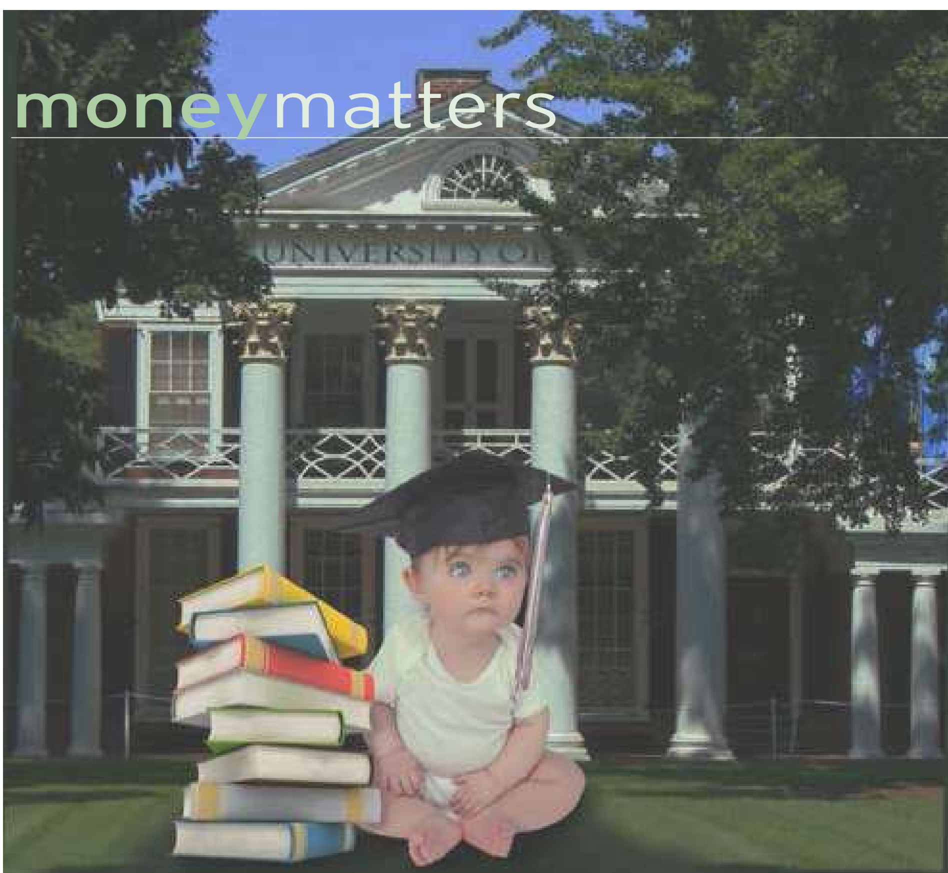

College Planning 101

Preparing for the Marathon of Your Child's Education

by Barry Wind and Jeremy A. Pearce

Many parents who have welcomed their first child recently or who have toddlers or children in elementary school turn to financial advisors for help in planning for their child's education. Typically, parents are faced with questions such as: "Will my child go to college?" "Should I pay for some, or all, of their college bills?" "How do I save for my child's education?"

Thankfully, there are several options to help parents who want to make saving for their child's college expenses a priority for the family. Many states sponsor their own versions of college savings plans and some plans allow for larger contribution limits than others. Many of the different types of college savings plans allow for tax-deferred growth, with the opportunity to make withdrawals free from tax when used for higher education purposes. Among the more popular options in education planning are 529 college savings plans, Coverdell Education Savings Accounts (ESA) and UGMA/UTMA Accounts.

The Coverdell ESA is an investment account that is owned by the parents for the benefit of the child's education. Parents can contribute up to $2,000 per year, and funds can grow tax-deferred until they are withdrawn for qualified educational expenses, which includes kindergarten through the 12th grade. The funds can be invested in most publicly-traded securities, including stocks, bonds, mutual funds and exchange-traded funds (ETFs).

Coverdell advantages include: funds grow tax-deferred; withdrawals for qualified expenses are tax-free; few limitations on investment options. Disadvantages are: low contribution limits compared to other savings alternatives; and contributions are not tax-deductible.

UGMAs and UTMAs are custodial accounts, owned by the parent on behalf of the child. When the child reaches adult age, the account and its holdings are transferred to the child and can be used by the adult child for any purpose they see fit, hopefully for their college expenses.

These accounts may have some tax benefits for the custodian, and the investment options have few limits. On the negative side, parents lose control of the assets just as the need for college funding arises. In addition, financial aid may be lowered when the child takes ownership of the account.

There are other ways to save for your child's college. Withdrawals from Roth IRAs can be utilized for educational purposes although only if your retirement is fully secured through other means and you have worked with a tax professional to ensure that you can do so without penalty or a tax bite. Simply funding college expenses out of existing savings and investments is also an option, though you will likely be missing out on tax deductions and deferrals.

However you decide, it is important to start planning sooner rather than later. The time value of money takes on greater meaning when you start to realize just how fast kids grow up.

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