at the end of each two-year budget cycle shall not revert to the general fund. State legislation provides that interest and income earned from investments shall remain in VPEP's account. State legislation further provides that VPEP's assets are to be preserved, invested, and expended solely pursuant to and for the purposes of the program and may not be loaned or otherwise transferred or used by the Commonwealth for any other purpose. Based on the advice of its actuarial consultants, the Board has adopted what it considers to be conservative actuarial assumptions so that it will be better positioned to satisfy its future obligations.

Securities Law Considerations

The Contracts will not be registered under the Securities Act of 1933, based in part on assurances received from the staff of the U.S. Securities and Exchange Commission in a no-action letter to the effect that it would not recommend enforcement action if the Contracts are not registered based on the representations in the letter. The Virginia State Corporation Commission has issued an order stating that the Contracts are exempt from Virginia state registration. VPEP Contracts have not been registered with the securities regulatory authorities of any state. The Contracts have not been registered as investment companies under the Investment Company Act of 1940 (the "1940 Act") pursuant to Section 2(b) thereof, which provides that no provision of the 1940 Act applies to any instrumentality of a state.

Virginia And Federal Tax Considerations

VPEP Account Owners who file a Virginia state income tax return can deduct VPEP Payments from their Virginia taxable income. Only the Account Owner of record as of the end of the calendar year can take a Virginia state tax deduction for Payments to his or her accounts. The deduction is limited to $2,000 per year per VCSP account (VPEP, VEST CollegeAmerica or CollegeWealth), or the amount contributed to each VCSP account during the year, whichever is less, with unlimited carry forward until the full amount has been deducted. The $2,000 per year limit does not apply to Account Owners who are age 70 or above, who may deduct the entire amount of their Payments in a single tax year. If a Contract is cancelled for a reason other than the student's death, disability, receipt of a scholarship, or rollover to another VCSP account, any amount of the refund previously deducted from the Account Owner's Virginia taxable income as a result of Payments to the cancelled VPEP account must be added back to the Account Owner's Virginia taxable income in the year the refund is received. Only the Account Owner of record of a VPEP account as of the end of the year is eligible to take the Virginia state tax deduction for Payments made to that account. **Individuals who choose to make Payments to a VPEP account owned by another individual or entity are not eligible for the Virginia state tax deduction.** The Virginia state tax deduction for UTMA/UGMA VPEP accounts belongs to the Beneficiary, and is reported under the Beneficiary's social security number. UTMA/UGMA custodians are not eligible for the Virginia state tax deduction for Payments made to an UTMA/UGMA VPEP account.

If an Account Owner or other individual making Payments on a VPEP Contract lives in a state other than Virginia, the state tax consequences may differ from those described here. The Virginia state income tax deduction and exemption are available only to VPEP Account Owners who file Virginia tax returns. Contributions to other states' qualified tuition programs are not eligible for the Virginia state tax deduction. Before investing in VPEP, potential participants who do not live or pay taxes in Virginia should determine whether the state in which they live or pay taxes offers a qualified tuition program with benefits not available through VPEP.

Section 529 of the Internal Revenue Code (26 U.S.C. Section 529) governs the federal tax treatment of qualified tuition programs such as VPEP and the federal tax consequences for Account Owners and Beneficiaries of such plans. As of the date of this printing, the Internal Revenue Service had not issued final regulations governing the application of Section 529 to qualified tuition programs. VPEP has been structured to meet all current federal requirements and, therefore, the VCSP itself does not pay federal income tax. Final regulations or changes to the Internal Revenue Code or to the *Code of Virginia* could affect the tax consequences of participation in a qualified tuition program. The Board may modify VPEP as necessary in the future without prior notice to comply with any such changes.

