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FUNDS & PERSONAL FINANCE

You Face Choices In Saving For School

Wealthy Rely On Trusts

But don't overlook 529's plans, which offer tax breaks that trusts omit

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The rich are different, said F. Scott Fitzgerald. Yeah, they use trusts to pay for their kids' education.

Nice stereotype. In reality, trusts aren't always the best way to save for school costs. 529 plans should figure into your thinking. That goes for high net worth taxpayers too. Here's how to figure out which savings vehicles to use, says Randi Grant, partner with the accounting firm Berkowitz Dick Pollack & Brant in Miami and Fort Lauderdale, Fla.

First, look at the benefits of 529 plans, also known as qualified tuition programs. Foremost, your money grows tax-free. "Not even just tax-deferred," Grant said. "So when you take out money for eligible education purposes, you pay no tax on the growth or income."

You can also put more into a 529 plan each year than into, say, Coverdell education savings accounts. Those have a \$2,000 yearly cap.

"Basically, most people are limited only by the annual gift-tax exclusion," Grant said. That's the amount you can give to someone without having to pay tax on it. This year that's \$11,000 for individuals and \$22,000 for couples.

Better yet, a special rule lets you accelerate five years' worth of gifts into a single year

when the money goes into a 529 plan.

"So a husband and wife can put \$110,000 in one shot into a plan for each kid," Grant said.

If they can afford it, they could do that for as many youngsters as they want.

It also takes that money out of your taxable estate if you don't die within those five years. If you do pass away, the pro rata portion goes back into your estate for tax purposes.

Yet another benefit is that some states let you deduct 529 contributions for your state income tax calculation. Usually you must use that state's plan.

You're free to choose among state plans. "You may not like your own state's plan the best because it might have high expenses, you might not like its investment adviser or its investment choices," Grant said.

529 plans differ in a key way from another savings option, Uniform Gifts to Minors Act accounts.

The person who puts money into a 529 is considered the owner.

A Safety Net

With a UGMA, money inside the account becomes the property of the child who is a beneficiary once he reaches your state's age of majority, usually 18 or 21.

"After that, he owns it," she said.

If you don't like how the originally intended 529 beneficiary is turning out, you might be able to shift the account to another member of the family, Grant says.

It's also available to you in the worst-case scenario. "Say you lose your business and

ABCs Of 529s

Some Web sites that have descriptions of how 529 plans work

■ savingforcollege.com:

At this Web site you can also find tools to analyze 529 plans. An evaluation compares features of various state plans. Another section shows past performance of 529 plans.

■ collegeboard.com

■ ici.org

your money," Grant said. "You can take the money back. You'll pay income tax on the earnings. And you'll owe a 10% penalty on the whole thing."

One key negative to 529s: Like several tax rules, they are due to expire after 2010.

"If you put in money now, withdrawals after 2010 would be taxable unless Congress makes 529s permanent," Grant said. "This would be very unpopular to take away." Until Congress acts, the future of 529s is uncertain.

Cumulative contribution caps vary among states.

As of Aug. 1, Louisiana's \$205,175 is the lowest lifetime cap.

South Dakota and New Jersey have the highest cap, \$305,000.

People generally use irrevocable trusts for education savings.

But those trusts lack some tax breaks that 529s enjoy. For one, a trust may have to pay annual tax on its earnings. Beneficiaries are liable for taxes on some payouts.

Also, once you make a gift to an irrevocable trust, you can't

take it back. "That's different from the rules for a 529," Grant said.

So why does anyone use a trust?

Several reasons. One is that you have freedom of choice concerning investment options.

And you are free to fine-tune your investments as often as you want. Generally with a 529 you are limited to making changes only once a year.

Also, with a trust you can have an unlimited number of beneficiaries. You can choose a trustee, who decides how money is doled out.

In addition, some states will let your trust own a 529 plan account.

This is worth considering if you set up a trust many years ago, but haven't started a 529 yet. By adding the 529, you introduce tax breaks to the trust.

Adding Value

Suppose a trust you set up years ago now holds \$1 million. Let's say your state's 529 cumulative contribution cap is \$235,000.

If you shift that much of the trust's assets into the 529, it is sheltered from tax.

So how can you reconcile the different strong points of 529s and irrevocable trusts?

If you can afford to put aside more than a 529 will allow, you may want to start by funding a 529 to the maximum if you find one whose investments and strategy you like.

"That way, you take advantage of the 529's tax breaks with money earmarked for college expenses," Grant said. "Then you can put any extra assets into a trust. It can be used for education or any other purposes you choose."

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