



Daniel Gibson

Have 529 plans lost their luster?

Daniel Gibson, Financial Consultant

Are you utilizing a 529 plan for your child's college education? If so, now is a good time to consider your savings plan options and ensure that this vehicle is still right for you.

In 2001, 529 plans soared to the top of the college funding list when the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became law. EGTRRA made plan earnings withdrawn for qualified college expenses exempt from federal income taxes, as well as most state income taxes. This sweeping change makes 529 plans a worthwhile option for many investors. For example, Wisconsin's Edvest program allows participants to contribute as little as \$25 per month when setting up an automatic investment plan, a \$250 lump sum, or as much as \$246,000. Each year, Wisconsin residents can then deduct up to \$3000 against their Wisconsin state income taxes (as long as the recipient is a dependent child, grandchild, niece, or nephew).

In 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the Act) considerably narrowed the gap between 529 plans and other college-funding alternatives. Unlike previous tax legislation that signifi-

cantly altered the landscape of college funding, this Act has no direct impact on college funding. Rather, its impact stems from its reduction of the taxes on capital gains and dividends. This change makes savings alternatives, like custodial accounts and taxable stocks, a much more viable option for many investors.

Many experts believe 529 plans lost some of their appeal once the Act lowered capital gains rates and cut stock dividend rates from ordinary income tax rates to the equivalent of the new capital gains rates. The Act lowered the capital gains rate from 20 percent to 15 percent for higher-income taxpayers and from 10 percent to 5 percent for lower-income taxpayers. Since students usually fall into the lowest tax brackets, the new tax rates are giving new life to alternative savings vehicles.

Take custodial accounts, for example. These accounts allow irrevocable gifts to be made to minors. For children under age 14, the first \$750 in annual account earnings is tax-exempt, the next \$750 is taxed at the child's rate, and the remaining funds are taxed at the parents' tax rate. Once the child turns 14, all earnings are taxed at the child's rate. Assuming the taxable earnings are all long-term capital gains or qualified stock dividends, the child, age 14 or older, would probably pay the lowest tax rate. In addition, custodial account fees are typically lower than the fees for most 529 plans.

And unlike funds in 529 plans, custodial account funds are not restricted to education costs. These funds can be used for other expenses, such as a car to get your child to and from school.

Proponents of 529 plans are left to point at the remaining downside of custodial accounts. These accounts currently count more heavily against potential needs-based financial aid than 529 plans because the funds are in the child's name. In addition, gifts to the account are irrevocable, leaving the child with complete control of the funds at the age of majority (21 in Wisconsin).

Some other savings plan options worth considering include the gifting of stocks or stock mutual fund shares to the student. However, just like 529 plans and custodial accounts, these options should be reviewed for their overall benefit before any change is made.

Your best strategy in the wake of the Act still depends on your individual financial goals and objectives, income tax bracket, your child's potential financial aid, and your desire to maintain control of the assets. Furthermore, everything could change again in 2011 if legislation is not drafted to extend the tax-free withdrawal feature of 529 plans.

When planning for your children's education, a financial planner can offer invaluable guidance and identify the best savings vehicle for you.

Based in Madison, Wis, Dan Gibson is a fee-only financial consultant with SVA Planners Inc. For more information, call Wisconsin Medical Society Insurance and Financial Services, Inc. toll free at 866.442.3810.