VPEP Payments are NOT deductible from federal taxable income at the time of contribution. The increase in the Contract's value (the earnings) is tax deferred, and is not taxable at the federal level upon distribution if the Contract is used for a qualified higher education expense, such as tuition. **If you live in a state other than Virginia, please check with your state tax department to determine the state tax treatment of these earnings.** If you cancel your VPEP Contract, the earnings portion will be taxed as ordinary income in the year of the refund. Cancellation refunds made for a reason other than the Beneficiary's death, disability or receipt of a scholarship will be subject to an additional federal penalty tax of 10% of the earnings, reported on the taxpayer's federal tax return. There is no Virginia state income tax liability for the federally taxable portion of a cancellation refund in the event of the Beneficiary's death, disability or receipt of a scholarship, nor are such distributions subject to the 10% of earnings federal penalty tax. Cancellation refunds from a VPEP Contract or rollovers to another state's qualified tuition program may require the recapture in Virginia taxable income of some or all amounts, if any, that the Account Owner deducted from his or her Virginia taxable income related to Payments on a VPEP Contract.

VPEP will accept transfers from a Coverdell Education Savings Account or Series EE or I Bonds. If you are funding your VPEP Contract with funds from a Coverdell Education Savings Account, certain Series EE or I U.S. Savings Bonds, or another Section 529 account, you must provide the breakdown of the amount you contributed and the amount of interest earnings. For transfers from a Coverdell Education Savings Account, please provide an account statement issued by the financial institution that acted as trustee or custodian showing basis and earnings (or losses) in the account. For redemptions of qualified Series EE or I U.S. Savings Bonds, please provide either a statement, a Form 1099-INT issued by the financial institution that redeemed the bonds, or an IRS Form 8815, showing interest from the redemption of the bonds. Please ensure that you redeem the bonds in the same calendar year that you fund the VPEP Contract. If you have additional questions about the redemption of U.S. Savings Bonds, please contact the Bureau of Public Debt at 1-202-874-4000 or at **www.treasurydirect.gov**, or the Internal Revenue Service at 1-800-829-1040. For rollovers from another Section 529 program, the program manager must provide a statement showing contributions and earnings (or losses).

If you own more than one VPEP Contract for the same Beneficiary, the Internal Revenue Service requires that we aggregate the earnings on all of the accounts for reporting purposes. Each year there is a distribution from one of your VPEP Contracts, you will receive an IRS Form 1099-Q that reflects the aggregated earnings. If the distribution is made to an institution of higher education, as is the case with most VPEP distributions, we are required to send the Form 1099-Q to the Beneficiary. If the distribution was for a qualified higher education expense, you will not owe any federal or Virginia income tax related to that distribution. **If you live in a state other than Virginia, please check to determine your state's treatment of income from another state's qualified tuition program that is tax exempt at the federal level.**

VPEP will not determine whether an expense is qualified or non-qualified. You will be required to maintain records adequate to prove your qualified expenses. VPEP participants must complete and send in an Intent to Enroll Form so that we can make payment arrangements directly with the school. The 10% of earnings federal penalty tax for non-qualified distributions is reported on the taxpayer's federal tax return, and will not be withheld by VPEP. HOPE and Lifetime Learning federal tax credits may be available for families who pay qualified higher education expenses, which include the cost of tuition and fees. VPEP participants who otherwise meet eligibility requirements may be entitled to use these credits. In order to take advantage of the HOPE and Lifetime Learning federal tax credits, you must allocate your higher education expenses among the various federal higher education tax incentives. For example, if you qualify for a HOPE federal tax credit for tuition paid in 2006, you could not also use a tax-free distribution from your VPEP account for that same expense. Please be aware that the coordination of the various federal higher education tax incentives can be quite complex. Please contact a tax professional or the Internal Revenue Service at 1-800-829-1040 for assistance in determining your eligibility for the various tax incentives and in allocating your higher education expenses.

For more information, please refer to Publication 970, "Tax Benefits for Education," which is available on the Internal Revenue Service web site, **www.irs.gov**, or by calling toll-free 1-800-829-1040.

