

Planning Ideas—IRC Section 529 Plans

In recent weeks, it was widely reported that the college debt burden of graduating students rose again in 2010. In fact, while two decades ago less than half of students graduated with any debt, and the average debt was only about \$10,000, it is expected that students graduating in the spring of 2011 will have an average of about \$29,000 of college loans. In response to the problem, President Barack Obama has ordered changes to the federal student loan program, limiting the monthly payments for certain borrowers based on their income and then forgiving any unpaid debt after 20 years. Unfortunately, this proposal, even if it were to be enacted, won't be of help to affluent and high net worth (HNW) clients with family incomes of more than \$100,000.



Even as student debt rises, few doubt the value of higher education. The College Board's recent study *Trends in College Pricing 2010 and Trends in Student Aid 2010* found that:

- **Average annual earnings ranged from \$18,900 for high school dropouts to \$25,900 for high school graduates, \$45,400 for college graduates and \$99,300 for the holders of professional degrees (medical doctors, dentists, veterinarians and lawyers).**
- **Over a work life, earnings for a worker with a bachelor's degree compared with one who had just a high school diploma increase by about \$1 million for non-Hispanic Whites and about \$700,000 for African Americans; Asians and Pacific Islanders; and Hispanics.**

What this points to is the ever-increasing importance of saving for children and grandchildren's higher education. One tax-favored way to do that is the IRC Section 529 Plan, which are available to all clients, regardless of income. Test your knowledge about Section 529 with the following quiz. Answers are at the end.

Section 529 Quiz

1. Section 529 plans can be categorized as which of the following?
 - I. Savings plan
 - II. Pre-paid plans
 - III. Lottery plans

- A. I and II only
- B. I and III only
- C. II and III only
- D. I, II, and III

2. Section 529 plans may be offered by _____?

- I. States
- II. Advisors
- III. Institutions

- A. I and II only
- B. I and III only
- C. II and III only
- D. I, II, and III

3. The annual Federal tax deduction for contributions to Section 529 plans is _____?

- A. Zero
- B. \$2,000
- C. \$5,000
- D. \$13,000

4. A Section 529 plan is the same as a Coverdell ESA.

- A. True
- B. False

5. With the typical Section 529 savings plan, the state guarantees investment returns.

- A. True
- B. False

6. Federal tax benefits associated with Section 520 plans include:

- I. Tax-free growth
- II. Easy conversion to a Traditional IRA
- III. Tax-free withdrawals for qualifying education costs

- A. I and II only
- B. I and III only
- C. II and III only
- D. I, II, and III

7. What types of fees are common with a Section 529 college savings plan?
- I. Enrollment fees
 - II. Annual maintenance fees
 - III. Asset Management fees
- A. I and II only
B. I and III only
C. II and III only
D. I, II, and III
8. When would investment in Class B shares in a Section 529 college savings plan be most appropriate?
- A. Anytime
B. When the beneficiary is within only a few years of needing the funds
C. When the beneficiary is several years away from needing the funds
D. Never
9. What exceptions to the penalty tax are available on non-qualifying distributions from Section 529 plans?
- I. The beneficiary dies
 - II. The beneficiary becomes disabled
 - III. The beneficiary decides not to go to college and uses the distribution to cover job-hunting expenses instead
- A. I and II only
B. I and III only
C. II and III only
D. I, II, and III
10. Contributions by a parent or grandparent to a Section 529 plan qualify for the annual exclusion.
- A. True
B. False

Bottom Line

Section 529 plans are valuable tools for education planning. With costs already high and rising far faster than inflation, Advisors need to know the basics. How did you do on the quiz?

Answers to Quiz Questions:

1. A
2. D
3. A
4. B
5. B
6. B
7. D
8. C
9. A
10. A

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