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Saving for College

How to help your clients select the best investments for their 529 plans.

by *Neal Frankle, CFP*

Most 529 college savings plans offer a variety of investment options ranging from very conservative fixed income to more aggressive equity investments. My experience tells me that most clients make the 529 investment decisions based on their investment risk tolerance rather than considering what is best for their child. That could be an expensive mistake.



For example, let's assume your client's daughter just gave birth to her first child. Your client is so pleased that they run down to the bank to open up a 529 plan. When the clerk asks how your client would like to invest the money, the client thinks about all the money they lost in the stock market since 2000 and they blurt out "anything but the stock market!" Assuming your client deposited \$10,000 in the plan, their fixed income account would grow to \$24,000 over the next 18 years (assuming a five percent annualized return). Had your client selected moderate equity growth, the account could have grown to \$47,000 (assuming a 9 percent return). Congratulations! Your client just cost their first grandchild \$23,000.

So how *does* your client make the decision? Consider the child's age when your client starts the plan. In most cases, if your client has more than 10 years before the child goes to college, a moderate equity portfolio is the best option. Your client can also select an "age-based" option that automatically adjusts to a more conservative asset allocation as the child ages. Even though I personally do not favor it, this is a very popular option and certainly better than plopping all the money into fixed income for the duration.

But what should your client do if they don't know in which state the child will start college? It doesn't matter. In most cases, withdrawals made from 529 plans can be used at any educational institution in which federal student aid is available — even if the school is not located within the state offering the plan your client uses. Have your client visit the [Free Application for Student Aid](#) (FAFSA) Web site to see if the school your client has in mind is eligible.

What does your client do if the beneficiary decides to become a professional NASCAR driver and skips college? Your client can always change the beneficiary to someone else in the family. They can even name themselves and go back to school for that Ph.D. in philosophy your client always wanted.

As an alternative, the client can take the money out of the plan. However, your client probably won't want to do this unless they have a real emergency. Any earnings growth in the account will be

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taxable to your client at their ordinary income rate plus a 10 percent penalty.

OK, the client is sold on the 529 plan. But should your client set one up for all their children or should they set up separate accounts.

I suggest that they set up individual accounts. The reason most people want to set up one account for all the children is to avoid paperwork and reduce account fees. If your client sets up a "master" 529 plan, this only delays the extra effort and paperwork. Since each 529 plan can only have one beneficiary, they will have to set up new accounts for each child and transfer funds (tax-free) from the master account later on.

While it does make sense to minimize account maintenance fees, there may be ways to accomplish that without setting up a "master" 529. Keep in mind that some 529 plans waive their annual account maintenance fees (which can range anywhere from \$5 to \$50 per year) if the client maintains a certain balance in their 529 accounts or if they sign up for the automatic contribution plan. Also, many 529 plans impose no account maintenance fees at all.

Opening separate accounts for each child is a good idea for many reasons. One is that the client can tailor the plan and investment option within that plan for each child. For example, let's assume your client opens accounts for their grandchildren and they are located in different states. It could make sense to use the 529 plan in the state where the grandchild lives if there are special state tax breaks for withdrawals from the in-state 529 plan, or if the state provides preferable treatment to residents in its own 529 plan when awarding state grants.

Also, by keeping the accounts separate, their client keeps their intentions clear. If something were to happen to the client, and all the funds they set aside to help the grandchildren are in the name of just one grandchild, the children could face a difficult time attempting to resolve the ultimate disposition of the 529 funds. With separate accounts, their client can easily name the appropriate successor on each account and eliminate any confusion or discord in the event their client dies or becomes disabled.

*[Neal Frankle](#) is the author of **Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity**. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. To receive a free report on how to find the best funds, contact him by sending [e-mail](#).*

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