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# How to Save for College

## Financial Columnist Kevin Bourke Gives Lay of Land

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Dear Kevin,

We have four children, ages 2, 5, 6, and 17. We've been able to save enough to send the eldest to a private college next fall, but with three little ones to plan for, and with tuition going through the roof, we have no idea how to save enough for all of them. How can we prepare financially?

Paige in Goleta

Dear Paige,

Four kids? Yes, that could be very expensive indeed. According to [www.finaid.com](http://www.finaid.com), a student financial aid information website, college inflation averages somewhere around 8% annually, or more than twice the rate of general inflation. Saving for college is therefore crucial, and you're doing the right thing thinking about solutions now, rather than later.

With your younger three kids, time is on your side. For example, **if you started to invest \$100 a month per child**, and earned 8% on that investment, when your six-year-old is ready for college, you'll already have saved over \$23,000. Your five-year-old will have over \$27,000, and your two-year-old will have over \$38,000.

There are many ways to finance a college education. One of the oldest, and least attractive, is through the UTMA, the Uniform Transfer to Minors Act.

**A UTMA account is simply a bank or brokerage account in your child's name** with one parent as custodian, but at least three drawbacks exist. First, if you as parents gift a large amount into the account, there may be a gift tax due. Second, UTMA accounts are already subject to high taxes. Third, when your child turns 18, they can do anything they want with that money. There are no strings attached and no conditions on college attendance.

A better alternative may be to open a Coverdell Education IRA. **The principal appeal of the Coverdell Education IRA is its tax-favored status.** There is no tax deduction for money deposited, but it does grow tax-free if used for qualifying education expenses. The Coverdell Education IRA has the added distinction of allowing the funds to be used for K-12 grade. In fact, funds can be withdrawn tax-free if used for qualified K-12 or higher education expenses. The account value is also removed from the contributor's estate.

Some disadvantages do exist for high-income earners. They may not qualify to make contributions,

and the maximum annual contribution from all sources can't exceed \$2,000. Also, control over the account doesn't go to the beneficiary until age 30.

Consider the Section 529 College Savings Plan. Named after the portion of the IRS tax code which created them, Section 529 plans are like the Coverdell Education IRA, because they allows contributions to grow tax-free if used for qualifying education expenses. Some states even allow an income tax deduction for contributions. Unfortunately, California isn't one of them.

But unlike the IRA, **a Section 529 plan lets you place up to \$60,000 in the account in one year** with no gift tax consequence, and anyone can contribute to a 529 plan regardless of income. Some 529 plans can be opened with as little as \$25.

The account owner maintains full and complete control over the account regardless of the beneficiary's age, the account value is removed from the contributor's estate, and qualified withdrawals may also be used at any eligible educational institution in the country.

The big difference is funds cannot be used for K-12 expenses.

I would recommend this plan for higher-wage earners who want to contribute high-dollar amounts, and who want to remove assets from their estate for estate planning purposes.

**Then there's the Section 529 Prepaid Plan. This option allows the parent to pay for tomorrow's college tuition in advance, at today's price.** The plus with this option is that funds invested now won't fall behind tomorrow's cost of college tuition. It's a plan that allows for tax-free distributions for higher education, but it's really for those who know which school they want their child to attend and want to lock in expenses now, and for those who are uncomfortable investing in the stock and bond markets.

California is one of the 33 states that do not offer the pre-paid option, although individual educational institutions might.

Lastly, I'd advise you to look into **US Savings Bonds, Series EE or I.** The U.S. Government issues bonds that, under certain specific circumstances, pay tax-free interest if used for higher education. The big plus is that they are guaranteed by the government.

But the bond value is still included in the contributor's estate, and the maximum annual contribution is \$30,000 face value. Higher-income earners may not qualify to make contributions, and returns are fixed and might be lower than other investment options.

This is by far the most conservative option available, and people who choose to go this route are generally willing to forgo potential greater returns in exchange for the governmental guarantee.

I've only listed five ways to save for college. Let them serve as starting points for you and your family. For more college financing strategies, take a look at:

[www.finaid.org](http://www.finaid.org)

[www.savingforcollege.com](http://www.savingforcollege.com)

[www.sec.gov/investor/pubs/](http://www.sec.gov/investor/pubs/)

The big incentive to start saving now is to assure your child the luxury of NOT having to deal with repaying college loans, and being in financial debt, the moment they earn their diploma.

Establishing a plan now to save for educational expenses can help make that a reality. What a truly valuable gift you will have delivered.

Kevin Bourke is a registered principal with and offers securities through LPL Financial Member FINRA/SIPC.