# College Savings Accounts

## Funding for college with added tax benefits.

There are many types of accounts you can establish to save money to fund education. Many offer tax advantages or other benefits.

### 529 College Savings Plans

The 529 is an education savings plan operated by a state or educational institution. The plans typically allow high lifetime contribution limits that vary by each state's plan. With a 529 plan, the full value of your account can be used at any accredited college or university in the country, as well as some schools outside the U.S., so check to see if your institution is eligible under 529 rules. Additional benefits include:

- No federal income tax is paid on earnings used to pay college expenses.
- As long as your money stays in the plan, your investment grows tax-free.
- Your contributions to a 529 or an Education Savings Account (Coverdell ESA) are considered gifts from you to the beneficiary of those accounts.
- For more information about specific state 529 College Savings plans, check out savingforcollege.com which offers a 529 Evaluator that permits you to compare specific features of multiple state plans.
- Another good 529 Plan resource is available at collegesavings.org, which is an affiliate of the National Association of State Treasurers.
- It can be used for tuition expenses of up to $10,000 at public, religious and private K-12 schools.

### Education Savings Accounts (ESA)

The Education Savings Account (ESA), also known as a Coverdell Education Savings Account, has become a very attractive college savings vehicle for many people, including families that wish to save for elementary and secondary school expenses.

The Coverdell ESA allows you to make an annual non-deductible contribution to a specially designated investment trust account. Your account will grow free of federal income taxes, and withdrawals from the account will be completely tax-free as well. You will need to meet certain requirements in the years you wish to contribute, and in the years in which you take withdrawals. There are some items to be aware of, however, such as the following:

- Current tax law prohibits funding an Education Savings Account once the beneficiary reaches age 18.
- Your contribution goes into an account that will eventually be distributed to your child if not used for college. You cannot simply refund the account back to yourself like you can with most 529 plans. This means you lose some degree of control.
- The ESA is on equal footing with the 529 plan when applying for federal financial aid. The account is considered an asset of the account custodian, typically the parent. Withdrawals are not reported as student or parent income as long as they are tax-free for federal income taxes.
- Coordinating withdrawals with other tax benefits, especially the Lifetime Learning credit, can be tricky. Be sure and check with your tax advisor.
- The account must be fully withdrawn by the time the beneficiary reaches age 30, or else it will be subject to tax and penalties.

## UTMAs/UGMAs (Uniform Transfer to Minors Act/Uniform Gift to Minors Act)

In most states, minors do not have the right to enter into a contract, and so cannot directly own investments purchased as part of their college savings account. In particular, parents cannot simply transfer assets to their minor children, but instead must transfer the assets to a trust. The most common trust for a minor is known as a custodial account (an UGMA or UTMA account).

These accounts provide a way for gifts to be made to a minor without requiring the presence of an appointed guardian for the minor, and which satisfies the Internal Revenue Service requirements for qualifying a gift for exclusion from estate tax. However, keep in mind that these accounts are not considered "college savings" accounts.

The earnings are neither tax-deferred nor tax-free, nor do the funds have to be used to pay for education expenses. The money can be used to pay for most things, except what are considered regular living expenses. This Act allows the donor of the gift to transfer the title to a custodian who will manage and invest the property until the minor reaches a certain age. The age is generally twenty-one but is different in some states (usually eighteen in those cases). In addition, since UGMA and UTMA accounts are in the name of a single child, the funds are not transferable to another beneficiary. For financial aid purposes, custodial accounts are considered assets of the student. This means there is a higher impact on financial aid eligibility. Parents who have saved money in their child's name using a traditional UGMA or UTMA account can consider liquidating the account and rolling the money over into the custodial version of a 529 college savings plan.

Keep in mind that the money in the custodial account technically belongs to the child, so he or she receives it upon reaching legal age. That's true even if the money in a custodial account is transferred to a 529 plan. Since the 529 only accepts cash, you must liquidate the assets. You should check with your tax advisor for details before transferring assets, since a sale of assets within the UTMA/UGMA is a taxable event.

## U.S. Savings Bonds

U.S. Savings Bonds offer a low-risk and modest return investment for saving for your children's college education. Generally, you must pay tax on the interest earned on U.S. savings bonds. However, you may be able to cash in qualified U.S. savings bonds to pay for certain education expenses, without having to include in your income some or all of the interest earned, if you meet certain conditions. Check with your personal tax advisor for more details.