Independence Day - Saving for College

July 2014

We want to wish you a Safe and Happy 4th of July! We also want to explain how we "give back" through our Referral Program. When anyone refers a client to us, we make a contribution to a charity specified by the person making the referral.

Thank you to all who have already referred us clients. My staff and I sincerely appreciate your continuing confidence and support. We strive to provide top-notch financial planning and management services.

Happy and safe Independence Day wishes to all.

Saving for College? Why You Should Consider a 529 Plan

Summer has arrived and many parents are already preparing for the back-to-school rush. If college is in your children's future, you may also be wondering about the best way to save for this ever-increasing expense. One option is the 529 plan.

What is a 529 plan?
A 529 plan is a tax-advantaged investment vehicle sponsored by a state or educational institution that is designed to help families put aside funds to pay for future college costs. It's named after Section 529 of the Internal Revenue Code (IRC).

Because there are so many 529 plan options available, it's important to do your research before investing. You should also be aware of the differences between prepaid tuition plans and college savings plans.

- **A prepaid tuition plan** is what it sounds like-a plan that allows you to pre-pay all or part of the costs of a college education. Operated by a state government, the plan is guaranteed to increase in value at the same rate as college tuition.
- **A college savings plan** differs from a prepaid plan in that the plan is managed by a mutual fund company, which determines the investment choices available. Contributions are made to a portfolio of mutual funds or other selected investments, and the account owner bears the risk of investment returns. In other words, there are no guarantees.

Despite the risks, there are advantages to the college savings plan option. While funds in prepaid tuition plans typically must be used at public colleges in a particular state, funds in college savings plans can be used at any college accredited by the U.S. Department of Education-at home or abroad. Also, there is generally no time limit on taking distributions from college savings plans; most prepaid tuition plans, on the other hand, require tuition credits to be used by the time the beneficiary reaches age 30.

I can help you assess which plan type is the best fit for your financial goals.

529 plan benefits
Many people consider 529 plans a good investment because of their federal, state, gift, and estate tax advantages. In addition, these plans are easy to maintain and their affect on financial aid is relatively small. Let's take a closer look.

Federal tax. Contributions to a 529 college savings plan are typically invested in a mix of equities and fixed income mutual funds. Similar to an IRA, the earnings on the contributions are tax-deferred; however, unlike a traditional IRA, distributions from the 529 plan are federal tax-free, as long as the funds are applied toward payment of qualified higher education expenses, which typically include tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible higher education institution. Room and board may also be covered.

State tax. Your state may offer a full or partial income tax deduction on contributions made to a 529 plan. Of all states that impose personal income tax, only seven-California, Delaware, Hawaii, Kentucky, Massachusetts, Minnesota, and New Jersey-do not currently allow some level of deduction for contributions to state 529 plans. I can help you determine the availability and extent of the allowable income tax deduction.

Gift and estate tax. A 529 plan can also serve as an effective gift and estate tax planning tool. A contribution to a 529 plan is considered a gift to the plan beneficiary; therefore, the amount of the contribution is deducted from the donor's estate. The contribution is also considered a gift of present interest, so it qualifies for the annual gift tax exclusion ($14,000 in 2013).

There's another gift tax benefit that's unique to 529 plans. A donor can "front-load" five annual exclusions into one initial gift to the 529 plan beneficiary, and elect to treat the contribution as if the gift had been made over five consecutive years. Using this five-year election, a donor can gift up to $70,000 (5 x $14,000) to a single plan beneficiary without incurring any gift tax liability. This sum is removed immediately from the donor's gross estate.

Control. When you, the plan donor, contribute to a 529 plan, the assets remain in your control. The named beneficiary of the plan has no rights to the funds. When it is time to distribute the funds to pay for the beneficiary's college expenses, you are the one who controls when distributions are made and for what purpose. You can even take funds out of the plan for your own personal use at any time; however, any earnings on the withdrawal will be subject to income tax, and you will incur a 10-percent penalty tax.

Low maintenance. A 529 plan provides an easy, hands-off method of saving for future college expenses. Once you find the appropriate plan, the enrollment process is simple and straightforward. The plan assets are professionally managed by the investment company, and you don't have to touch the plan until it's time to start taking distributions.

Financial aid impact. Not only do 529 plans offer substantial income, gift, and estate tax savings, but they also have a limited effect on students who apply for financial aid. A plan owned by a parent or a dependent student is assessed at a rate of 5.64 percent when determining the expected family contribution. A plan owned by a grandparent, however, would not be reported on the federal financial aid application as a countable asset for determining financial aid eligibility.

Other considerations

In recessionary periods, when state tax revenues may decline and stock market returns may be lower than expected, state-sponsored prepaid tuition plans may have difficulty fulfilling their obligations to investors. Historically, under these conditions, prepaid plans have either closed to new investors or increased their pricing. Therefore, it's important to consider whether a plan is backed by the full faith and credit of the state.

Also, keep in mind that state-sponsored prepaid plans provide maximum benefits when the student attends an in-state public college. If the student attends an in-state private school or an out-of-state school, the plan may return only your contributions, or it may refund your contributions with a small amount of interest. Finally, most state-sponsored prepaid tuition plans cover undergraduate tuition costs only; generally, room and board, fees, books, and graduate school expenses are not covered. With a college savings plan, on the other hand, distributions can be used to pay for more than just tuition.

College expenses can be a great burden, but a 529 plan can help you manage the load. With so many options to consider when it comes to investing in these plans, it's important to discuss your needs and learn how the right 529 plan can help you pursue your college savings goals. Please contact my office to discuss your college savings goals.

The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that a college-funding goal will be met. By investing outside of your state of residence, you may lose any state tax benefits, but this is not the case for California residents. Only the earnings portion of a nonqualified withdrawal will be subject to ordinary income tax, at the recipient's marginal tax rate; it will also be subject to a 10% penalty. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.

My staff and I deeply appreciate the continuing opportunity to work with you. Please let me know if you have any questions or requests. Thank you.

Sincerely,

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