

March xx, 2004

Gregory F. Jenner, Esq.
Acting Assistant Secretary for Tax Policy
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington DC 20220

Dear Mr. Jenner:

I am writing to you today on behalf of the College Savings Foundation ("CSF"). CSF is a 501(c)(6) organization dedicated to the advancement of 529 college savings programs. CSF's mission is to help American families achieve their education savings goals by working with public policy makers, media representatives and financial services industry executives in support of education savings programs. CSF's members include many of the country's leading financial services firms, and collectively manage approximately \$10 billion in savings-type qualified tuition programs, representing over one-third of the dollars in such programs.

CSF serves the education savings industry as a central repository of information and an expert resource for its members and for representatives of state and federal government, institutions of higher education and other related organizations and associations. The primary focus of CSF is building public awareness of and providing public policy support for 529 plans - an increasingly vital college-savings vehicle. CSF's members include firms that offer 529 college savings programs and/or participate in those programs as investment managers; associate members include law firms, accounting and consulting firms, governmental and non-profit agencies and individuals who support CSF and its mission.

On March 9, 2004, several members of the Foundation attended a meeting with you at the Department of the Treasury concerning 529 savings programs. The meeting was very informative for all of the participants and we look forward to continuing to work with you and your staff as you develop the policy for these important programs.

As a followup to our meeting, CSF would like to emphasize the following points:

- (1) CSF does not support the abuse of 529 plans;
- (2) The members of CSF have generally been consistent in designing and administering their programs in ways that do not encourage abuses of section 529; and
- (3) CSF is committed to preserving the integrity of 529 plans. Thus, we are willing to support changes to 529 plans to prevent abuses even if those changes result in more restrictive provisions than previously permitted by section 529.

We believe that the vast majority of 529 savings plan accounts are certainly not the subject of any abuses. The average account balance in accounts at CSF member firms is less

than \$10,000, and only a fraction of one percent of accounts have balances over \$100,000. Further, the majority of members' accounts are funded through periodic, systematic contributions, not through lump sum contributions.

You noted at the meeting that section 529 permits an account to receive contributions from multiple contributors, and this is a source of difficulty for you and your staff. For securities law, privacy and other administrative reasons, most, if not all, programs administered by CSF members treat all contributions as coming from the account owner, even if a non-owner transmits the money to the program. We would support any changes needed to require that each account have only one contributor, i.e. the owner.

You also expressed concern that an ability to change an account's owner could lead to creative forms of abuse. We note that members' plans generally do not permit a change of account owner except in case of death or certain defined legal proceedings, usually divorces. Changes connected to legal proceedings are usually (although not always) embodied in a court order. We would support any requirement that changes of ownership be limited to death or other changes resulting from involvement in the judicial system.

You noted also that it is possible to change the beneficiary of an account to a person who is not a member of the family of the original beneficiary. You expressed concern that an individual seeking to avoid transfer taxes could consolidate multiple accounts with a single beneficiary and thus avoid transfer taxes entirely. You also indicated that you were not comfortable relying on substance over form arguments to win cases where the programs are abused in such a way.

First, as was noted at the meeting, CSF has not seen evidence that such a strategy is being employed. Second, most or all programs managed by CSF's members permit a change of beneficiary only to another family member. While this would not eliminate entirely the potential for abuse you noted, we believe that there are probably other ways in which the same end can be achieved with less administrative difficulty by abusing other arrangements, including trusts containing Crummey powers. We would support any changes needed to limit changes of beneficiaries to family members. We would also support any changes eliminating the ability of an account owner to engage in changes of beneficiary to combine multiple accounts into an account or accounts with the same beneficiary in any abusive manner.

One way to do this is to limit the number of accounts for other beneficiaries that could be changed to be for the benefit of a favored beneficiary to one per year. Such a change would not have an impact on persons who truly desire to use 529 plans for higher education, but should severely crimp the ability to avoid transfer taxes in the way that you are concerned with. As a more general matter, we believe that the gift tax treatment of changes of beneficiary needs to be reformed. Given that accounts are controlled by owners, not by beneficiaries, we believe that changes of beneficiary should result in gift taxes, if any, to the owner, not the beneficiary. We also think it very possible that if the current structure were to be challenged by an innocent beneficiary, it could be held to violate the Due Process Clause of the U.S. Constitution.

You also expressed concern that 529 savings programs could be used as retirement savings plans, i.e. that the advantage of tax deferral could outweigh the expenses of the 529 program. We do not believe this is an attractive option for retirement savers. A low cost deferred variable annuity, which also has underlying mutual fund investments, is a much more attractive retirement savings vehicle. There are deferred variable annuities with very low charges and a broader variety of mutual fund investment options than in 529 plans, and withdrawals from those annuities after age 59 1/2 are not subject to a 10% federal penalty tax, as would be withdrawals from a 529 program.

We believe that the above approaches would better serve the public policies underlying section 529 than the proposals contained in the President's 2005 budget. As noted at the meeting, we believe that three elements of the President's proposal are particularly troubling.

First, shifting control of accounts to beneficiaries would be highly problematic. In addition to the administrative difficulties inherent where minors may control accounts, we believe that parents would be significantly more reluctant to open accounts at all. UGMA and UTMA accounts suffer from this drawback, and parents find 529 accounts much more attractive on this point.

We also believe that the proposed new excise taxes on non-qualified withdrawals would have a similarly deterring effect. Although we were greatly relieved to find out that the proposals would not require program administrators to track aggregate non-qualified withdrawals, we do believe that the possibility that such taxes would be imposed would deter many people who could ultimately use the accounts for their intended purpose from ever opening them at all.

Finally, we believe that requiring a change of beneficiary at age 35 is bad public policy. Many people return to school after age 35 to further their educations, often to retrain for new careers. We believe that adopting such a requirement would again deter account formation without curbing any abuse.

We thank you for your consideration. If you have any questions about this letter or would like to discuss the issues further, please call me at 817-474-8298 or e-mail me at david.pearlman@fmr.com

Sincerely,

David J. Pearlman
Chair, Regulatory Affairs Committee
College Savings Foundation