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Client Alert

Save Money & Pay for College by
Unlocking the Potential of Section 529

College costs are astronomical. Today, for approximately \$100,000, you can get a four-year education at a private college. In 18 years, the cost is estimated to rise to approximately \$250,000. Are you ready?

In the old days, you would earn money, invest some of it, and use the proceeds to pay for college. In the process, the money is taxed twice – once when you earn it and once when you pay tax on the investment earnings. Today, there is a tax-free way to put money aside for higher education.

What is a Section 529 Account?

Today, the federal government has authorized state-sponsored college savings plans for those who want to make gifts to defray the educational expenses of a designated beneficiary. As compared to the old taxed way of saving, both Section 529 plan earnings and distributions used for educational expenses are tax-free.

Approved educational institutions run the gamut from trade and vocational schools to Ph.D. granting universities. The only caveat is that the school be in the United States. Qualified expenses include fees, room and board, books, supplies and required equipment.

Every state has set up a College Savings Plan, with different plan specifics and different financial advisors. For example, TIAA-CREF administers the New York State College Savings Plan.

How can I set up a 529 account?

Assuming you are a U.S. citizen or resident alien, you can set up an account by making a gift to a named beneficiary who can be anyone – relative, friend, colleague, even yourself.

Suppose you set up an account for a grandchild who chooses not to go to college. No problem. You can change the beneficiary at any time. You may open accounts in more than one state for the same beneficiary or different ones. You do not have to live in a state in order to use that state's plan. Likewise, the beneficiary does not have to attend college in any specific state.

How much money can I put into an account?

In many states you can open an account with less than \$100, but typically you may want to consider putting all or some of your annual gift exclusion [currently \$11,000 per person] to the

plan. As long as the amount you contribute is less than the annual exclusion you won't need to file a federal gift tax return.

If it makes sense as part of your investment and gifting plan, you can front load a Section 529 account by contributing five years of annual exclusions in the first year [\$55,000 for an individual/\$110,000 for a couple filing jointly]. Currently New York State limits the total contribution per plan to \$100,000, but other states have higher limits.

How is the money invested?

State plans differ. You do not control the investments, but you can choose among funds offered by the particular state's advisor, and you can change your investment option once a year or even change states to a new investment advisor. In New York State, TIAA-CREF offers a series of investment options ranging from a conservative fixed-income fund to a high equity option. Advisor fees vary with each advisor, but typically fall between .25% and 4.5% of the money invested.

What are the tax benefits for the donor?

The donor in New York State can deduct contributions of up to \$5,000 a year from their NY taxable income [husband and wife filing jointly can deduct \$10,000]. In addition, the money in college savings plans is not considered part of the donor's estate.

What are the advantages of a Section 529 approach to college savings?

You are in control because you can select the beneficiary, the disbursements, and the type of investment for the plan.

What's the catch?

There are none at the moment, except that the account must be in place for three years before the owner can withdraw money to pay for the beneficiary's qualified educational expenses. Funds withdraw earlier or for non-educational purposes are subject to all applicable state and Federal taxes and a penalty on the portion of the money that represents investment growth.

How can I find out more about college savings plan specifics?

You can call whatever financial institution you currently work with and ask for information on the Section 529 plans they manage. Or you can visit the following Web sites: www.collegesavings.org, www.savingforcollege.com, or www.morningstar.com/centers/529.html#section=529.

If you have any questions about these plans and your personal situation, please contact either
Donald Hamburg, 212.907.7380
Steve Chill, 212.907.7350.

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