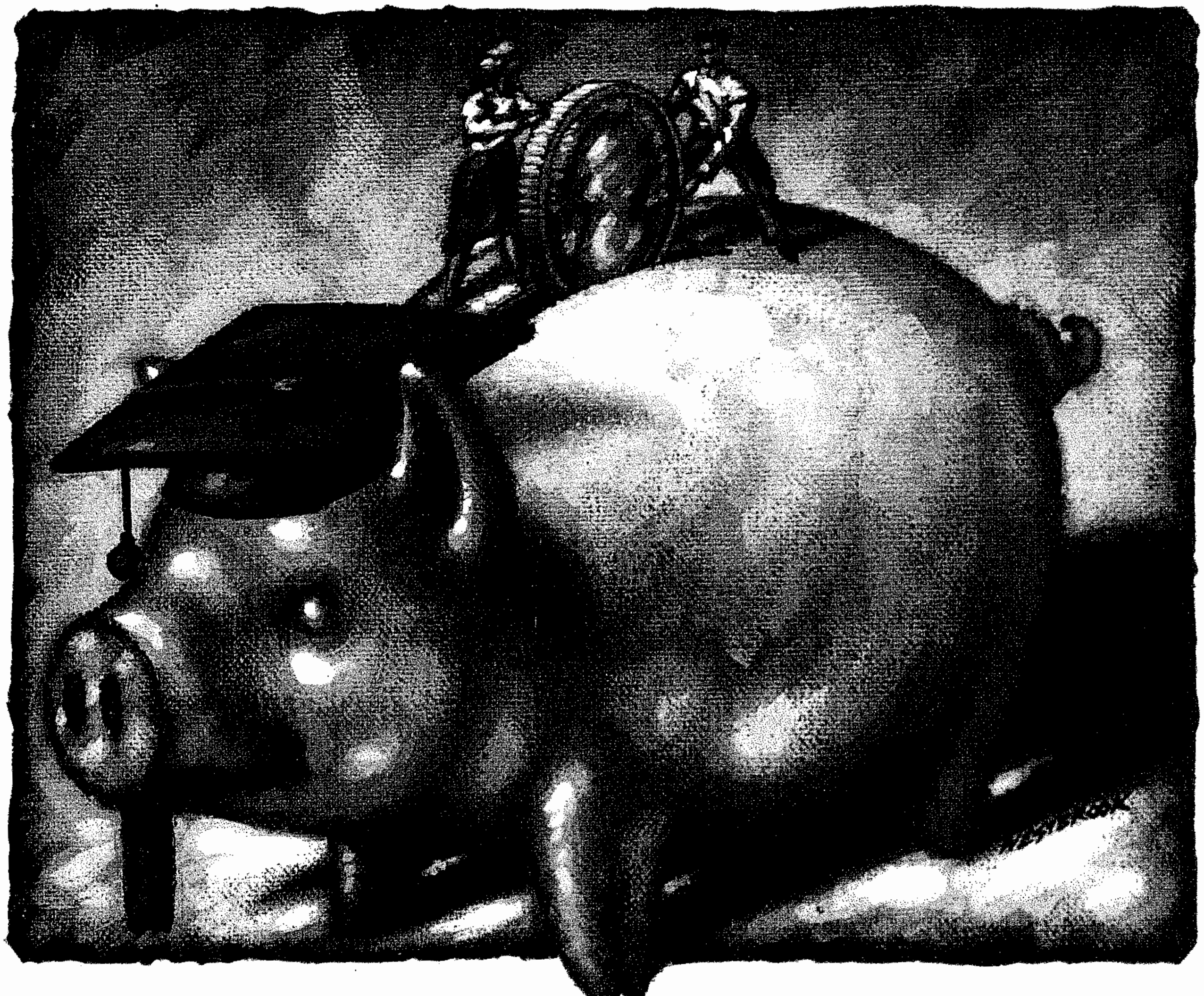
MONEY TALKS

TAP Into This

Tuition plans give parents the means to make college costs affordable.



By Tina Traster

Nancy and Dennis Cohen (not their real names) have started to think about saving for college, though their one-year-old is still in diapers and barely toddling. The Philadelphia-area couple know that by the time their son is ready for college, they will be nearing 60 and facing both retirement and college costs.

If the couple put $1,000 in a 529 college-investment plan today, and contributed $485 a month through 2020, they would save enough to fund a four-year education at a private college where tuition costs would be around $45,000 per year.

Since their introduction, 529 plans have been the rage because of tax-free growth, tax-free withdrawals, high-contribution limits and flexibility regarding beneficiaries. There are two broad categories for 529s—prepaid programs and investment plans.

