The Rennie Quarterly Return

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Saving For College

According to the Bureau of Labor Statistics, healthcare costs in the US grew by 43% over the decade ending December 2013. Headlines declare that this rapid growth is a major risk when contemplating a comfortable retirement.

For young and some middle-aged savers, another risk looms even larger. The BLS data shows that college tuition and fees grew by a whopping 81% over the same decade. Books and room and board grew even faster.

Data published by The College Board shows that for 2013-2014 the average annual college expense (tuition and room and board) ranges from $18,391 for a four-year in-state school to $40,917 for a private school.

It is not unreasonable to anticipate college career costs exceeding $250,000 per student in the not-to-distant future, depending on the college. How is a young family to prepare? Fortunately, there are tools to help.

529 College Savings Plans

Named for Section 529 in the Internal Revenue Code, these are state-sponsored college savings plans. They offer savers tax-exempt income and growth on contributed assets when withdrawn for qualified education expenses. They also offer very high relative contribution limits.

State sponsorship is largely irrelevant. For example, assets in California's ScholarShare Plan can be used for qualified college expenses incurred nationwide or abroad.

529 Plans must have an owner (parent/grandparent) and a single beneficiary (student/child). Contributions to a 529 Plan are considered gifts to the beneficiary. As such, individuals may contribute up to $14,000 ($28,000 for couples) annually to a 529 Plan account without triggering gift tax. A special provision permits contributing five times this amount ($70,000) in one year provided no contributions are made by the same donor in the subsequent 4 years.

Anyone can contribute to a beneficiary's 529 Plan, including relatives and friends. However, the maximum total contribution limit is $370,000 for most state plans.

The 529 Plan account owner maintains complete control over the assets, including making investment choices. They may even change the beneficiary to another eligible family member should a scholarship be awarded or costs end up lower than expected. 529 Plans are treated as assets of the owner and generally have a low impact on financial aid eligibility. However, they are excluded from the owner's gross estate in most cases, making 529s an attractive estate planning tool.

If balances are not used for qualified education expenses, they may be withdrawn by the owner subject to a 10% penalty on earnings.

529 Plans today hold the majority of college savings dollars. However, other savings vehicles are still in use.

Coverdell ESAs

Coverdell Education Savings Accounts provide many of the same benefits as 529 Plans. However, contributions are limited to $2,000 per beneficiary per year. Unfortunately, the ability to contribute phases out for upper income earners.

Unlike 529s, Coverdells permit withdrawals for qualified K-12 expenses.

The limited contributions offered by Coverdells diminishes their attractiveness substantially in today's market.

UGMA/UTMA Accounts

UGMA and UTMA accounts are custodial accounts held for the benefit of a minor. As such, contributions to these accounts are irrevocable gifts to the child. They do not offer tax exemption, but may move assets into a child's low tax-bracket environment.

Earnings are taxed to the minor, not the custodian. In addition, custodianship terminates automatically when the child reaches the age of majority. The assets in an UGMA/UTMA are treated as assets of the child for financial aid purposes, impacting qualification to a greater extent than the same dollars in a 529 Plan.

There are no restrictions regarding using the assets, as long as for the benefit of the minor during the custodial period.

The fact that the assets transfer at majority regardless of need or intended use makes UGMA/UTMA accounts unattractive to many would be donors.

Loans & Financial Aid

The "needs gap" between savings and college costs is most often filled by loans and/or financial aid. The numerous choices entailed are beyond the scope of this newsletter.

So Is It Worth It?

Despite anecdotes of dropout billionaire high-tech CEOs, all credible studies still point to a substantial lifetime earnings uplift, $1 million or more, attributed to a four-year college degree. Enhanced career mobility and lower risk of unemployment are also benefits. We expect these will persist.

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Our Two 1¢

"An investment in knowledge pays the best interest".

Benjamin Franklin

Quarterly Trivia:

How many US Presidents attended US Military Academies?

Three: Grant (West Point), Eisenhower (West Point), Carter (Naval Academy)