

## Comment Letter Recommending Improved Section 529 Plan Tax Disclosure, April 2002

April 1, 2002

Diane G. Klinke, Esq.  
General Counsel  
Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 600  
Alexandria, Virginia 22314

### Re: Municipal Fund Securities

Dear Ms. Klinke:

The Investment Company Institute<sup>1</sup> is writing to recommend that the Municipal Securities Rulemaking Board (MSRB) consider adopting a new disclosure requirement that would promote investor understanding of the state tax consequences associated with an investment in a Section 529 college savings plan.

Today, most states either have established, or are in the process of establishing, a Section 529 plan. While a plan established by one state may be sold nationwide, and while all 529 plans provide for favorable tax treatment under the federal tax laws, typically those states that provide advantageous state tax treatment for investments in their Section 529 plans only provide it to those investors who are residents of their state. Concerns have been raised that some investors may be purchasing out-of-state Section 529 plan securities without taking into account that plans offered by the investor's home state may provide more favorable tax treatment.<sup>2</sup> Clearly, the tax treatment accorded under a particular state's plan is one factor that an investor should consider prior to investing in a plan.<sup>3</sup>

To ensure that investors are aware of this issue, the Institute recommends that the MSRB require that written disclosure be provided to all investors in a concise and understandable manner, alerting them to the fact that the investor's home state may only offer favorable tax treatment for investing in a plan offered by such state. In particular, we recommend that the MSRB issue an interpretive notice (with an opportunity for public comment) under Rule G-32, relating to broker-dealer disclosure delivery obligations, to require all broker-dealers offering or selling Section 529 plan securities to provide investors with such disclosure.<sup>4</sup> A disclosure requirement of this type would promote investor understanding of this issue among all investors, including those who invest without the guidance or advice of a broker-dealer.<sup>5</sup>

Consistent with previous MSRB interpretations of Rule G-32, we recommend that the MSRB provide that this disclosure requirement may be satisfied by the issuer including it in the official statement.<sup>6</sup> Indeed, it is our expectation that this is how the disclosure would ordinarily be made. For those issuers that elect to include the disclosure in their official statements, the Institute recommends that the MSRB require that it appear in a prominent location in the document. We would, however, oppose a requirement that the disclosure appear on the cover page, because that incorrectly could imply that state tax consequences are the preeminent factor that an investor should consider.

The Institute appreciates your consideration of our recommendation. If you have any questions about it or would like additional information, please call me at 202/326-5815 or Tamara Reed at 202/326-5825.

Sincerely,

Craig S. Tyle  
General Counsel

cc: Ernesto A. Lanza, Senior Associate General Counsel

## ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 9,040 open-end investment companies ("mutual funds"), 487 closed-end investment companies and six sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.952 trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders.

<sup>2</sup> See, e.g., "Who's Giving Advice on 529s?," Jane Bryant Quinn, *Newsweek* (March 18, 2002); "State Education Gurus Questioning 529 Plan Disclosure," *Fund Action* (March 18, 2002); and "College Savings Plans: The Race Is On," John Kimelman, *New York Times* (January 13, 2002).

<sup>3</sup> While the state tax treatment of an investment in a Section 529 plan is an important factor, we wish to emphasize that it is only one of a variety of other important factors that also should be considered by investors. These other factors include investment minimums, maximum contribution limits, fees and expenses, investment options, etc. In many circumstances it may be advantageous for an investor, based upon a consideration of the totality of these factors, to invest in an out-of-state plan and forego any state tax advantages offered in connection with the plan in the investor's home state.

<sup>4</sup> The Institute believes it is appropriate for the MSRB to impose this additional disclosure requirement in connection with the delivery of Section 529 plan official statements even in the absence of a similar requirement in the case of traditional municipal securities. First, the targeted market for Section 529 plan securities is generally middle-income investors saving for their children's college education, as opposed to the market for traditional municipal securities, which is more likely to be made up of wealthier, more sophisticated investors. Second, unlike traditional municipal securities, 529 plans are a relatively new product and there may be less knowledge among investors about the tax consequences of investing in them.

<sup>5</sup> Two examples of this type of disclosure currently in use by our members are as follows:

For residents of states other than [the state sponsoring the plan]: If your state sponsors a 529 program, that program may offer state income tax benefits not available to you through [X] program. Please consult your tax adviser.

Some states offer favorable tax treatment to their residents only if they invest in the state's own plan. You should consult with your tax adviser about any state or local taxes.

<sup>6</sup> See "Notice Regarding the Disclosure Obligations of Brokers, Dealers and Municipal Securities Dealers in Connection with New Issue Municipal Securities Under Rule G-32," MSRB (November 19, 1998).