College Savings Plans:
Breaking Down the Complexities

The increasing cost of higher education saddles many young adults with massive amounts of student debt. This student debt makes it harder to balance other important financial obligations such as buying a home, having a wedding, or starting a family. Young adults who graduate with less student debt have more flexibility and financial opportunities later in life. By planning ahead, family and loved ones can help set up their children or grandchildren for success by minimizing or even eliminating the need for student loans. For those working to cover some or all of a child's higher education expenses, it's important to make the most of every dollar saved. That's why it's critical to pick the right college savings plan and take advantage of all opportunities to minimize the cost of college.

A College Savings Plan May Help

A college savings plan may be helpful for two reasons. First, it can help prioritize saving up for the expenses of higher education. Many families have other financial goals they're working towards and having a specific account set aside for college can help make it clear which funds are being allocated for college. Secondly, college savings plans help you make the most of your money. A general savings account may not offer a return on investment, and a brokerage account may not provide the same advantages as a college savings plan. Although any savings account is better than no savings account, an account specific to college expenses can provide more benefits to help you make the most of the money saved.

3 Types of College Savings Plans

There are three main types of college savings plans in the United States. The right plan for you depends on a variety of factors, including your income level, the level of investment flexibility you're looking for, and the level of responsibility you're comfortable giving to the child.

529 Plan

This is one of the most popular college savings plans, and for good reason. Each state offers its own 529 plan, but most of them offer major tax advantages compared to a standard savings or brokerage account. Most states offer tax breaks on contributions, and then the earnings on the account grow tax free. The withdrawals are also tax free, as long as they're for education expenses. Another benefit of a 529 plan is that you have the option to change the beneficiary—this way if one child ends up not using the funds, another child could become the beneficiary.

Education Savings Account (ESA)

Another popular college savings plan is an Education Savings Plan (ESA). With an ESA, you can contribute $2,000 after-tax per child every year, and the earnings grow tax free. ESAs have a variety of investment options, which means more investment flexibility than some other college savings plans.

UTMA or UGMA

A Uniform Transfer to Minors Act (UTMA) or Uniform Gift to Minors Act (UGMA) is another popular college savings option. The biggest differentiator between these accounts and other college savings accounts is that the money from a UTMA/UGMA doesn't have to go towards college expenses. These accounts are in the child's name, and the child gains full control of the account when they turn either 18 or 21. Once the account is turned over to the child, they are not required to spend the money on education expenses. In some instances, this may prove advantageous, but it also leaves a lot of room for abuse by the child. For example, if the child decided to use the money to buy a car instead of paying tuition, he or she would be able to do so.

Beyond Savings Accounts

College savings accounts can be incredibly helpful, but there are also other ways to help minimize the cost of college.

Scholarships

A plethora of college scholarship options exist. Even if a child doesn't qualify for a full-ride academic or athletic scholarship, there are plenty of other options available. Smaller scholarships are often overlooked, which means there's often less competition. Smaller scholarships won't cover the whole cost of college, but a few of them can quickly add up.

AP Classes

Not only do AP classes help students prepare for college coursework, but they can also help lower college expenses. AP classes are taught at the student's high school but function like a college class. Students who pass can receive college credit for taking the class. Starting school with college credits allows them to take fewer classes, and therefore, spend less money and even potentially graduate a semester early.

Discussing College Expenses

Before your child goes to college, it's important to discuss the financial implications of college, especially if your child will be taking out student loans. In our day and age, a college degree is often required in many professional fields and worth the cost. Be sure to discuss questions like:

- When will they need to start making payments?
- How will interest affect the total amount of their student loans?

College also comes with many expenses beyond tuition—textbooks, living expenses, transportation, etc. Talking to your child beforehand about how these expenses will be covered can help minimize stress later on. The more you can save and prepare now, the more you can ease the financial burden on your child.

Additionally, we recommend that you work with a financial advisor to discuss the complexities of the college savings plans available to you. Financial advisors can look at your overall financial plan to make sure you're making the most of every hard-earned dollar saved. Contact us to see how we can help.

Sources:

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