College Savings

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This course explores each of the investment savings accounts you can set up for your child as you prepare for their future.

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Introduction

- For many households, college is the most common option that people save for when it comes to their children. There are **529 accounts** designed with tax advantages specifically for education expenses that we will discuss.
- However, there are also other accounts like **UTMA** and **UGMA accounts** that have some of the same benefits as the 529 accounts but are not as limited to how the funds can be used. We will make sure that you understand all the similarities and differences for each option so you can make the most informed decision on what is best for your child.

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529 Accounts

- As previously mentioned, 529 accounts were created for parents to save specifically for college education. They are investment funds managed by the state that you, your spouse and other family members are able to contribute to on behalf of your child.
- As long as the funds in the account are used for qualified expenses, the money can be used **tax-free**. The account also grows **tax-free**.
- 529 accounts may also be referred to as 529 savings plans.

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529 Accounts

- A 529 plan offers target date funds which are age-based investment options. Generally, the funds with later target dates are going to invest more aggressively because they are taking more risks for a higher reward. A fund with a closer target date will invest more conservatively because it is focused on protecting capital more.
- You can choose your state plan or another state's plan. However, there may be tax breaks you are eligible for when you contribute to your home state depending on the plan. Consult with a Certified Public Accountant or a tax professional.

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529 Accounts

- Qualified expenses include college tuition, room and board, equipment, books, and sometimes K-12 tuition depending on the state plan. If you use the funds for any other expenses, you will pay taxes as well as a 10% penalty.
- Each plan has a designated beneficiary so if you do not need to use the funds for education expenses for your child, you can change the designated beneficiary to another member of your family that will be using the funds for education expenses. This will allow you to still use the money **tax-free**.

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529 Accounts

- Since the plan is owned by you as the parent, the account will not show as an asset under your child's name if they apply for financial aid through FAFSA. The Expected Family Contribution (EFC) is the number calculated that is intended to be the likely amount a family is expected to pay in college costs. This number increases by 5% with a 529 plan in place which is much less than an UGMA/UTMA account.
- There is also no annual contribution limit to 529 plans but there may be a lifetime contribution limit per beneficiary.

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UGMA/UTMA Accounts

- UGMA stands for the **Uniform Gift to Minors Act** and UTMA stands for the **Uniform Transfer to Minors Act**. They are **both custodial investment accounts** that are largely similar with a couple key differences.
- UGMA accounts are limited to purely financial products such as cash, stocks, bonds, mutual funds and insurance policies. UTMA accounts include all of the financial products as well as any type of property.
- The second difference between the two accounts is state specific. UTMA accounts are available everywhere in the U.S. except for South Carolina and Vermont.

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UGMA/UTMA Accounts

- A custodial account means that you, as the parent, act as the owner until your child reaches the age of majority or what your state considers adult age. Once your child reaches the age of majority, the account is transferred in your child's name for them to use without any restrictions. The age of majority can range from 18 to 25 depending on your state.
- You can set up an UGMA/UTMA account through your existing brokerage or bank. Since this account is still considered a brokerage account, the account is still taxable at both the child *and* the parent's tax rate. You can visit www.irs.gov to see the current applicable tax rate for gains in UGMA/UTMA accounts.

UGMA/UTMA Accounts

- UGMA/UTMA accounts can be used for any type of expenses and don't have to be used for education purposes. However, the account is still considered the child's property even though they do not have access to it until adulthood. This means that you will have to list the UGMA/UTMA account as your child's property if you did decide to apply for FAFSA.
- When the UGMA/UTMA account shows under your child on the FAFSA, this makes the Expected Family Contribution (EFC) amount to *increase by 20%* instead of 5% with a 529 plan in the parent's name.

UGMA/UTMA Accounts

- UGMA/UTMA accounts also cannot change beneficiaries like 529 plans. The account is considered your child's asset from the moment it is opened and cannot be transferred to another child.
- This is something to consider if your child does decide to go to college and will apply for financial aid but at that point, this account can still be used for college expenses. Except the expenses will not be tax-free.

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There is no wrong option when it comes to saving for your child's future.

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Summary

- 529 savings plans are the best options for parents who know their child will be going to college (*because it isn't an option for them not to go)*. The tax advantages on the qualified expenses outweigh any other savings account.
- UGMA/UTMA accounts are the best options for parents who regularly invest themselves and want to provide their child with a nice nest egg upon reaching adulthood with no limitations.

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Be sure to check out our other courses!

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