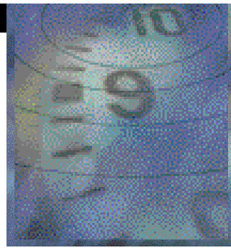

legal matters

The Magic Number 529

College saving is a big concern for many parents, and Section 529 plans provide tax and estate benefits for anyone saving for children's college education. The most important thing is to "just do it."

BY JOHN ALLEVATO

First, let me say that this column's topic is not only something I counsel with clients about, but that I currently experience on a daily basis.

I have two children in college and two more at home in the wings. One of my children goes to a private university; the other is a student at a public university in another state—paying out-of-state tuition. When you hear what sounds like outrageous claims for the cost of college, believe it! When you hear that the published rates for tuition, room and board, and fees are not your only costs, but that you should allow for "incidental" expenses, believe it.

And more important, believe it when I tell you that saving for college for your children should begin now, no matter the ages and number of children you have.

Saving for college can be as simple as what our parents may have done for us—a savings bond here and there, or a savings account in the child's name. Or it can be as complex as a newfangled Section 529 plan, which we will discuss here. If you take anything away from this article, take this—no matter what form it may take, save something, somewhere for your children's upcoming college expenses.

We'll talk about ways to put away some dollars, and in whose name those dollars should be saved. There are many and various methods for putting away money for college, but here I'll focus on the one most people are talking about right now. First, some background.

While they must be state-sponsored, Section 529 plans do not have to be purchased directly from the state in which you live or the state in which your child will attend college.

Forget about aid—for now

The vast majority of readers of this column can forget about most need-based financial aid. If your income is over $100,000, qualifying for need-based college aid is a pipe dream. Let's focus on how to put away the dollars we will need for little Johnny or Jane. You can also forget about those great tax incentives and deductions available for college expenses as your income is probably too high for you to qualify, at least as the tax laws are written at this time. That said, it's still possible that when the time comes, your child may get some aid—there is a lot of merit-based (i.e., non-need based) aid from colleges, es-

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pecially private colleges. Don't give up all hope. But you probably can't plan on these types of aid before your child reaches college age.

Ownership of Assets

As tempting as it may sound to put assets in your child's name to save for college, at the time your expected contribution is figured when it comes to applying for financial aid, assets in your child's name are considered available at a higher percentage than assets in your name. Now, if you agree that qualifying for college aid at your income level is a non sequitur, then putting assets in your child's name for college has other benefits.

First, your child's assets are not available to your creditors. So putting the money in your child's name does accomplish some asset protection planning for you, which is not a small attribute. Second, when your children reach age 14, unearned income is taxed to them at their tax rates, which will probably be much lower than yours at that time. Until age 14, some of their unearned income can be "sheltered," if you will, but larger amounts will end up on your return. So, if you invest wisely, and defer income at that time or invest in low-income-producing securities, you can convert to higher-income-paying securities when your child reaches age 14, and have the income taxed at their lower rates.

One huge drawback to putting assets in your child's name is that, at some point, those assets become your child's. At that time, usually age 18, maybe 21, if your child is responsible and carries out your wishes, the money will be used for the payment of college expenses. However, if your child has a different idea about things at that time, you no longer have control over the money. Sobering thought, isn't it.

A way around that is to set up a trust to use for college funding. For these, consult an attorney familiar with such trusts, which utilize certain provisions of the tax laws to allow money to be invested and held for distribution until your child attends college.

The best way to save for college, however, may be a Section 529 Plan. We'll get to it.

Making Gifts

A quick lesson on transferring money to your children is in order. As I have mentioned in previous articles, and you may know, you can give away $10,000 in cash or property to any person every year without tax consequences to the recipient. That is $10,000 per child per parent, or $20,000 per child per year for both parents. To "give" it away to your children means you must part with it—putting it in certain trusts or in certain accounts for which your children will qualify. The significance of the ability to gift $10,000 per year to any other person is that those amounts will not count against your ability to transfer, while you are alive or at death, the sum of $675,000 (for 2001, scheduled to rise to $1,000,000 under current law in the year 2006) to anyone without gift or estate tax consequences.

Since any person can make a $10,000 gift per year to any other person, other family members can also donate to the cause of your children's college education.

There is one important additional rule to know. In addition to the ability to gift $10,000 per year, you can make a gift of that amount and also pay qualified tuition expenses of a person during any one year. So, if you are fortunate enough, grandma can pay for your child's' college tuition and make gifts of $10,000 per year to your child in the same year.

Section 529 Plans

You have probably heard of the Section 529 plans by now. (You read this far, didn't you?) The plans are a fairly recent phenomenon, prodded along by the rise of state prepaid tuition plans. This plan can be a state-sponsored prepaid tuition plan, or something similar called an educational savings account. It is this latter type which you may want to investigate to accomplish your college savings objectives.

One nice feature of these plans is that they have become relatively simple to establish. While they must be state-sponsored, Section 529 plans do not have to be purchased directly from the state in which you live or the state in which your child will attend college. In fact, a small cottage industry has arisen in that virtually all the major brokerage firms offer such plans for the asking.

The tax benefits are plenty. First, amounts of income and gain within the plan are tax-deferred, generally until amounts are withdrawn to pay for your child's education, at which time the child is taxed on the taxable portion of the amounts withdrawn. Second, these plans allow the person controlling the account (that's you, mom and dad), to make gifts qualifying for the annual exclusion amount of $10,000 per child per year, while at the same time continuing to control the account.

Thus, no automatic turning over the account to the children when they become adults or attain age 21. And while funds are invested, the person establishing the account, generally the parents, can control the investments in the account.

These funds must be used for college expenses, though. To the extent they

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are not, penalties can apply. However, the account can be transferred to another member of the family of the designated beneficiary if that becomes necessary. You can also transfer more than $10,000 per year per child to these plans, provided you designate the transferred amount as being for subsequent calendar years. Thus, you can make larger transfers up front to many of these plans immediately, allowing their tax-deferred nature to take over.

Sound good so far? It should. It is a nice solution to most higher income parents' dilemma of wanting to put enough money away for college, yet retain control to some extent and realizing favorable income tax consequences on the earnings and gains in the account. Plus, these accounts don't have to be established by parents—anyone can open one for your child.

Still, it is no panacea. Nothing ever is, it seems. First, these benefits may vary from state to state—check carefully before implementing one of these plans to make sure the favorable tax consequences apply to your state. Many of the plans implemented by the large investment houses are done under the auspices of a state, one which usually has flexible provisions. Remember, though you don't need to be a resident of that state to participate.

The second consideration, these assets will be considered as available when need-based agencies determine how much you can contribute towards your child's education. But, as noted above, most physicians' children will not qualify for need-based aid in the first place.

Look into the availability of these plans as part, or the centerpiece, of your college education financial planning. They are a great boon for higher income individuals. When it comes to saving for higher education, there is no time like the present, so have your financial planner or estate planner implement one of these plans now. ■

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