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September 2001 Investment News

**...a child born this year will face a tab of \$234,000 for four years at a private school or \$108,000 at a public school.**

### The Rising Cost of A College Education

What will it cost for a college education in 2019? As much as \$234,000!

Many of our younger clients face the daunting financial challenge of providing a college education for their children. For over thirty years, members of our firm have assisted clients with this financial burden.

The cost for college is currently rising at about two times the rate of inflation. According to collegeboard.com, the total cost for the 2000-2001 academic year averaged \$22,533 for a private four-year school and \$10,458 for a public four-year school in-state (\$15,686 out-of-state). Assuming a 5% annual increase in college costs, a child born this year will face a tab of \$234,000 for four years at a private school or \$108,000 at a public school.

In this newsletter, we will look at some of the most attractive options parents and grandparents may want to consider to cover some or all of these ever-increasing costs.

### The Custodial Account Has Worked

One of the most popular strategies is to establish a custodial account for the benefit of a child under the Uniform Gift to Minors Act. Our firm has used this approach with clients for many years. UGMA accounts are attractive because they provide good investment flexibility (we've preferred the use of mutual funds, but other investment vehicles may be used) and generous contribution limits (\$10,000 without exceeding the annual gift tax exclusion). Currently, the first \$750 of investment earnings each year is tax-free. Until the child reaches age 14, earnings between \$750 and \$1,500 are taxed at the child's rate and additional amounts at the parent's rate. After age 14, all earnings above \$750 are taxed at the child's rate.

One important consideration about a UGMA account is that upon reaching age 21 (the age of majority in Mississippi), the child takes ownership of the assets. Although the account may be intended for college, there is a risk (although probably small) that the child may use it for other purposes.

Advisors have mixed opinions about one potential drawback of a custodial account – its impact on the financial aid calculation. The student is considered to have ownership of the account, and the assets are counted nearly seven times more heavily in the federal financial aid formula as compared with assets held in a 529 Savings Plan (see below). Obviously for those who apply for need-based financial aid, the higher the income and assets, the less likely that it is that they will qualify.


### The Education Savings Account is Expanded

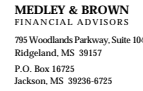
Previously known as the Education IRA, the Education Savings Account offers tax-deferred growth and tax-free withdrawals for qualified education expenses. This year's tax legislation provides an expanded annual contribution limit of \$2,000 beginning in January 2002 with the caveat that families with incomes above \$190,000 may face limitations. Nonetheless, if you were to invest \$2,000 each year for the next 18 years and earn 10% annually—a rate which a number of good common stock funds have earned—you could accumulate \$100,000, close to the projected cost of four years at one of our public universities in Mississippi.

Another attractive enhancement provided by the new tax law is that qualifying education expenses for tax-free withdrawals have been expanded to include private elementary and secondary schools in addition to colleges and trade schools. According to Walter Murphy, CPA, of Tann, Brown and Russ in Jackson, qualifying expenses include tuition, fees, room and board, uniforms, transportation, extended daycare and may even include home computers.

Similar to other IRAs, contributions may be made up to April 15th, and as with UGMA accounts, Education Savings Accounts provide the flexibility to direct investments. Contributions to Educational Savings Accounts are not deductible, and there is a 10% penalty withheld on earnings from non-qualified withdrawals.

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### Enter The 529 Savings Plan

A relatively new entrant in the college savings game, the 529 Savings Plan is a qualified tuition plan which combines the generous contribution limits of UGMA accounts and the tax-free earnings and withdrawals (for qualified expenses starting in January 2002) of Education Savings Accounts and offers the added benefit of no income restrictions.

Our state's offering, the Mississippi Affordable College Savings Program (MACS), has received favorable reviews since being introduced on March 20<sup>th</sup> of this year. In its May issue, *Money* magazine recognized it for its attractive state tax benefits, and Savingforcollege.com, a leading Internet guide to 529 plans, awarded it a top rating for residents. According to Jim Tolve, Public Relations Spokesman for TIAA-CREF, the program manager for MACS, there were 366 accounts opened in Mississippi with a total investment of \$1,190,000 as of August 13, 2001.

A MACS account can be opened with a minimum investment of \$25, and you can continue to contribute as long as the account does not exceed \$235,000 (an amount that should be sufficient for a private education in 18 years). The money can be used at nearly all colleges, universities, trade/vocational schools or post secondary institutions in the country, as well as certain foreign schools. In addition to state and federal tax-exempt growth, MACS accounts provide for an annual state income tax deduction for contributions up to \$20,000 per year for joint filers (\$10,000 for single filers). A downside of a 529 savings plan is a 10% federal tax penalty and ordinary income tax for non-qualified withdrawals.

Another negative is the limited investment choice and control. The MACS plan offers three investment choices of which you can select one or more: a managed allocation option, a 100% equity option and a money market option. Once an election is made, it cannot be changed, although future contributions can be invested differently. Thus, unlike the custodial account and Educational Savings Account where you may initially invest your money in WorldCom stock and later move it to the Oakmark mutual fund, with the 529 plan, for each contribution you must stay with your initial investment choice for the life of the plan. Ouch!

### Which plan will work best?

That depends on your priorities. Each plan has pluses and minuses, and there are complexities to each that this brief summary cannot address (a discussion with your tax advisor would be wise before choosing a plan). The key is to get started early if you have a child or grandchild bound for college. We know that time can be a huge friend in investing.

### News Worth Mentioning


We are pleased to announce that Tim Medley has been honored by *Worth* magazine as one of the country's 250 top financial advisors for 2001. *Worth* presented its Best Financial Advisors list in its September 2001 issue's cover story. This marks Tim's fourth appearance among this elite group.

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