

Financial Developments & Topics

WESCAP Management Group

Section 529 College Savings Plans

Inside this Issue:

- Section 529 College Savings Plans
- Tax Law Changes for Gifts and Roth IRAs

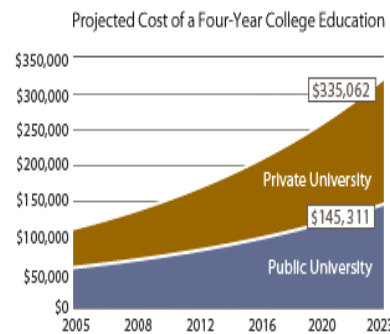
Highlights:

- College costs continue to increase above the inflation rate.
- Section 529 College Savings Plans can help pay for post-secondary educational expenses and may provide favorable estate and tax benefits to donors.
- Two new tax laws have been passed which impact several areas of financial planning. In this newsletter we highlight two specific areas: charitable contributions and Roth IRAs.
- Under certain scenarios taxpayers can now use IRA distributions to make charitable donations without having the withdrawn money count towards taxable income.
- Roth IRAs will be available to taxpayers of all income levels beginning in 2010. To take advantage of this opportunity, some individuals may wish to establish non-deductible IRAs now and convert them to Roth IRAs in 2010.

According to the College Board's "Trends in College Pricing" report (10/24/06), average tuition and fees at public four-year colleges for the 2006-07 academic year rose to \$5,836 while the cost of private school education increased to \$22,218.

State-administered College Savings Plans (often called 529 plans) are attractive vehicles for accumulating savings to pay for these often extraordinarily expensive post-secondary educational costs. Any indi-

vidual (the donor), regardless of income level, can fund an account for any individual beneficiary – while still retaining control over the account.



2004 Trends in College Pricing, published by The College Board.

Once a 529 plan has been funded, investment earnings grow tax-free in the account. Withdrawals made by the beneficiary are federal tax exempt. **The federal tax exempt benefit was set to expire in 2011, however this feature was made permanent as a result of a new tax law.**

For tax-free treatment, the money must be used for qualified educational expenses including: tuition, room and board, books, required equip-

(Continued on page 2)

Impact of Recent Tax Law Changes

As a result of new tax laws, in 2006 and 2007 individuals over age 70½ can donate up to \$100,000 from their IRAs to qualified public charities. As long as the gift goes directly from the IRA to the charity, the distribution will not be treated as taxable income. However, since the gift is not part of income, no deduction is available to the donor.

WESCAP clients interested in making a charitable donation from their IRA

should contact us to assist with this process.



Roth IRAs have some significant advantages over traditional IRAs. For example, unlike a traditional IRA, distributions from a Roth IRA are generally tax-exempt. In addition, taxpayers with Roth IRAs are not required to take minimum distributions at age 70½ and can even continue to make contributions to their accounts after age 70½.

Currently, Roth IRAs can only be opened by taxpayers with adjusted gross incomes under \$100,000. However, starting in 2010, this income threshold is effectively eliminated.

Some individuals may find it beneficial to establish non-deductible IRAs now and convert them to Roth IRAs in 2010. Because of the numerous issues to consider, we will discuss this topic in detail at a later date.

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About WESCAP: WESCAP Management Group is a registered investment advisor and fee-only financial advisory firm. WESCAP has been serving individuals and families since 1988. For additional information, please contact Rick Weinlein, Mark Gleason, Alan Gelb or Joel Edstrom. You can contact us at (818) 563-5170 or via e-mail at contact@wescapgroup.com

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Section 529 College Savings Plans—Continued

(Continued from page 1)

ment, and fees. If withdrawals are not used for qualified expenses, the earnings are taxable and subject to a 10% penalty payable by the recipient. At any time, a donor can revoke the plan and take back the plan balance provided he pays the tax and penalty. The plan's beneficiary can also be changed at any time to any of a wide array of the beneficiary's relatives without tax consequences.

An individual donor is allowed to make an annual contribution of up to \$12,000 towards a beneficiary's 529 account without gift tax consequences. In most cases, the donor's contribution is removed from his own estate. Using a special election, an individual donor can make a one-time contribution of up to \$60,000 (married couples gifting jointly can contribute up to \$120,000).

However, any subsequent contribution for the next 4 years to the same beneficiary would have gift tax consequences.



Each state's plan is unique and offers a limited number of investment choices from one or more financial vendors. The most important variables among 529 plans include: state taxation, expenses, and investment flexibility. Some states tax the qualified withdrawn earnings, others do not. About 30 states offer income tax deductions on contributions.

Expenses, including set up and/or annual administration fees paid to the state, asset management and/or

administration fees paid to the vendor, and commissions paid to a financial broker, can total up to 3% per year. Choosing plans with lower fees is an easy way for a donor to help increase the potential for satisfactory long-term account results.

Investment flexibility, which means the number and type of investment choices available to the donor and the ease of making changes to those choices, is often cited as a major drawback of 529 plans. Investment options are limited to those available in each state's plan, and under most circumstances, changes to those choices are allowed only once per year. Investment programs will fall into one of three general categories: age-based, static, or self-directed.

While other college savings vehicles exist and cer-

tainly should be considered (such as gifting appreciated assets to a UTMA account), recent changes to tax law now often make 529 plans the best option among these choices.

To select a plan, a donor, after considering other savings methods and any special tax breaks from his own state plan, should look for a 529 plan with low expenses and investment flexibility.

WESCAP has written an in-depth report on 529 plans, which includes details about some attractive state-sponsored programs and our top selection among 529 plans. This complimentary report is available upon request.

