Saving for College (or Trade School)

Ways to save and why it's important
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Let's start by stating the obvious. **College is expensive.** Shoot, just picking a college these days can be a five-figure affair, with in-person visits to multiple campuses seemingly becoming the norm.

Let's continue by pointing out another truth. **Saving for college can be a challenge.** After all, it is young families that are tasked with this endeavor, and we all know that there is no shortage of competing demands for that "next dollar" when you are raising little ones.

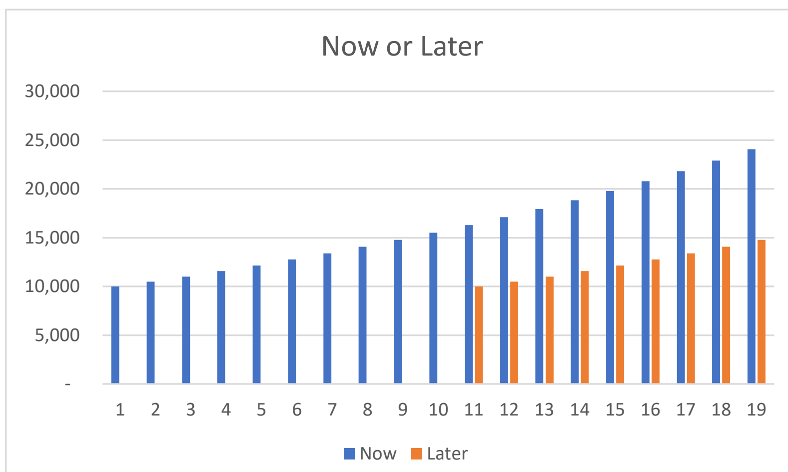
Finally, let's make clear another less obvious (or accepted) reality. **College is not for everyone.** Of course, you don't know whether that's the case for your little one (whether it's your kid or your grandkid) when they are still filling diapers and sucking their thumb. Thankfully, every option we are going to present has built-in flexibility that should make it such that you can save confidently, even when you are not confident of what the future holds for your loved one.

This all said, there are ways to tackle this daunting challenge – and our job is to point out two things:

1. **The benefits of saving**
2. **How to most effectively save**

Let's start with the benefit of saving...

First, you know that a dollar saved (and invested) today is going to serve you much better than a dollar saved 10 years from now. To your right, you'll find a quick illustration:



Assumes 5% annualized return
Actual results will vary significantly.
Past performance is no guarantee of future results

Secondly, the majority of families do not have the cash flow to cover $80,000 per year of college costs as they are incurred. Unless loans are desired, "savings + cash flow" is usually the only feasible route to take.

Thirdly, speaking of loans – we all know the horror stories of student loans weighing down graduates as they try to establish a life on their own. These loans serve as a significant barrier to wealth creation, as they delay the ability to start saving for retirement or putting a down payment on a house. No, student loans are not inherently bad, but an overreliance on them can certainly be detrimental.

With that in mind, let's turn our attention to the "how" part of this equation...

When saving for college, you have a few options. Some are better than others, as some have been designed specifically for this purpose and receive tax advantages that meaningfully increase their value relative to other options. We'll list all the common approaches, with a quick look at the advantages and disadvantages of each. We'll then look most closely at 529 Plans, as they are typically the preferred means by which to save towards this goal.

529 ACCOUNTS

These are tax-preferred savings accounts designed specifically for the purpose of saving for higher-education costs. With them, an individual (e.g. parent or grandparent) owns the account and designates a beneficiary (e.g. child, grandchild...or THEMSELVES).

Upsides:

- Investments grow tax-free and withdrawals are tax-free if used for qualified education expenses.
- Flexible in that you can change the beneficiary at any time without any penalty.
- Very high annual contribution limits.
- Gets assets out of your estate for estate tax considerations.

Downsides

- Penalties and taxes are assessed on a portion of any withdrawals that are not for qualified education expenses.

UTMA ACCOUNTS

These are taxable accounts that are owned for the benefit of a minor, with an adult (usually a parent) acting as the custodian. Funds in these accounts must be spent solely for the benefit of the beneficiary.

