

09/02/2007

Tax change makes college savings plan more attractive

By: Alan Weiss, Special to the Register

Saving for college is not so simple. The cost is rising faster than are household incomes. According to the College Board, the average cost for a four-year private college in 2006-2007 climbed 5.9 percent from the previous year. The increase in each of the three prior years was approximately the same percentage.

Many of us started saving for college using UGMA (Uniform Gift to Minors Act) accounts. Before 2006, certain investment income for children younger than 14 was taxed at their parents' higher tax rate. In 2007, the higher rate was extended to children younger than 18.

Starting in 2008, the "kiddie tax" will expand to include dependents younger than 19 and dependent full-time students younger than 24. If your children will be 18 through 23 by year-end, you should consult with your tax adviser to discuss tax planning strategies.

This latest tax change makes saving for education expenses through a 529 plan more attractive than ever, since the 529 plan grows tax-free. Traditional 529 plans invest in stocks and bonds. Prepaid 529 plans allow you to save for your child or grandchild's education by letting you prepay tuition at today's prices for an education that may be years away. How does it work?

Suppose you open a prepaid 529 plan for your newborn daughter in 2007 and contribute \$10,000. Assume that the tuition at the college your grandchild eventually will attend is currently \$30,000. By investing now, you're purchasing a tuition credit worth one-third of a year's tuition, eliminating the uncertainties of college inflation.

For many years, prepaid 529 plans were administered by the states and covered state schools only. But a private alternative, the Independent 529 Plan set up in 2003, is owned and operated by private colleges and universities. It is administered by TIAA-CREF Tuition Financing Inc. and lets you prepay costs for hundreds of private colleges.

"When you open up an Independent 529 Plan, you name a specific beneficiary but don't name a specific school," explained Nancy Farmer, president and chief executive officer of Independent 529 Plan.

"If you open an account with \$10,000, you bought that amount of 2006-2007 tuition at any of the 270 schools that are currently participating or any schools that may join in the future," she said.

When you set up an Independent 529 Plan, you receive a certificate that you must hold for at least 36 months. First-year students at participating colleges who are just opening an account are thus still able to prepay all or part of their senior year. If you were just keeping college money liquid in a taxable savings account, the prepay option makes sense.

The investments underlying the 529 savings plan can, by choice, become more conservative as the child nears college age, said Farmer, who advises participants to compare the return of such a fixed investment option against the approximately 6 percent tuition inflation rate.

Still, your child or grandchild may not want to attend any of the schools covered by the prepaid plan. As with a Traditional 529 Plan you can change beneficiaries, including naming yourself if you decide to go back to school.

One investment strategy is to diversify your college savings portfolio into three parts. First, put some money in your state-sponsored 529 plan, especially if you receive a tax deduction. Second, a portion of the money could go into a national 529 plan if you like the investment options. Third, put some of the money into an Independent 529 Plan and consider that to be the fixed income portion.

The Independent 529 Plan can give you peace of mind and make saving for college simple.

Alan P. Weiss is president of Regent Wealth Management Group in Woodbridge. He is a certified financial planner and a certified public accountant. Readers are reminded that certain investments and investment strategies may not be appropriate for them and that all investments involve risks and uncertainties.