

**529INSIGHT™***The Independent Report on 529 College Savings Plans***INDUSTRY UPDATE****529 Plans – Where Are They and Where Are They Going****INSIDE THIS ISSUE:**

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As 2004 begins, 529 College Savings Plans continue to grow in consumer popularity and are beginning to join the main stream of investment options available to families seeking a tax advantaged way to invest for college expense. Research indicates that there are currently over 4 million accounts open nationwide with estimates indicating that by the end of 2010 there will be approximately 300 billion dollars invested in 529 Plans across America. The reason for this seems obvious, there are currently more than 70 million children under the age of 18 for whom parents are struggling to save money for college. During the 2002/2003 academic year tuition and fees at 4 year public institutions rose by almost 10% and private colleges and universities had a tuition and fee increase of almost 6%. While scholarships and financial aid will assist with this ever increasing cost of a 4 year education, it is important for families to begin saving as much as they can for college expense. The 529 College Savings Plan continues to afford families a tax advantage way of doing so.

As the 529 Plan industry matures, we are seeing an increase in the number of services and opportunities for families saving for college. Specifically, the microinvesting

“trend” appears to be gaining speed.

Microinvesting is a term used to describe the “rebate” or “free” money being offered by merchants for shopping at their stores. Similar to airline miles, several 529 related businesses offer rebate dollars which can be directed into your 529 College Savings Plan to assist with long term savings.

As 2003 came to a close we saw an increasing number of families using the 529 College Savings Plan as a gift making vehicle. The 529 Plan was used to transfer assets from a parent or grandparent into a 529 College Savings Plan as part of both an education savings plan as well as a gift giving strategy. Industry experts expect this trend to continue as 529 College Savings Plans take hold with key advisors and financial and estate planners. While many of the 529 Plans being offered are sold through advisors, it is the Accounting industry and Estate Planning industry that will have the greatest effect on the use of 529 Plans as a gift-making vehicle.

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## MILITARY FAMILY TAX RELIEF ACT ENHANCES 529 PLANS

On Veterans Day, 2003 President Bush signed the Military Family Relief Act of 2003 into law adding a number of beneficial provisions for military families and military personnel. One of these changes affects 529 College Savings Plans. Specifically, the Military Family Tax Relief Act allows for penalty free withdrawals from Coverdell Savings Accounts and 529 College Savings Plans if the person for whom an account was established obtains ap-

pointment to a military service academy. As background, attendance at a military academy has never been considered to be a "scholarship" for purpose of Coverdell Savings Accounts and 529 College Savings Plans. Under previous 529 College Savings Plan law, if a student received a traditional scholarship to college, then funds saved in a 529 Plan could be withdrawn and not subjected to the 10% penalty tax (although the funds with-

drawn would be subjected to ordinary income tax). Attendance at a military service academy was never considered a scholarship, and as such, if assets were withdrawn from the 529 Plan originally established for the student who was attending the military academy, the 10% penalty would apply. The recent legislation signed by President Bush eliminates the 10% penalty for these military service attendees.

*"The recent legislation signed by President Bush eliminates the 10% penalty for military academy attendees."*

## COLLEGE SAVINGS PLANS AND ATTENTION TO INVESTMENTS

Similar to any other financial investment, it is important that the consumer focus on the underlying investments in a 529 College Savings Plan portfolio. During the economic down turn of the past few years many investors saw their stock portfolios shrink by 10% or more. Many of these investors changed their 529 Plan investments from stock portfolios to portfolios rich in bonds. Now that the economy has started to turn, bonds are starting to lose value as the stock market and interest rates rise. The consumer can only change investments in a 529 College Savings Plan once per year, and so it is important

that when the opportunity arises, the consumer should consider reallocating portfolios that are heavily invested in bonds into equity positions.

For those who are invested in age-based portfolios, the 529 Plan Manager has a systematic method of shifting portfolios for you. The portfolios are heavily invested in equities during a child's younger years and are shifted to almost exclusively a bond portfolio as the child approaches college age. Pressure will now be brought upon these Plan Managers to be certain that appropriate bonds are in the portfolio as bond prices sink

and equities rise. Historically, having a large portion of the portfolio invested in bonds in the years just prior to attending college was a safe and appropriate step to take. This theory needs to be reconsidered in light of the decrease in value of bonds and the increase in stock equity markets. As a result of this, we may see an increasing number of Plan Managers utilizing a stable value fund or a money market fund for the years just prior to attending college.

