College Funding Options

You can plan to meet the costs through a variety of methods.

How can you cover your child's future college costs? Saving early (and often) may be the key for most families. Here are some college savings vehicles to consider.

529 plans. Offered by states and some educational institutions, these plans let you save up to $14,000 per year for your child's college costs without having to file an IRS gift tax return. A married couple can contribute up to $28,000 per year. (An individual or couple's annual contribution to the plan cannot exceed the IRS yearly gift tax exclusion.) These plans commonly offer you options to try and grow your college savings through equity investments. You can even participate in 529 plans offered by other states, which may be advantageous if your student wants to go to college in another part of the country.[1,2]

While contributions to a 529 plan are not tax-deductible, 529 plan earnings are exempt from federal tax and generally exempt from state tax when withdrawn, as long as they are used to pay for qualified education expenses of the plan beneficiary. If your child doesn't want to go to college, you can change the beneficiary to another child in your family. You can even roll over distributions from a 529 plan into another 529 plan established for the same beneficiary (or for another family member) without tax consequences.[1]

Grandparents can start a 529 plan, or other college savings vehicle, just as parents can; the earlier, the better. In fact, anyone can set up a 529 plan on behalf of anyone. You can even establish one for yourself.[1]

529 plans have been improved for 2016 with two additional features. One, you can now use 529 plan dollars to pay for computer hardware, software, and computer-related technology, as long as such purchases are qualified higher education expenses. Two, you can now reinvest any 529 plan distribution refunded to you by an eligible educational institution, as long as it goes back into the same 529 plan account. You have a 60-day period to do this from when you receive the refund.[3]

If you have a 529 plan and received such a refund at any time during January 1-December 18, 2015, you have until Tuesday, February 16, 2016 to put that money back into your 529 plan. If you meet that deadline, the distribution will not be seen as a non-qualified one by the IRS (i.e., fully taxable plus a 10% penalty).[3]

Investors should consider the investment objective, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. A copy of the official statement can be obtained from a financial professional. Before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Coverdell ESAs. Single filers with adjusted gross income (AGI) of $95,000 or less and joint filers with AGI of $190,000 or less can pour up to $2,000 annually into these tax-advantaged accounts. While the annual contribution ceiling is much lower than that of a 529 plan, Coverdell ESAs have perks that 529 plans lack. Money saved and invested in a Coverdell ESA can be used for college or K-12 education expenses. Coverdell ESAs offer a broader variety of investment options compared to many 529 plans, and plan fees are also commonly lower.[4]

Contributions to Coverdell ESAs aren't tax-deductible, but the account enjoys tax-deferred growth and withdrawals are tax-free so long as they are used for qualified education expenses**.** Contributions may be made until the account beneficiary turns 18. The money must be withdrawn when the beneficiary turns 30 (there is a 30-day grace period), or taxes and penalties will be incurred. Money from a Coverdell ESA may even be rolled over tax-free into a 529 plan (but 529 plan money may not be rolled over into a Coverdell ESA).[2,4]

UGMA & UTMA accounts. These all-purpose savings and investment accounts are often used to save for college. When you put money in the account, you are making an irrevocable gift to your child. You manage the account assets. When your child reaches the "age of majority" (usually 18 or 21, as defined by state UGMA or UTMA law), he or she can use the money to pay for college. However, once that age is reached, that child can also use the money to pay for anything else.[5]

Imagine your child graduating from college debt-free. With the right kind of college planning, that may happen. Talk to a financial advisor today about these savings methods and others.

Citations.

1 - irs.gov/uac/529-Plans:-Questions-and-Answers [8/24/15]
2 - time.com/money/3149426/college-savings-esa-529-differences-financial-aid/ [8/21/14]
3 - figuide.com/new-benefits-for-529-plans.html [1/13/16]
4 - time.com/money/4102891/coverdell-529-education-college-savings-account/ [11/9/15]
5 - franklintempleton.com/investor/products/goals/education/ugma-utma-accounts?role=investor [2/3/16]
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