



Investment Insights

Kevin Kennedy

Enable Your Child's Success September 2, 2005

The first day of school. What other day could pack fear, excitement, dread, uncertainty, and relief all into one? Hundreds of smiling children, backpacks strapped to their small frames, all ready to embark on another year of learning, experiencing, and growing. And, accompanying these future leaders of society, an equal number of proud parents, filled with expectations of success and growth for their little stars.

If past trends hold true, more than half of these youngsters will be future college students. They will fulfill their goals, and our hopes for them, and be ready to earn a degree that, based on demographic studies, will empower them to succeed financially and personally in a competitive, evolving economy.

There's only one problem with this rosy scenario: the average cost of four years of college is currently more than \$75,000. For my first-grader to attend my alma mater, UC Davis, when he graduates high school, the number will more likely be north of \$150,000!

Needless to say, that's a lot of money. For many people, paying that entire cost isn't possible. But if we're going to push our kids to study and learn, shouldn't we do our part, however small or great, to enable them to fulfill their potential? Just as your child sacrifices to do well in school, we too can sacrifice to begin saving for college so they have the opportunity to maximize their potential.

Section 529 Plans

The name 529 plan refers to IRS Code 529, which established the framework for a tax-advantaged way to save for college. These accounts are available to all Americans, regardless of income levels. 529 accounts are typically set up with a parent acting as the account owner, and the child as the beneficiary. In many cases, contributions to an account can total upwards of \$200,000, making it possible to cover most or all college cost liabilities through a 529 account.

A 529 plan account has two major advantages over other college savings vehicles. First, it has brilliant tax advantages. Tax-wise, a 529 plan account works much like a ROTH IRA: contributions are made with after-tax dollars, but withdrawals come out free of state and federal taxes if they meet certain restrictions. In the case of the 529, withdrawals must be used to pay for qualified college expenses of the account beneficiary

to be tax-free. Qualified expenses can include tuition, books, and room and board. Being able to withdraw money tax-free can have a huge benefit when you take into account the growth you will likely see over the years in money you contribute to the account, and the taxes that would normally be due when the profits are withdrawn. Under the current law, this tax benefit is set to expire in 2010, after which point distributions would be taxable to the beneficiary. However, many tax experts believe this law will be made permanent so that distributions for qualified expenses will always be tax-free.

The second big advantage of 529 plan accounts is the fact that the owner of the account, typically the parent, controls the assets in the account. Unlike Uniform Gift/Transfer to Minor accounts, the assets in a 529 account do not become the property of the beneficiary when they turn 18 years old. In fact, in most cases the beneficiary can be changed to another member of the immediate family. Thus, if a designated beneficiary does not use any or all of the money in his/her account for college, the beneficiary can be changed to a sibling for their benefit.

There are a couple of additional strategies we have recommended to clients that I'll touch on briefly. First, by taking advantage of accelerated gifting laws, it is possible for a husband and wife to contribute up to \$110,000 in one year to a child's 529 plan account. This is allowable because you can treat the one-time gift as being made over a five-year period, thus coming in under the annual \$11,000 gift tax exclusion. This is also true for grandparents, and this can be a great way for grandparents to reduce the size of their estate for tax purposes.

The second strategy we've been employing takes advantage of the downturn in the markets over the past few years. If you currently have a UTMA account for your child, it may be worth less than the amount you contributed to it. If you do have a capital loss, you may be able to sell the assets in the account and transfer that money into a 529 plan account without owing taxes. This strategy is attractive to many parents because the future growth of these assets will benefit from the advantageous tax laws regarding 529's. Some restrictions do apply when using this strategy, so again it is best to talk with your advisor on how you can use this situation to your advantage.

For more information on 529 plans, feel free to call or e-mail us. You can also check out www.savingforcollege.com for more detailed information and current news on 529 plans.

Kevin Kennedy is president of Kevin Kennedy, LLC, a registered investment advisor firm in Alameda. Reach him at 510-748-1898 or Kevin@KevinKennedyLLC.com. Stocks, bonds, and mutual funds involve risk, including loss of principal. Past performance is no guarantee of future results.