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## MUTUAL FUND SCANDALS AND 529 COLLEGE SAVINGS PLANS

The last quarter of 2003 saw a flurry of activity by state attorney generals seeking to unravel improprieties in the mutual fund marketplace. Since 529 College Savings Plans are often managed by mutual fund complexes, the scandal has trickled down to impact the investor saving funds in a 529 College Savings Plan.

The charges which are currently being investigated relate to market timing of mutual fund trades by hedge funds and late day trading by other mutual fund investors giving them an advantage over the average investor. As these allegations are investigated, the various state treasurers that entered into contracts with these mutual fund complexes managing their 529 Plans have raised concern.

As a direct result of these scandals, several states have taken steps to terminate contracts with an accused mutual fund company, or in the alternative have taken steps to add other mutual fund options to their existing program. Some others have begun to develop new programs within the state. While many states have a single provider for their state's 529 College Savings Plan the governing

federal law does not require that there be only one provider. In fact, several states have multiple 529 Plan providers within the state.

Unlike the average mutual fund investor who upon hearing bad news might choose to liquidate a mutual fund position to escape the fall out of the scandal, the 529 College Savings Plan investor does not have that level of flexibility. Remember that you can only switch your 529 Plan from one plan to another one time every 12 months. For this reason, if you have already made a switch in the past 12 months you cannot do so again without incurring a penalty tax. One strategy that is available is to change the beneficiary on the current 529 College Savings Plan to another family member and then make the switch to a different 529 Plan. After switching to another 529 Plan, you can name the original beneficiary as the beneficiary on the account.

Experts in the industry have concluded that the effect of the mutual fund improprieties will have little to no effect on the average consumer investing in a 529 College Savings Plan. Since many of the accusations focus on

market timing and inappropriate trades by hedge funds, it is expected that very few of the investments in a 529 College Savings Plan portfolio will be directly affected by the specific wrongdoing. Nonetheless, the reputation of a number of mutual fund companies will be tarnished, and as such, investors may move assets to other fund companies. The trickle down effect may be that these accused fund companies have a difficult time administering their programs thereby increasing fees and expenses to keep the plans operating.

It is far too early to determine what the actual fall out from this scandal will be, however, the 529 College Savings Plan investor should not take quick steps to move assets out of a 529 Plan if moving the Plan will incur a penalty tax, ordinary income tax, or other state based penalty for moving the plan. With the benefit of additional time, the industry will determine the extent of the wrongdoing and the steps to be taken to make investors whole. Since saving for college is a long-term proposition, we should be cautious to take short-term steps that may cause us more harm in the long run than good.

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## INDEPENDENT PLAN LAUNCHED

In early September, 2003, the Tuition Plan Consortium, LLC launched the Independent 529 Plan as the first 529 prepaid plan designed to help finance private college education. Prior to this time, all prepaid plans had been created by individual states for colleges within their state's borders. The Independent 529 Plan is a collaboration of over 200 private colleges throughout the United States. Similar to other 529 prepaid plans, the Independent 529 Plan allows for the purchase of tuition certificates that can be used to pay future tuition costs. The program is sponsored by the Tuition Plan Consortium, LLC and is managed by TIAA/CREF.

Much like other prepaid plans, in the event the beneficiary does not attend one of the participating schools, then the program allows for a refund of contributions. The refund amount is the amount paid for the tuition certificates adjusted by the net investment performance of the program with a maximum gain or loss of 2% per year. If the amount refunded is not used for qualified higher education expenses, then the earnings portion will be subjected to federal and in some cases state income tax as well as the 10% federal penalty.

It is expected that additional colleges and universities will join the consortium. The plan originally envisioned approxi-

mately 290 schools as part of the original offering. When first launched, there were only 223 private colleges and universities that agreed to participate in the plan. One reason suggested for this is that being a member of the consortium means that the colleges and universities are contractually obligated to the consumer to have these tuition certificates offset the cost of college in the future. Over the past several years the increase in tuition costs has far out paced the return available in the investment marketplace, and this may be causing some of the colleges and universities to re-think the appropriateness of joining the consortium.

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### ABOUT COLLEGE SAVINGS CONSULTANTS

College Savings Consultants, Inc is a consulting firm based in Wellesley, Massachusetts focusing exclusively on Section 529 College Savings Plans. Founded by Richard A. Feigenbaum, author of the “529 College Savings Plan” published by Sourcebooks. College Savings Consultants provides consulting services to Financial Institutions, 529 Plan Managers, Broker Dealers, Financial Advisors and Employee Benefit Managers to develop market strategies, technology and education solutions for their 529 plan products and offerings.

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