Prepaid programs guarantee a certain amount of future tuition. In other words, you are buying tomorrow's tuition at today's prices. In contrast, 529 investment programs are dependent on market performance, which gives you some control over managing your investment but also subjects you to market volatility.

For years, families have been allowed to save for college in state-sponsored prepaid tuition plans and use the funds to pay for tuition at any school nationwide. Recent attention has been focused on the new Independent 529 plan, a prepaid tuition plan sponsored by a consortium of 200 private colleges, including 21 in Pennsylvania.

"If your child plans to go to one of the 200 colleges in the Independent plan, it's a legitimate option, but if you don't know which college he or she wants to go to, the Pennsylvania TAP plan provides more flexibility," says Karen McIntyre, a certified financial planner at Executive Financial Services Inc. in Spring House, Pa. "In the independent plan, the funds can only be used for undergraduate tuition and enrollment fees, whereas with Pennsylvania's TAP prepaid plan, the funds can be used for any qualified educational expense, including room and board, books, computer, travel expenses."

Prepaid and investment plans share common traits: Both are tax-free, while the money grows in the account, and when taken out and used for qualified expenses, such as those mentioned above. If a child decides not to attend college, the money can be transferred to other college-bound family members. Earnings are taxed on withdrawal, and there is a 10-percent penalty on the earnings if funds are taken out and not used for college or related costs.

"Planning for college expenses is more an art than a science," says Tamara Kukainis, a certified financial planner for Schwartz Financial Associates Inc. in Cherry Hill, N.J. "Parents should work with a financial advisor to come up with a plan that is flexible so it can adjust to market conditions and changes in personal finances."

To create flexibility in a college-savings strategy, Kukainis advises that a family like the Cohens divide their savings plan for their young child among college-savings vehicles and non-college mutual funds. She suggests socking away 75 percent of the monthly $485 contribution it would take to cover the entire tuition into Pennsylvania's TAP 529 investment plan. The remaining 25 percent should go into mutual funds, choosing a blend of conservative, growth and aggressive funds. But remember that the asset allocation should become more conservative as college age approaches, says the financial planner.

The mutual fund accounts should be in the parents' name, rather than in the child's or in custodial accounts (UGMA or UTMA), to protect the child from becoming ineligible for financial aid and to maintain as much control over the money as possible. In financial-aid computa-

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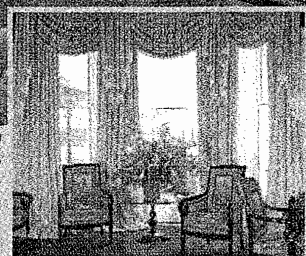

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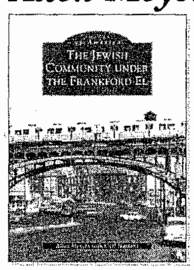

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Mail To: The Jewish Exponent, 2100 Arch Street, Philadelphia, PA 19103 tions, 529s are considered a parental asset, and parents' assets are assessed at a much lower rate than accounts held in a child's name.

Not everyone can tolerate risk when it comes to saving for a college education. For those who have lost money during the bear market, prepaid plans may be a more appealing option. However, prepaid plans do have some pitfalls: There is no control over investments because fund managers make the decisions.

Beware, too, that several states, including Pennsylvania, are projecting possible long-term shortfalls on their funds unless there's a turnaround in the market or a slowdown in tuition increases. Participants can't lose their principal but they may end up paying more than originally anticipated through added fees. As with any investment contract, read the fine print.

The new Independent 529 Plan will likely appeal to parents because it allows anyone to prepay for future tuition at a discount on today's costs. Best of all, the tuition is guaranteed; there is no risk, even if future tuition rises sharply or investment returns are weak. You may begin with as little as $500, or $25 per month with a monthly automatic bank or payroll transfer.

But there are some restrictions. Assets must be held in the plan for a minimum of 36 months before they can be withdrawn. Also, the contribution limit is $137,500 per beneficiary, less than half allowed in the Pennsylvania TAP plan. If a student chooses not to go to a participating college, the money can be used at a non-member school, but the investment return is capped at a maximum growth rate of 2 percent a year. This 2 percent increase is less than the historical rate at which tuitions have increased.

There are no fees associated with the plan, and increases in the value of the tuition certificates are tax-exempt. You are not required to choose a college to redeem the certificates until it is time for your child to enroll. The Independent 529 Plan will be managed by TIAA-CREF Tuition Financing, Inc.

*Tina Traster is a frequent contributor to **Inside**.*

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