The Independent 529 Plan | By Robert Bloom

EFFECTIVE SINCE SEPTEMBER 1, 2003, THE Independent Plan is a prepaid college-tuition arrangement applicable to 238 private undergraduate colleges. Launched in accordance with Section 529 of the Internal Revenue Code, this plan represents a consortium of these participating colleges on a national basis, in contrast to all other 529 plans, which deal only with public colleges on a state-by-state basis. TIAA-CREF, which provides professional management to many college retirement plans and 529 state plans, also directs and invests this pooled fund. Families or individuals can invest cash at a discount from today's tuition rates at participating colleges, which is applied to future instructional costs for their children, grandchildren, and other beneficiaries. There are no restrictions on the age of the beneficiaries. Given the recent rate of inflation for college tuition of 6% a year, this plan seems desirable. After all, how many families can expect to earn that rate annually on personal funds in light of the stock market performance in the recent past?

Given the recent rate of inflation for college tuition of 6% a year, the Independent 529 Plan seems desirable.

Each college has agreed to offer a discount, which it can raise or lower over time—but not below 0.5% compounded annually—from the current tuition rate. The yearly tuition and discount rate determine the contributions paid. If a donor decides to pay a lump-sum for all the college tuition, the tuition rate and discount then in effect would determine the total contribution.

Donors deposit funds on an after-tax basis, which will grow and be distributed tax-free if the beneficiary attends a participating college. The tuition discount is also tax-free. In contrast to other 529 plans, donors contributing to the fund don't pay any fees to TIAA-CREF or the fund. Instead, the participating colleges pay annual fees to TIAA-CREF. The federal tax benefits of this plan apply from September 2003 through December 2010. (The Economic Growth and Tax Relief Reconciliation Act of 2001, which covers the tax treatment of 529 plans, expires on December 31, 2010, after which date qualified distributions would be taxable at the federal tax rate of the beneficiary unless Congress amends the law.)

To participate in this plan, a donor doesn't have to select the college for the beneficiary immediately. Instead, he/she chooses five prospective colleges so as to be advised of how the contribution applies to each school. A plan could be started for a minimum of $25, with contributions as low as $500 in the following two years. The maximum contribution represents five years of tuition and fees, but not room and board, for each beneficiary. Furthermore, five years of contributions up to a maximum of $55,000 ($110,000 for joint returns) can be prepaid by the donor for each beneficiary in one year without paying gift taxes—treated as though $11,000 ($22,000 for joint returns) were contributed equally over five years, assuming no other gifts are made by the donor to the beneficiary in these years. This is the maximum gift tax benefit under 529 plans according to IRC 529(c)(2)(b). The advantage of such prepayment is that this amount earns interest tax-free from the time of contribution. If the donor dies before the end of the five-year term, the prorated portion of the contribution that has yet to earn the tax benefit would be subject to federal estate tax, as stated by IRC 529(c)(4)(c).

The contributions must be held for a minimum of three years in order to be used for prepaid tuition. Then they can be refunded to the donor if requested based on a maximum 2% gain or loss, depending on the performance of the fund. An independent 529 fund may be transferred without penalty to a relative of the beneficiary, but not beyond a first cousin. If the beneficiary (1) has no eligible relatives to whom this plan could be transferred, (2) receives a tuition scholarship, or (3) decides not to attend college at all, then all the earnings accumulated would be taxable and subject to an IRS Section 529 penalty tax of 10%. On the other hand, should the beneficiary decide to attend a state college, the contributions could be rolled over tax-free to a 529 state plan at a discount below its future value at that time, not to exceed the 2% stipulation.

The donor, not the beneficiary, controls the accounts. The independent plan covers only undergraduate education, while state plans also provide for graduate school. All 529 plans can reduce, if not eliminate, students' future eligibility for financial aid since the fund is included in the parent's assets for such purposes. If the investment fund fails to cover the full tuition, the balance would have to be paid in the future at the rates existing then.

Finally, note that several state 529 plans—Colorado, Kentucky, Ohio, Texas, and West Virginia—have recently been suspended and thus are not accepting new contributions. Such plans have been managed like actuarial pension funds, based on long-range estimates. The problem has been that these state plans invested in risky common stocks, the prices of which have fluctuated significantly on the stock market in recent years. Moreover, state college costs have risen considerably. Under the Independent 529 Plan, TIAA-CREF invests the pooled funds in diversified institutional mutual funds, which are conservative in nature. The schools bear the risk of investment performance in this plan in contrast to the state plans where risk is borne by the individual administrators. On the other hand, there are also 529 state savings plans not involving the prepurchase of tomorrow's tuition at today's costs, where the donors shoulder the risk depending on the nature of the portfolio chosen, such as aggressive or conservative.

For frequently asked questions about the Independent 529 Plan, refer to www.independent529plan.org. ■

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[STRATEGIC MGM'T] *cont'd from p. 8*

Medical Device and Diagnostics business unit acquired four separate disruptive businesses in the 1980s: Cordis (stents), Lifescan (blood glucose monitors), Vistakon (disposable contact lenses), and Ethicon (endosurgery). Those four acquisitions grew at a compound annual rate of more than 40% during the 1990s, accounting for almost all of the division's growth. Similarly, in the early 1990s, the Washington Post Company recognized that there were disruptive trends that were poised to change the education industry as education moved beyond the classroom. It acquired Kaplan and a number of other training companies. The training and education part of the Washington Post Company now accounts for more than 50% of its revenue.

New Growth

By using disruptive innovation theory, CFOs can help their companies grow by making better use of their investments in innovation. They can curtail investment in improvements along overshot dimensions. They can scan for disruptive developments that are incubating far away from the core business and either invest to counter the disruptive development or snatch up one of the emerging attackers. ■

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