College is Expensive. Make Sure You Have a Plan in Place.

Are you aware of the different options available to you when saving for your children's (or grandchildren's) college costs? Here is a glimpse at each option.

The hallmarks of an ideal college savings plan would include limitless contributions, important tax benefits, minimal impact on financial aid, and flexibility in choosing a college. No one savings plan is perfect, but some come closer than others.

A 529 plan provides many potential benefits. Couples can contribute up to $30,000 a year without triggering the gift tax. You can contribute more if you use some of your lifetime gift tax exemption. Your money has tax deferred growth potential, and withdrawals for qualified higher education expenses are both tax-free and not reported on the Free Application for Federal Student Aid (FAFSA®). Other withdrawals are subject to taxes and penalties, and investment strategies may be limited. You can choose a 529 plan that you can use to pay for colleges in all 50 states. There are no income limits for 529 contributions*.

A Roth IRA is a flexible alternative. Contributions grow tax-free, and you can withdraw them tax-free at any time. Earnings grow tax deferred, and withdrawals are tax-free if you follow the rules. You avoid penalties on early earnings withdrawals when used for qualified education expenses. You can set up a Roth IRA (Individual Retirement Account) for maximum investment variety, and the account's value isn't included on the FAFSA (although withdrawals count as base-year income). However, annual contributions are limited to $6,000 ($7,000 if the account owner is 50 or older), and contributions by high-income earners are limited.

Consider UGMA and UTMA accounts. There are no income limits for contributions to Uniform Gifts to Minors Act and Uniform Transfers to Minors Act accounts. These accounts let you put aside up to $15,000 ($30,000 for couples) in a child's name, free of the gift tax. However, you can put aside more by using some of your lifetime gift tax exemption. A child's interest, dividend, and capital gain (IDCG) income exceeding $2,100 may be subject to tax. If a dependent child's only income is IDCG and it's less than $10,500, you can choose to report the income on your tax return.

Qualified U.S. Savings Bonds are safe. You can invest up to $10,000 a year, per owner per bond type in these government-backed bonds. You can redeem them free of federal taxes when used for qualified higher-education expenses. The bonds earn a modest amount of interest, but the interest exclusion phases out for higher-income bond owners. The FAFSA counts savings bonds as assets of the bond owner.

There are even more options. For example, you can set up trust accounts and/or invest in mutual funds/exchange-traded funds. These have their pros and cons as well.

* Prior to investing in a 529 Plan investors should consider whether the investor's or designated beneficiary's home state offers any state tax or other state benefits such as financial aid, scholarship funds, and protection from creditors that are only available for investments in such state's qualified tuition program. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary.

The Roth IRA offers tax deferral on any earnings in the account. Withdrawals from the account may be tax free, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59 ½ or prior to the account being opened for 5 years, whichever is later, may result in a 10% IRS penalty tax. Future tax laws can change at any time and may impact the benefits of Roth IRAs. Their tax treatment may change.

Government bonds are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

This information is not intended to be a substitute for specific individualized tax or legal advice. We suggest that you discuss your specific situation with a qualified tax or legal advisor.

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