MO$T IS A MUST

by Tim Farmer, PhD and Greg Geisler, PhD

Almost any Missouri resident paying post-secondary education expenses can benefit from the State of Missouri's 529 college savings plan called MO$T. MO$T offers a generous state income tax deduction of up to $8,000 ($16,000 for married couples) annually for contributions, making it one of the best 529 plans in the nation. Like all 529 plans, investment earnings and withdrawals are tax free if used for the beneficiary's post-secondary educational expenses including tuition, fees, books, supplies, and room and board. Each MO$T account has one owner and one beneficiary—which can be the same person! (If it is the same person, be aware that a relatively large reduction can occur in financial aid eligibility.)

Making it Easy

Many low or middle income taxpayers may be reluctant to use MO$T because they perceive investing to be complex and are less likely than high income taxpayers to have brokers/advisors to handle the details of investing. However, setting up a MO$T account is easy and contributions, which do not have to be through a broker, can be as little as $25 ($15 if through payroll deduction). (See www.missourimost.com for more information.) To make the investment choice simpler, MO$T provides three age-based mutual funds (called the Conservative, Moderate, and Aggressive Options) from Vanguard. In all three, the investments are automatically adjusted to become relatively more conservative as the beneficiary approaches college age. MO$T also provides 15 other mutual fund alternatives from Vanguard and American Century. The least risky of these is the Vanguard Interest Accumulation Portfolio.

It Doesn't Take Long

Taxpayers may think of 529 plans as long-term investments for new parents with the foresight and financial means to save early for a child's future college education. While this is certainly an objective of the plans, MO$T can provide tax savings even if a Missouri resident is only able to save for college costs one year ahead of time. Effective August 28, 2006, MO$T requires that a contribution be held in the account for 12 months before withdrawal to pay college costs—otherwise Missouri tax penalties apply . (Prior to this date, no holding period was required, so contributions could be withdrawn just a few days after being made.) Students (or their parent(s) or relative(s)) who are both Missouri residents and income taxpayers paying for college costs one year in the future or later benefit from MO$T. To summarize, MO$T is "a must" because a MO$T account owner can obtain the state income tax deduction on funds deposited and then withdrawn after only one year. A long time horizon is not required to benefit from MO$T!

Sweetening the Pot

Obtaining a Missouri income tax deduction on contributions to MO$T does not preclude taking either the HOPE or Lifetime Learning federal tax credit when withdrawals are made from MO$T to pay tuition and fees. Be aware that if "adjusted qualified education expenses" for the year are less than the withdrawals from MO$T for the year, some of the earnings from the time the money was invested in MO$T becomes taxable. If a MO$T withdrawal occurs shortly after the funds were held in the account for one year, there is generally a small amount of earnings so this rule has only a minor effect.

Illustrations

Statistics show that lower and middle income families are much less likely to participate in 529 savings than are higher income families (Dynarski, *National Tax Journal* June 2004). As Table 1 shows, low or middle income taxpayers (i.e., 15% and 25% columns) can benefit greatly by using MO$T. Table 1 assumes that the contribution to MO$T is one year before the withdrawal and there is no change in the investment's value during that year. For simplicity, table 1 ignores the fact that the Missouri tax savings are one year earlier than the federal tax effects.

Table 1: Tax Savings if Contribution to MO$T in Same Year as Higher Education Expenditures

(1) Federal marginal tax rate (MTR)	15%	25%	35%
(2) Contribution to MO$T	$8,000	$8,000	$8,000
(3) Multiplied by Missouri (MO) MTR[a]	× 6%	× 6%	× 6%
(4) MO income tax savings (from MO$T deduction)	$480	$480	$480
(5) Federal income tax savings from Lifetime Learning credit[b c]	$1,600	$1,600[d]	$0[e]
(6) Minus (1) × (4) (federal income tax increases because MO income tax paid is less so federal "Itemized Deductions" is less[f])	−72	−120	−168
(7) Net federal income tax savings	$1,528	$1,480	−$168
(8)Total income tax savings (4) + (7)	$2,008	$1,960	$312

[a] Assumes "MO taxable income" exceeds $9,000 which means that MO MTR = 6%.
[b] For simplicity, assumes tuition and fees equals (2) Contribution to MO$T.
[c] Assumes higher education expenditures qualify for Lifetime Learning credit—not HOPE credit.
[d] Assumes "modified adjusted gross income" is low enough that none of the credit is phased out.
[e] When federal MTR = 35%, "modified adjusted gross income" is above the credit's phase-out range so the tax credit = $0.

[f] Assumes taxpayer itemizes deductions for federal purposes instead of taking standard deduction. If taxpayer takes standard deduction, total income tax savings will equal (4) + (5).

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