Upsides:

- Complete flexibility with what the funds are used for (doesn't have to be higher-ed), so long as they are used for the benefit of the stated beneficiary.
- Can be used before, during, or after college years

Downsides:

- Taxable for life of account under the kiddie-tax rules
- Custodian must grant full control of the account to the beneficiary at the age of majority, even if the custodian thinks it is unwise to do so!

TAXABLE SAVINGS

Money for college doesn't have to be in an account with your kid's name tagged to it! It can come from anywhere, including your own taxable investment account (or even checking/savings):

Upsides:

- Complete flexibility with what funds are used for
- Available any time without penalty

Downsides:

- No tax-preferred status like a 529 account
- Taxable at your own tax rates for capital gains and dividends
- Assets remain in your estate

ROTH IRA

You can contribute to a Roth IRA and then use the value of the contributions to pay for college without incurring penalties or taxes. If you are over 59-1/2 when the college funds are needed, you can also access the earnings.

Upsides:

- Can also be used for retirement if not needed for college.
- iReceives many of the same tax benefits as a 529 plan.

Downsides:

- Much lower contribution limits each year.
- You are tapping into what could be valuable retirement funds to pay for college.

By no means are these the ONLY ways to save for or fund higher education. However, they are typically the most prudent, so we have looked at them here. We are happy help you explore other options where they may be appropriate. However, let's now turn our attention back to 529 accounts, given their importance in this landscape.

A closer look at 529 accounts...

So let's now go back to looking at the 529 account in greater detail. Here is a summary of the **nine key points** about these accounts, as we see things;

1. **Accounts are owned by an individual,** typically a parent or grandparent, on behalf of a single beneficiary.
2. **Contributions are after-tax** and are considered gifts to the beneficiary (but are revocable, unlike any other type of gift).
3. **Contributions are invested** in accordance with your own risk tolerance and goals and grow tax-free.
4. **Withdrawals are tax-free** so long as they are used for *qualifying* educational expenses. Most of what you can think of as "qualifying" likely meets the criteria (tuition, room & board, books, student fees, computers, etc.).

5. **You can change the beneficiary at any time,** and there is no cost or tax implication if transferred to an eligible family member.

6. **Non-qualified withdrawals are subject to taxes and a 10% penalty** (both applied only to the earnings, not the contributions). If the beneficiary receives a scholarship, you can withdraw funds in an equal amount to the scholarship without these penalties applied (taxes would apply to the earnings portion withdrawn).

7. **Anyone can make a contribution to the account,** not just the owner. Contributions each year are limited to the annual gift limit ($15,000 per giver), but there is a notable exception that allows you to do up to 5x more, if desired.

8. **It does not matter what 529 Plan you use.** Nearly every state sponsors one, including WA, but you can use a Plan from any state. If you live in a state where you are subject to an income tax, you may be eligible for a state tax-break for a 529 contribution. This usually requires you to use that state's Plan. Otherwise, the financial consequences are the same regardless of which Plan you choose (such as is the case here in WA).

9. **You don't have to use 529 assets for "college."** They can also be used for a number of other post-secondary education opportunities – including two-year associate degree programs, trade schools, and vocational schools – both at home and abroad (so long as the institution is qualified, which just takes a little time research on sites like savingforcollege.com)

Let's wrap it up!

That's a lot of info! If you are like most, your next question is, ***"Great – but what would you do if you were my shoes?"*** I will tell you that I have 529 accounts for my boys, but I will also say this is a personal decision that depends on a number of important factors. So, my answer to that question is – I would give MPCA a call to talk through education planning in the greater context of my financial plan. Our job is to help you identify your goals and then work towards them in the most efficient and effective way possible. My guess is that if helping pay for college (to whatever extent) is a value or goal of yours, a 529 likely makes sense, and it may make sense on its own or combined with other means by which you work towards this goal. For example, for some we advise that they save ~60% of the expected cost in a 529, while for others it makes complete sense to target 100% of the goal. We look forward to working with you to see what fits best in your plan.

Disclaimer

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