Ways to Save for College

In accumulating funds for college, one of the first questions a family will face is, "Where do we invest the money?" Many financial professionals will recommend that money for college be placed in relatively low-risk investments. If there is a long enough time frame, the savings may be placed initially in higher risk (and potentially higher return) investments. As the time for college gets closer, the funds can be shifted into more conservative choices.

The ultimate decision will depend on a range of factors such as the number of years until college begins, the amount of money available to invest, a family's income tax bracket, risk tolerance, and investment experience. A few of the more traditional approaches are:

- **Savings accounts:** Including CDs, money market accounts, and regular savings.
- **Tax-free municipal bonds:** Held either directly or through a mutual fund.
- **U.S. Treasury securities:** Such as treasury bills or treasury bonds.
- **Growth stocks/growth mutual funds:** For the long-term investor.

Tax-Advantaged Strategies

Under federal income tax law (state or local income tax law may differ), there are a number of tax-advantaged strategies available to accumulate funds for college expenses. The rules surrounding these strategies can be complicated and they should only be used after careful review with a tax or other financial professional:

- **IRC Sec. 529 qualified tuition program:** These plans allow an individual to either prepay a student's tuition, or contribute to a savings account to pay the student's "qualified higher education expenses." Contributions are not tax deductible, but growth in an account is tax-deferred. If certain requirements are met, distributions to pay qualified higher expenses are excluded from income. 529 plans involve investment risk, including possible loss of funds, and there is no guarantee a college-funding goal will be met. The fees, expenses, and features of 529 plans vary from state to state.

- **Coverdell education savings account:** Up to $2,000 per year may be contributed to a Coverdell ESA for an individual. Contributions are not tax-deductible, but growth is tax-deferred. Distributions are excluded from income if used for qualifying educational expenses. Other restrictions may apply.
- **Cash value life insurance:** Cash value life insurance can be an attractive, tax-favored means of accumulating college funds. If an insured dies before the student starts school, the policy proceeds can be used to pay college expenses.
- **U.S. savings bonds:** Interest on series EE savings bonds issued after 1989, or Series I savings bonds, may (certain limits apply) be excluded from income if qualifying education expenses are paid in the year the bonds are redeemed. The exclusion also applies to savings bond interest contributed to an IRC Sec. 529 qualified tuition program or a Coverdell ESA.

Who Owns the Funds?

A second issue facing families planning for college is the question of "Who will own the funds?" The answer to this question involves issues of control, income and gift taxes, and can impact a future application for financial aid:

- **Parents:** Either in accounts specifically earmarked for college or as a part of a general family portfolio.
- **Child:** Often a custodial account is used, under either the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA).
- **Trust:** In certain situations, usually involving wealthy families, specialized types of trusts may be used, such as a Crummey trust or charitable remainder trust.

Impact On Financial Aid

For need-based financial aid purposes, assets considered to be owned by the **parents** have a relatively small negative impact. Assets considered to be owned by the **child** have a much greater negative impact. Trust assets are often considered to be owned by the child, but this can vary widely. Frequently, trust provisions restrict access to principal, thus forcing inclusion of the trust assets in the eligibility process each year that a student is in school. Non-trust assets can be "spent down" in a year or two, limiting their financial aid impact.

Other Resources

There are a number of excellent references and guides to investments and college planning available in bookstores and public libraries. State and federal agencies involved in higher education also are excellent sources of information. In addition, there are a number of sites on the Internet which can provide information, including the following:

- **The College Board** – https://www.collegeboard.org
- **FinAid! The SmartStudent® Guide To Financial Aid** – http://www.finaid.org
- **College Savings Plan Network** – links to state-run web pages on prepaid tuition or college savings plans, at: http://www.collegesavings.org
- **U.S. Department of Education – student aid website** – https://studentaid.ed.gov/sa/

Begin Early and Seek Professional Guidance

Developing a plan to save for a child's college education can be complicated. Questions can arise involving income tax, estate and gift taxes, investment issues, and the impact of asset ownership on financial aid eligibility. Individuals are strongly advised to begin a savings program as early as possible, and seek professional guidance.