October 9, 2000

INVESTING FOR COLLEGE CAN BE TAX DEFERRED

Most parents know that future college costs will be outrageous.

But are there methods of savings that offer both growth and tax deferral?

The three plans to consider are the Roth IRA, state sponsored 529 or TAP plans, and tax-managed investment plans.

Roth IRA plans offer the parent both control (of the money) and tax deferral, since the money grows not only tax deferred for the initial five years but tax-free thereafter. The issues with the Roth IRA are the $2,000 limit (per parent) each year for after-tax contributions and the income restrictions to qualify. Working couples, whose combined incomes exceed $150,000 (AGI), are excluded from contributing to a Roth IRA. A new bill before Congress, however, may soon raise the annual contributory limits to $5,000 per person, per year. If the bill is passed, this option may make the Roth IRA a more viable choice.

State sponsored 529 or TAP programs are also becoming more popular as the cost of a college education increases.

New Jersey offers a 529 savings plan that allows parents to invest in a state-managed fund that grows tax deferred, both at the state and at the federal level. Called "New Jersey's Better Education Savings Trust" (BEST), information can be obtained on the Internet at NJ BEST or via telephone toll free at 877-465-2378.

In the early years of growth, the funds are invested more aggressively to provide better growth potential. However, as the child gets closer to college age, the funds are more conservatively invested. This can be viewed as either good or bad, depending upon your point of view. Funds can be used for colleges or trade schools, either in or out of state. If the funds are unused for one child, they can be passed on to another child of the same generation. If the funds are totally unused, the account can be withdrawn, less a 10 percent penalty as well as income tax on the deferred growth within the portfolio.

For many parents, and especially grandparents, who may want to prefund a child's education to perhaps reduce their own estate tax liability, these state savings plans may be quicker and more convenient than setting up a complicated trust that has to be managed each year. In this case, the state acts as trustee and money manager.

In Pennsylvania, a "Tuition Account Program" (TAP) is offered. A TAP is different than a 529 plan. A TAP plan is structured at a discounted price to the cost of a future college education. For example, a $100,000 future college fund may require an investment of $20,000 today, depending upon the child's age. This is similar to the savings bond concept. A $50 US Savings bond costs only $25 today -to be redeemed for full value in 18 years. Although different in structure, the Pennsylvania TAP has many of the other features offered in the New Jersey 529 plan, like tax deferral and state sponsored administration.

One restriction of the TAP plan: the purchaser or child must be a resident of the state of Pennsylvania. Information on the PA plan can be obtained via the Internet at PA TAP - or toll free at 800-440-4000.

Tax-managed portfolio accounts are my personal favorite, but they require professional management and account minimums tend to be larger than many parents can afford.

Of course, the best plan is any one that is established early in the child's life.

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