Federal Gift Tax

Section 529 provides that VPEP Payments are a completed gift of a present interest for federal gift tax purposes. Payments to qualified tuition programs like VPEP are not currently excluded from taxable gifts as tuition payments under IRC Section 2503(e). Section 529 provides a five-year averaging provision for any contributions in one taxable year that are greater than the current $12,000 ($24,000 for married couples) annual exclusion from federal gift and generation-skipping transfer tax. This means that if total contributions by any one individual to a single Beneficiary in any one tax year is greater than $12,000 ($24,000 for married couples), the Account Owner or other individual contributing the funds may elect to average the total amount of the gift over a five-year period. This would allow maximum contributions of up to $60,000 ($120,000 for married couples) in one tax year without federal gift tax consequences. An individual who makes a maximum contribution of $60,000 ($120,000 for married couples) may not make additional gifts to the same Beneficiary until the end of the five-year averaging period without incurring federal gift tax consequences. Please contact a tax professional or the Internal Revenue Service at 1-800-829-1040 to determine how to make the five-year averaging election on IRS Form 709. Section 529, as amended, also provides that distributions from a qualified tuition program will not be treated as taxable gifts.

The five-year averaging rule may be applied to rollovers to a new Beneficiary. If an Account Owner later transfers a Contract to another Account Owner, that transfer may be deemed a gift. If the amount of the current $12,000 annual exclusion is increased, an additional gift may be made in any one or more of the remaining years of the averaging period up to the difference between the higher exclusion amount and the original exclusion amount.

Federal Generation-Skipping Transfer Tax

In addition to possible federal gift and estate tax consequences, federal generation-skipping transfer tax may apply to VPEP Payments. If the Beneficiary is deemed to be a member of a generation that is more than one generation younger than the generation of the Account Owner or other individual contributing to the Contract, or if the new Beneficiary is more than one generation younger than the previous Beneficiary, federal generation-skipping transfer tax may apply. VPEP Payments that qualify for the annual gift tax exclusion are not subject to generation-skipping transfer tax. Generation-skipping transfer tax will be payable only on the amount by which gifts in excess of the annual exclusion amount exceed the Account

Owner's or other individual's lifetime generation-skipping transfer tax exemption ($2 million for 2006). Consequently, this tax is unlikely to apply to many Account Owners or other individuals making Payments. Where it applies, however, the generation-skipping transfer tax is imposed at the maximum federal estate tax rate. These federal tax provisions are complex and each taxpayer's situation is unique, so please contact a tax professional or the Internal Revenue Service for specific information on these provisions and how they may affect you.

Federal Estate Tax

Generally, no amount is includible in the Account Owner's gross (taxable) estate as a result of the purchase of a VPEP Contract. This means that amounts used to pay for a VPEP Contract are removed from the Account Owner's gross estate. If, however, the Account Owner dies before the end of the five-year averaging period discussed above, if the Account Owner has made that election, the Account Owner's gross estate will include the portion of the Payments allocable to the years following the Account Owner's death. Section 529 also provides that the gross estate of a designated Beneficiary of a qualified tuition program such as VPEP includes the value of any interest in an account maintained with a qualified tuition program on behalf of that Beneficiary in the event of the Beneficiary's death. Please contact a tax professional to determine the effect of the federal gift and estate tax provisions on your individual situation.

2001 Tax Act Changes

The 2001 Economic Growth and Tax Relief Reconciliation Act made significant changes to the federal estate, gift and generation-skipping transfer taxes. These provisions are effective for taxable years beginning after December 31, 2001, and "sunset" after December 31, 2010, unless Congress takes further action. Among other things, the 2001 Tax Act reduces certain tax rates, increases exemption amounts, and phases in a complete repeal of the estate and generation-skipping transfer taxes by 2010. Account Owners are encouraged to consult their tax or legal adviser to determine the effect of federal and state tax laws on their specific situation.

Individual tax situations vary greatly. Please consult a tax adviser concerning any legal or tax implications arising from the purchase of a VPEP Contract. The Virginia College Savings Plan cannot provide legal, financial or tax advice, and the foregoing summary should not be construed as legal, financial or tax advice with respect to any particular individual's legal or tax consequences from the purchase, use, transfer, rollover or cancellation of a VPEP Contract.

IRS Circular 230 Disclosure: The information concerning the federal tax consequences of participating in VPEP is general in nature and does not take into account individual circumstances that may affect the tax treatment for a particular individual taxpayer. In addition, the information concerning tax consequences is not a "covered opinion" as that term is defined in IRS Circular 230 and, therefore, it is not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.