FINANCIAL PLANNING RESOURCES:

Savings Vehicles for Higher Education: Pros & Cons

Find the Right Savings Vehicle for Your Family

With the cost of tuition rising at such a rapid pace, many parents want to get a head start on saving for their children's higher education. The best college savings vehicle for your family's situation will depend on your goals. Let's review the pros and cons of some typical college savings plans.

529 PLANS

Pros:

- The funds are invested and grow tax-deferred.
- Each year you can contribute up to the annual gift tax exclusion amount, which is $15,000 in 2021. You can also make a one time contribution of between $15,000 and $75,000 to be pro-rated over five years. The pro-rated annual contribution amount would go toward your gift tax exclusion. For example, if you deposit $50,000 it will be applied as $10,000 each year, leaving you with $5,000 in unused annual exclusion.
- You may receive a state income tax deduction for your contributions. In Kansas, those who file Married Filing Jointly can deduct up to $6,000 per child or up to $3,000 for individual filers.
- Withdrawals are income tax free for qualified expenses (tuition, mandatory fees, computers, required books, supplies, equipment, and qualified room & board expenses).
- There are no age restrictions, meaning you may contribute to a child's 529 even after they have turned 18.
- There are no income restrictions therefore you can contribute to these accounts no matter how much you make.
- Funds can be used for education expenses prior to college.
- The beneficiary of the account can be changed.

Cons:

- 529s are included as an asset in the financial aid calculation on the Free Application for Federal Student Assistance (FAFSA), therefore you are less likely to receive more favorable types of financial aid from the government.
- If the funds are not used for qualified education expenses you will be subject to a federal and state income taxes on the earnings portion of the withdrawal and a 10% federal tax penalty.

COVERDELL EDUCATION SAVINGS ACCOUNT (ESA)

Pros:

- You receive tax-deferred growth with tax-free withdrawals on your funds as long as they are used for qualified education expenses (similar to 529 plans).

Cons:

- Your contributions are limited to $2,000 per year per child.
- There are age restrictions: you will no longer be allowed to contribute to the account once the beneficiary turns 18. The beneficiary also has to use all of the funds by age 30, unless

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he or she chooses to transfer to another type of account (529, ESA for a relative, normal brokerage account, etc.)

- There are income restrictions: the income phaseout begins at $190,000 Modified Adjusted Gross Income for those filing Married Filing Jointly.
- ESAs are included as an asset in the financial aid calculation on the FAFSA, therefore you are less likely to receive more favorable types of financial aid from the government.

ROTH IRA

Pros:

- Withdrawals used for qualified education expenses are not subject to the 10% early withdrawal penalty.
- Roth IRA funds are not counted as an asset in the financial aid calculation on the FAFSA.
- If the account is in the child's name and he or she decides not to go to college or does not use it all, he or she can save these funds for retirement.

Cons:

- Your contributions are limited to $6,000 per year, or $7,000 once you turn 50.
- There are income restrictions: $198,000-$208,000 is the phaseout in 2021.
- Withdrawals are included as income on the FAFSA so this could affect financial aid given in the later years of college.
- The account holder must have earned income at least equal to the contribution made for the year in order to contribute to a Roth IRA. This can make it difficult for a Roth IRA to be opened in the name of a child if they do not have a job where they earn income.

UNIFORM TRANSFERS TO MINORS ACT (UTMA)

Pros:

- You can contribute up to the annual gift tax exclusion amount, which is $15,000 in 2021.
- There are no restrictions on withdrawals: this could be used for a new car, a down payment on a house, etc.

Cons:

- The earnings and gains are taxed to the minor: the first $1100 of unearned income is tax exempt; the next $1100 of unearned income is taxed at the child's tax rate. Anything above $2,200 is taxed at the parents' marginal tax rate for children age 18 and under, or age 19-24 if they are a dependent, full-time student.

You should always consider the investment objectives, risks, charges, and expenses associated with investing before deciding to utilize these accounts. Your financial planner can help you determine which option is the best choice for your family!

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