

When Saving for College, You've Got Some Good Choices

By Douglas Applegate, Investment Representative

If you're going to invest for your children's college education – and you should – then you need to make some decisions. Specifically, which types of investments should you use?

Fortunately, you've got a lot of options. Let's look at a few of them:

UGMA/UTMA

You can set up a custodial account, as established by either the Uniform Gift to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA). This type of account may offer you some tax advantages. In an UGMA or UTMA account, the first \$750 of investment income is tax-free to a child under 14; the next \$750 is taxed at the child's rate, and any amount over \$1,500 will be taxed at your rate. After the child reaches 14, all their investment income is taxed at their rate.

You'll have to weigh the potential tax benefits of an UGMA/UTMA account against another factor: loss of control.

While your children are minors, you can still control the account, but once they reach the age of majority, then the money is theirs to do with as they please.

Section 529 Plans

One of the best college savings vehicles of these is the Section 529 plan, named after that part of the Internal Revenue Code authorizing these accounts.

You can choose from two types of Section 529 plans: a pre-paid tuition program or a savings plan. In a pre-paid tuition plan, you buy future tuition credit – at today's prices – at an in-state, public school. If your child or grandchild decides not to attend your state college, you can transfer the value of your contract to private and out-of-state schools.

In a savings plan, you put money in specific investments. All withdrawals will be free from federal income taxes; as long as the money is used for a qualified college or graduate school expense of the beneficiary you've named – typically, your child or grandchild. (However, the money will appear as income on the child's tax return.) Withdrawals for expenses other than qualified education expenditures may be subject to federal, state and penalty taxes. This tax benefit is effective through 2010, unless extended by the U.S. Congress.

Section 529 Plan Benefits

Of the two types of 529 plans, the savings plan is far more popular. In many ways, it offers more freedom than the pre-paid tuition plan, and, of course, it has tax advantages. But the 529 savings plan also offers other key benefits, including the following:

- High contribution limits — Section 529 plan contribution limits are typically quite high – more than \$200,000 per beneficiary in many state plans. Special gifting provisions apply. As with many investments, before investing in a 529, you should consult your tax professional.
- No residency requirements — You can generally contribute to the Section 529 plan of any state you choose, even if you don't live there. However, if you participate in your own state's plan, you may receive additional tax benefits.
- Investment flexibility — If you want to move your investment around, you can generally change to a different option in a 529 savings plan once a year. You also can transfer your account to a different state's program as often as once every 12 months.
- Estate-planning advantages — If you're a grandparent, you may be especially interested in the 529 savings plan. Because you can contribute large amounts of money to the plan, you'll be able to reduce the size of your taxable estate. Plus, even though the assets are out of your estate, you retain control of them. You decide who will get the money and when he or she will get it. You can even change the beneficiary to another family member.

Coverdell Savings Plan

The Coverdell Savings Plan (formerly known as the Education IRA) offers you another college-savings option. A Coverdell plan gives you many investment options; stocks, bonds, certificates of deposit, etc. And, effective since 2002, if you meet certain income limits, you can contribute \$2,000 a year to a Coverdell Savings Plan, up from just \$500 in previous years.

Your contributions to a Coverdell Savings Plan are not tax-deductible, but all earnings and withdrawals are tax-free, provided you use the money for qualified education expenses. However, any non-education withdrawals from a Coverdell plan, as with a Section 529, may be subject to a 10 percent penalty.

No matter how you save and invest, whether in a custodial account, a Section 529 plan, or a Coverdell Savings Plan, make sure you do save and invest. College is already expensive, and costs continue to rise rapidly. And, even if your children don't go to college, they'll probably need some help along the way – a down payment for a house or money to start a business, etc. By investing regularly, you can help your kids get off to a good start in the adult world, and that's a goal worth supporting.

Douglas M. Applegate is an Investment Representative with Edward Jones Investments. Located at Dry Creek & University in Littleton, CO.; he can be reached at 303-796-8834.