College Funding Options

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

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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 college savings plans.

Offered by states and some educational institutions, these plans let you save up to $17,000 per year for your child's college costs without having to file an I.R.S. gift tax return. A married couple can contribute up to $34,000 per year. (An individual or couple's annual contribution to a 529 plan cannot exceed the yearly gift tax exclusion set by the Internal Revenue Service.) As a single filer, you can even frontload a 529 plan with up to $85,000 in initial contributions per plan beneficiary or $170,000 if you're married– up to five years of gifts in one year – without triggering gift taxes.[1]

529 plans commonly feature equity investment options that you may use to potentially grow your college savings. Each 529 savings plan offers its own range of investment options, which might include age-based strategies; conservative, moderate, and aggressive portfolios; or even a mix of funds from which you can build your own portfolio. Typically, plans allow you to change your investment options twice each calendar year or if you change beneficiaries.[2]

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. Over 30 states currently offer a state income tax deduction or tax credit for 529 plan contributions. In most cases, the taxpayer must contribute to their home state's 529 plan to qualify for a state income tax benefit.

However, nine tax parity states offer a state income tax benefit for contributions to any 529 plan:

- Arizona/Arkansas/Kansas/Maine/Minnesota/Missouri/Montana/Ohio/Pennsylvania [3]

Earnings of 529 plans are exempt from federal tax and generally exempt from state tax when withdrawn, so long as they are used to pay for qualified education expenses of the plan beneficiary.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 another family member) without tax consequences.

With the passage of the SECURE 2.0 Act of 2022, a new rule allows distributions from a 529 plan to a Roth IRA. The new 529-to-Roth transfer rule is meant to increase comfort with 529 plans by alleviating concerns about unintended taxation, allowing families to maximize the time value of money by investing for tax-free growth on college savings as early as possible.[4] But the rule has limitations. Please visit with your tax professional before making any changes to your accounts.

Grandparents can start a 529 plan (or other college savings vehicle) just like parents can. In fact, there may be a benefit to this due to recent changes in how student aid is calculated. Now 529 accounts owned by grandparents are not reported as a student asset on the Free Application for Federal Student Aid (FAFSA). However, any distribution from this 529 plan is reported as income to the beneficiary. The FAFSA typically looks at income two years back so the distribution from a grandparent 529 could result in a reduction in eligibility in the year after next. [5] These plans now have greater flexibility thanks to the SECURE 2.0 Act.

Coverdell ESAs.

The total contributions to all Coverdell education savings account for a beneficiary from all sources are limited to $2,000 per year. This requires the contributors to coordinate their contributions to avoid exceeding the $2,000 annual contribution limit.

The $2,000 contribution limit for each contributor is phased out based on the contributor's income. It is reduced for contributors with modified adjusted gross income (AGI) of $190,000 to $220,000 for married filing jointly and half that for single filers. Taxpayers who file as married filing separately are ineligible to make contributions to a Coverdell education

savings account. The income phaseouts do not change and are not adjusted for inflation.[6]

Contributions to Coverdell ESAs aren't tax deductible, but the accounts enjoy 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, or taxes and penalties will occur. Money from a Coverdell ESA may even be rolled over into a 529 plan.[7]

UGMA & UTMA accounts.

These all-purpose savings and investment accounts are often used to save for college. They take the form of a trust. When you put money in the trust, you are making an irrevocable gift to your child. You manage the assets until your child reaches the age when the trust terminates (i.e., adulthood). At that point, your child can use the UGMA or UTMA funds to pay for college; however, once that age is reached, your child can also use the money to pay for anything else.[8]

Imagine your child graduating from college, debt free.

With the right kind of college planning, that may happen. Talk to a financial professional today about these savings methods and others.

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