The Best Way to Save For College: A Comprehensive Guide to State-Sponsored College Savings Plans and Pre-paid Tuition Contracts

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The Best Way to Save For College gives a comprehensive overview of qualified state tuition programs established under section 529 of the Internal Revenue Code. The implications of using qualified state tuition programs on tax, retirement, and estate planning are analyzed. The author also compares the qualified state tuition programs to other alternatives to a family in saving for college so that the best option can be selected. Possible future legislative changes that would affect the benefits of qualified state tuition programs are discussed.

The book has 13 chapters. Chapter 1 presents the history of qualified state tuition programs. It helps the reader get a good understanding of the state government's motivations to start up a qualified tuition program. It also discusses features that are likely to be introduced in the future. For example, qualified state tuition programs might offer more than one investment approach to participants depending on their risk tolerance.

Chapter 2 outlines the benefits of using qualified state tuition programs to save for a college education. The two major benefits are: 1) earnings in the account are tax-deferred until they are distributed in the future; 2) earnings are taxed to the beneficiary of the account when distributions are made for qualified higher education expenses. Since most beneficiaries (students) are in low income tax brackets, the tax burden is lessened. Some states also exempt the distributions from state income tax.

A qualified state tuition program is required to follow section 529 of the Internal Revenue Code. In chapter 3, the author describes the provisions of section 529, including the tax benefits made available to the participant, the tax rules for withdrawals, and various qualification requirements. This is a fairly technical chapter, and includes information that financial advisors will need when working with qualified state tuition programs.

In Chapter 4, the author presents the disadvantages of using qualified state tuition programs. The most significant concern is that saving for college with a qualified state tuition program can negatively impact the student's financial aid eligibility. Little time is spent reviewing other limitations of qualified state tuition programs, such as, the relatively low investment returns and high fees of these programs, the limitation on the duration, and the in-state residency and minimum purchase requirements.

Chapters 5 through 7 are particularly helpful for financial professionals as well as families to evaluate different programs. Chapter 5 presents the differences between the two categories of qualified state tuition programs, prepaid tuition plans and saving-type plans.

Chapter 6 provides a checklist for people who plan to use qualified state tuition programs. The checklist describes many areas in which the programs may differ from one another. Chapter 7 provides a state-by state comparison of programs. The best and the worst features of each program are also described, along with an overall rating of the program.

Chapters 8 and 9 analyze the implications of using qualified state tuition programs on income and estate taxes. The author analyzes the income tax advantages of using qualified state tuition programs outlined in Chapter 2. The author also discussed the tax benefit of borrowing money and contributing it into a qualified state tuition program. The advantage is that the interest paid on the debt is tax-deductible. If the donor is in a higher tax bracket, then there could be a tax benefit, as the money withdrawn from the program is taxed on the student's lower tax bracket. However, the author did not point out that to take advantage of this tax difference, the borrowing rate and the return you earn in the program have to be reasonably close. Since the return in qualified state tuition program is typically a lot lower, it is almost impossible to benefit from this advantage. The major

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estate planning benefit is that the donor can maintain control over the assets in the account, as the donor can change the beneficiary at will.

In Chapters 10 through 12, the author compares qualified state tuition programs with other investment alternatives, including education IRAs, Roth IRAs, series EE saving bonds, and mutual funds. An advantage of qualified state tuition programs is that they are available to all families regardless of income. The author points out that IRAs (especially Roth IRAs) are better than qualified state tuition programs for saving for college. Withdrawals from Roth IRAs for education expenses are tax-free, and assets in IRAs are treated more favorably for financial aid purposes than amounts in qualified state tuition programs.

Finally, Chapter 13 offers some strategies that can be used to take the advantage of the flexibility of the qualified state tuition program. For instance, strategies to take advantage of the flexibility of switching the beneficiary of the account.

This book offers a good guide to financial professionals who are unfamiliar with the mechanism of qualified state tuition programs. As a CPA, the author provides excellent analysis on the income and estate tax implications of qualified state tuition programs. However, the analysis of the financial aspects is weak, especially on the long-term risk-return trade-off of the qualified state tuition programs and other saving vehicles, as compared to other investments such as stock funds (Hanna & Chen, 1996). The returns of these programs are relatively low; therefore, one will have to invest a lot more in the program to guarantee the coverage of college cost.

The title, *The Best Way to Save For College,* is somewhat inappropriate for this book, which focuses primarily on qualified state tuition programs. Chapters 10 through 12 are rather short. Some practical examples in these chapters should help the reader get a better understanding of the comparative benefits of different investment vehicles. These examples will also provide guidance for financial professionals when applying the concepts for their clients. On the other hand, chapter 7 is long and redundant. It would have been better to put the detailed state-by-state comparison in an appendix and only a summary of the comparison in the chapter.

Overall, this is a valuable book for financial professionals who want to have a better knowledge about the mechanism of qualified state tuition programs.

References

Hanna, S. & Chen, P. (1996). Efficient portfolios for saving for college. *Financial Counseling and Planning*, 7, 115-122

Rationality Gone Awry:

