# How to Start a College Fund Early

Every parent wants to give their child the best possible future, and for many families, that includes higher education. But with tuition costs continuing to rise, figuring out how to pay for college can feel overwhelming. The good news? Starting a college fund early gives your savings more time to grow, making it easier to manage those future expenses.

**529 Plans: A Popular Tool for College Savings**

When it comes to saving for a child's education, 529 college savings plans are one of the most widely used and versatile options. These state-sponsored accounts are specifically designed to help families save for qualified education expenses, and contributions grow tax free as long as they're used for qualified expenses. Because of their flexibility and tax advantages, they're one of the most popular ways to save for college. Begin by evaluating your state's 529 plan, as that's often the best place to start for state tax benefits. However, you're not limited to your own state's plan—you can choose almost any state's 529 program that fits your needs.

Here's how they work:

- **Contributions**: Money added to a 529 plan is invested in a selection of funds or portfolios chosen by the account owner.
- **Growth**: Earnings grow tax free, meaning you won't owe federal taxes on the investment gains as long as the money is used for qualified education expenses.
- **Withdrawals**: Funds can be used for tuition, fees, room and board, books, and even some K–12 tuition (in certain

states) or trade schools.

Let’s say you start contributing $200 monthly when your child is born. By the time they’re 18, assuming a 6 percent annual return, you could have about $75,000 saved—and all the earnings would be tax free when used for education.

**Tax Benefits**

One of the biggest advantages of a 529 plan is its tax efficiency. Contributions are made with after-tax dollars, but the account’s growth and qualified withdrawals are tax free. Some states even offer tax deductions or credits for contributions, adding another layer of savings.

For example:

- If you contribute $5,000 to a 529 plan in a state offering a 5% tax credit, you could save $250 on your state taxes that year.

While $250 may not seem like much, over time, these tax savings can make a meaningful difference—reducing your overall education costs just by choosing the right savings plan.

**Investment Options, Age by Age**

529 plans typically offer a range of investment portfolios, from aggressive growth funds to conservative options. Your child’s age and your comfort with risk will help guide your investment choices.

In the early years (ages 0–10), it often makes sense to invest more aggressively, with a higher allocation to stocks that have the potential for long-term growth. By the time your child reaches middle school (ages 11–15), gradually shifting to a more balanced approach can help manage risk. As college approaches (ages 16+), many families move to more conservative investments, such as bonds or money market funds, to help protect savings from market downturns.

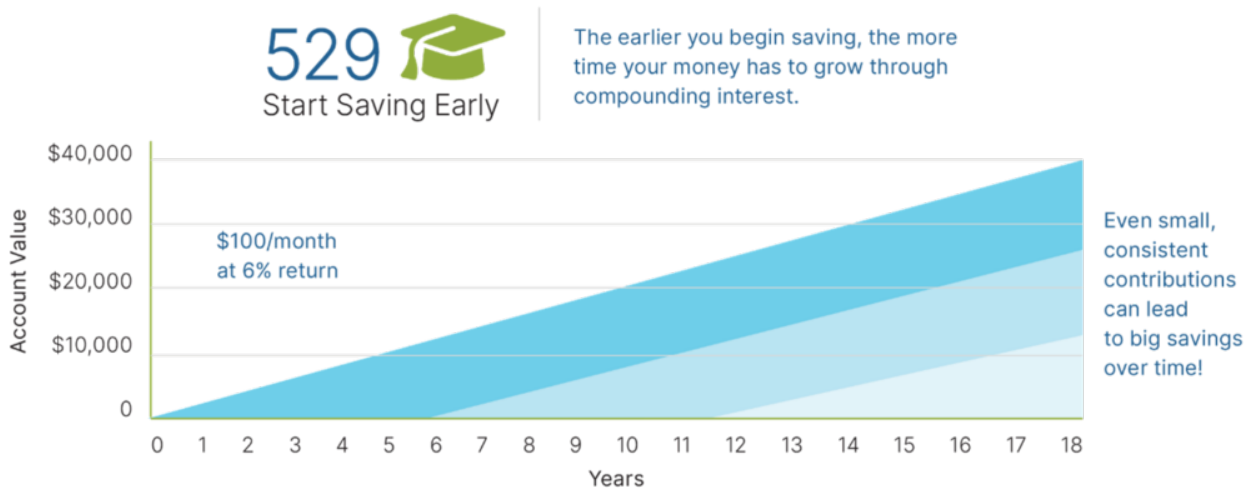
Keep in mind, many plans also offer “age-based” portfolios that automatically adjust the investment mix as your child gets closer to college age.

**Starting Early**

Time is your greatest ally when it comes to compounding growth, so it’s ideal to start as soon as possible. Setting up automatic monthly transfers often works better than trying to make larger annual contributions. For example, contributing $100 monthly feels more manageable than coming up with $1,200 at year-end. If you start contributing that $100 monthly at your child’s birth, earning an average annual return of 6 percent, you could have nearly $40,000 saved by the time they turn 18. Plus, regular contributions help you take advantage of market ups and downs through dollar-cost averaging.

Here are a few tips to get started:

- **Set up automatic contributions**: Most 529 plans allow you to schedule recurring deposits, making it easier to stay consistent.
- **Start small**: Even $25 a month can grow substantially over 18 years. Note that some plans do implement minimum contribution thresholds, though these are generally very low.
- **Gift contributions**: Encourage family members, such as grandparents, to contribute to the 529 plan as part of holiday or birthday gifts. College savings works best as a family effort, with everyone pulling together toward the shared goal of providing educational opportunities for the next generation.




**What If Your Child Doesn't Pursue College?**

Worried about what happens if your child doesn't go to college? 529 plans offer plenty of flexibility:

**Change the beneficiary**: The account can be transferred to another family member of the beneficiary, such as a sibling, cousin, grandchild, or even yourself.

**Use it for other education-related expenses**: Use the money for trade schools or vocational training or put it toward K–12 tuition (up to $10,000 annually, but only in certain states).

**Withdraw funds**: If the funds are withdrawn for nonqualified expenses, the earnings portion will be subject to taxes and a 10 percent penalty, but the principal contributions are not penalized.

**Repurpose the funds**: Recent changes in legislation allow up to $35,000 of unused 529 funds to be rolled into a Roth IRA for the beneficiary (subject to certain conditions).

This flexibility ensures that your savings don't go to waste, even if plans change.

**Exploring Alternatives**
While 529 plans are a popular choice, they're not the only option. Depending on your family's circumstances, other accounts might be worth exploring:

**Coverdell education savings accounts (ESAs)**: These accounts offer similar tax advantages to 529 plans but with lower contribution limits ($2,000 annually per child, subject to certain limits) and more flexibility in investment options.

**Custodial accounts (UTMA/UGMA)**: These accounts allow you to save money in a child's name, which they gain control of upon reaching adulthood. However, earnings are subject to taxes, and the funds can be used for any purpose—not just education.

Each option has unique benefits and trade-offs, so it's helpful to compare them carefully before making a decision.

**Building a Brighter Future**
Starting a college fund early may seem like a daunting task but breaking it into manageable steps can help you stay on track. Whether you choose a 529 plan, a Coverdell ESA, or another option, the key is to begin as soon as you can and contribute consistently.

Saving for college doesn't have to be overwhelming. By starting early, taking advantage of tax-advantaged accounts, and making saving a family effort, you can turn today's small contributions into tomorrow's opportunities—helping your child chase their dreams with confidence.

*The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee that an education-funding goal will be met. In order to be federally tax free,* *earnings must be used to pay for qualified education expenses. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10 percent penalty. By investing in a plan outside your state of residence, you may lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.*

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# Here is a Crash Course in 529 Plans and Their Impact on Financial Aid

Are you worried about the rising cost of education? 529 plans can be powerful college savings tools when you understand how to take full advantage of them.

**Start with the Basics**
529 plans are tax-advantaged college savings plans sponsored by a state or state agency, and there are two types:

- **Prepaid tuition plans.** With this type of plan, tuition and fees for a specific school are paid in advance.

- **Savings plans.** These are tax-advantaged investment vehicles (the account grows tax deferred, like individual retirement accounts [IRAs]). Savings can be used at most accredited colleges and universities in the U.S. or abroad.

**Make Your Plan Work for You**

When timed appropriately, contributions and withdrawals can help maximize your 529 plan. With most plans:

- **You can only contribute cash.** This includes checks, money orders, and credit card payments. You can’t contribute stocks, bonds, or mutual funds without liquidating them first.
- **Anyone can contribute.** With a 529 plan set up, gift giving just became easier!
- **There are investment options.** You can choose how to invest your contributions from a variety of investment portfolios.
- **You may be able to use funds for K–12 education.** Be sure to check as not all states recognize these updated provisions for K–12 education.
- **Research tax impacts.** Withdrawals used to pay qualified education expenses are free from federal income tax and may also be exempt from state income tax.

**The CliffsNotes on contributions.** To qualify as a 529 plan under federal rules, a state program can’t accept contributions more than the anticipated cost of attendance for the most expensive schools in the country. Most states have contribution limits of $350,000 and up per beneficiary.

The type of plan determines the limits:

- **Prepaid tuition plans.** These limit total contributions.
- **Savings plans.** These limit the value of the account (contributions plus earnings).
- **Minimum contribution requirements.** Some plans have requirements, such as minimum opening deposits or yearly contribution amounts.
- **State guidelines vary.** Contributions made to one state's 529 plan don't usually count toward the contribution limit in another state. Be sure to check the rules of each state's plan.

Should you fund your plan in a lump sum or over time?

- **Monthly investments may be an easy option.** 529 plan earnings grow tax deferred and can be withdrawn tax free if used to pay for qualified expenses. The sooner you put money in, the sooner you can start to generate potential earnings.
- **A lump sum may have unwanted gift tax consequences.** With limited opportunities to change your investment portfolio, you could get locked into undesirable investments for a period of time.

**Timing is everything!** Although 529 plans are tax-advantaged accounts, potential federal tax impacts are something to keep in mind. Under special rules unique to 529 plans, you can gift a lump sum of up to five times the annual gift tax exclusion—$75,000 for individual gifts or $150,000 for joint gifts—and avoid federal gift tax, provided you make an election on your tax return to spread the gift evenly over five years. (The federal gift tax exclusion is $15,000 for 2021.

Withdrawals should also be coordinated with education tax credits—the American Opportunity Credit and Lifetime Learning Credit—because tuition expenses used to qualify for a credit can't be the same tuition expenses paid with tax-free 529 funds.

## What About Financial Aid?

During the financial aid process, income and assets are examined to determine how much the student should be expected to pay for school before receiving financial aid. To maximize the beneficiary's future financial aid options, pay close attention to who is listed as the owner of your 529 plan.

**How to handle 529 plans owned by parents.** The value of any parent-owned 529 plan will be listed as an asset on the Free Application for Federal Student Aid (FAFSA). Colleges and the federal government typically treat 5.64 percent of parental assets as available to help pay college costs. By contrast, student assets are assessed at a rate of 20 percent.

Here are some additional things to keep in mind about parent assets:

- **Will the plan be considered an asset?** Parents are required to list a 529 plan as an asset only if they are the account owners of the plan.
- **A note for students who are dependents.** A 529 account owned by a dependent student—or by a custodian for the student—is reported on the FAFSA as a parental asset.
- **Yearly income guidelines.** If parental adjusted gross income is less than $50,000 and they meet a few other requirements under the simplified needs test, the federal government doesn't count any of their assets.* In this case, the 529 account wouldn't affect financial aid.
- **Subsequent years may look different.** For parent- and student-owned 529 plans, funds aren't classified as parent or student income the following year when they're used to pay for qualified education expenses.

**What about grandparent-owned 529 accounts?** If a grandparent is the account owner, the 529 plan doesn’t need to be listed as an asset on the FAFSA. Withdrawals from a grandparent-owned 529 account, however, are counted as student income—which is assessed at 50 percent—on the FAFSA the following year. This means financial aid eligibility could decrease by 50 percent in the year following the withdrawal. Grandparents may want to wait until their grandchild’s last two years of college to make a withdrawal if they are concerned about the potential impact on financial aid.

**Preparation Is Key**

You should review all your options to ensure that you’re financially prepared for education expenses. If you’d like to discuss 529 plans—or any other options—or if you have any questions about the information presented here, please contact me or my office.

** An applicant who qualifies for the simplified needs test may still be required to report assets on the FAFSA if they live in a state that requires asset information to determine eligibility for state grant programs. The asset information will be used only to determine eligibility for state grant programs. It won’t be used to determine eligibility for federal student aid. The states include Colorado, Georgia, Hawaii, Illinois, Minnesota, New Jersey, New Mexico, Ohio, Oklahoma, South Carolina, Vermont, Washington, Washington D.C., Wisconsin, and Wyoming.*

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Qualified Expenses:

• College/university cost of attendance (tuition, fees, books, equipment, and room and board)

• Certified apprenticeship programs (fees, books, supplies, and equipment)

• Student loan repayment ($10,000 lifetime limit per beneficiary and $10,000 per each of the beneficiary's siblings)

• K–¬12 tuition expenses up to $10,000 per year