Saving for College with a 529 Plan

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If your children or grandchildren are planning to attend college, you can begin saving now through a savings program known as a "529" plan designed to meet ever-rising college costs. These state-sponsored educational plans, including the highly ranked Michigan Education Savings Program (MESP) which has been in operation since 2000, allow your savings and reinvested earnings to grow tax free under professional investment management. The money can be withdrawn free from state or federal income tax for qualified college or vocational school expenses at any accredited school in the country including tuition, room, board and other expenses.

The 529 plans – named after Section 529 of the Internal Revenue Code – have proven popular nationwide, and every state now has at least one plan available. Michigan residents can choose any state's plan, but may find advantages to enrolling in the MESP, including an annual Michigan income tax deduction of up to \$5,000 (\$10,000 for joint filers) for plan contributions.

What makes the 529 plans so popular? First, there are the tax benefits, which ordinarily cannot be matched by competing private plans sponsored by financial institutions. Second, as the donor, you remain in charge of the account and most plans allow you to change the beneficiary or withdraw the funds at any time (subject to taxes on non-qualified withdrawals). Third, after you choose a plan and authorize regular deposits, your account requires no attention except to change investment options or switch to another state plan. Finally, there are usually no application fees, income or age restrictions, and the low minimum investment (\$25 for the MESP) and maximum contribution of \$200,000 per beneficiary in most plans (\$235,000 for the MESP) are attractive.

All 529 accounts must be professionally managed, but most state plans include several investment options. The Michigan plan, for instance, is managed by TIAA-CREF, which offers three choices: Balanced Option (blend of equity, real estate and fixed income funds), 100% Fixed Income Option and 100% Equity Option (US and foreign funds). MESP investment options can be changed annually.

If the child does not go to college or the 529 account is more than the qualified expenses, you can change the beneficiary to another family member, if one exists. If not, you can recover all of your contributions, but only 90% of any earnings, which are subject to a 10% excise tax for the non-qualified distribution. Any recovered earnings will also be taxed as ordinary income. Additionally, recovered contributions will generally be subject to state income tax if they were previously deducted on your state income tax return.

Contributions to a 529 plan qualify for the annual gift tax exclusion (currently $13,000), and better yet, you can contribute up to $65,000 per beneficiary and treat it as being made over a 5-year period at $13,000 per year. This feature allows you to remove substantial assets from your estate to reduce potential estate and gift tax without losing control.

A word of caution is in order concerning the unavoidable risk of investing for college through 529 plans. Virtually all plans have experienced losses in the value of 529 investment accounts in recent years due to the general decline in stock prices, market indexes and mutual fund share values from previous highs.

We hope you will find this brief general summary regarding 529 plans of interest if you are concerned with financing college expenses. However, the law and rules in this area are complex, subject to changes and should be carefully reviewed before investing. More detailed information with ratings of the MESP and other state 529 plans are available on the internet at www.savingforcollege.com. and www.misaves.com.