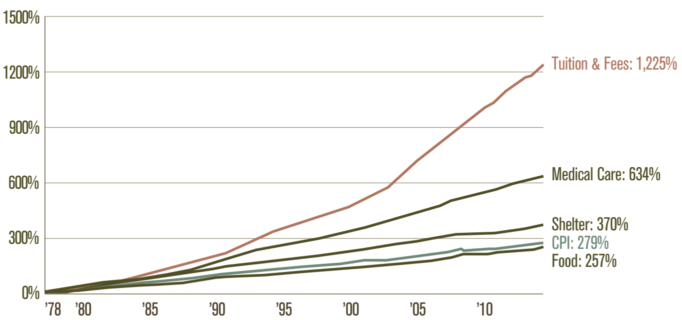
BY John Bohan, CFP®
V.P., Senior Wealth Advisor

Managing the Climbing Costs of College

As parents, my wife and I agree that our primary goal is to help our kids be successful in life. One highly influencing factor in being successful is getting a college degree, as it's been shown to contribute an average of $1 million to lifetime earnings when compared with a high school degree.[1]

EXHIBIT 10 INCREASE IN CONSUMER PRICES SINCE 1978

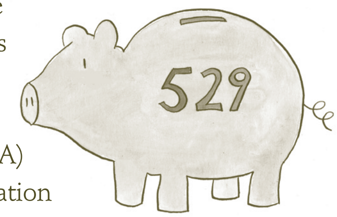


Source: Bureau of Labor Statistics

As our standard of living continues to improve in the U.S., the opportunity to go to college has become a reality for more and more teenagers. However, the rising costs of college education have dramatically outpaced average increases in our standard of living (Exhibit 10).[2]

During the 1970s, college costs did not increase all that much. However, that changed in the 1980s, when the average cost of college doubled–and sometimes tripled–the consumer price index (CPI), a proxy for the rate of inflation. By the mid-1990s, the average costs per year (including tuition, fees, room, and board) for a four-year public school had reached $4,000–and were north of $22,000 for a private school.[3] Since then, expenses have continued their meteoric rise. For the 2014/2015 school year, public school costs for in-state students catapulted to an average of $19,000 per year, while private schools averaged more than $42,000 per year.[3]

With student loan debt ballooning for our young adults, one way to reduce the burden is to start saving early for your children's or grandchildren's college expenses. There are several vehicles to facilitate this, including Uniform Transfer to Minors Act (UTMA) or Uniform Gift to Minors Act (UGMA) custodial accounts, Coverdell Education Savings Accounts (ESAs), and 529 plans.



- UGMAs are trust accounts established to enable minors to own securities. Money in these accounts is considered part of the custodian's taxable estate. Once minors reach the age of majority, which varies by state, they gain full control of the assets.[4] This introduces a risk that this newly minted adult chooses to spend his or her money on something other than a college education.
- UTMAs are trust accounts very similar to UGMAs, the difference being that they allow minors to own real estate, fine art, patents, and royalties, in addition to securities.[4]
- Coverdell ESAs are accounts with contribution limits of $2,000 per year for each child. Earnings grow tax-free unless the account is not depleted by the time the child reaches age 30, in which case earnings incur ordinary income taxes plus a 10% penalty. The primary benefit is that the funds can be used for primary, secondary, and college expenses.[5]
- 529 plans are education savings plans operated by a state or educational institution. Earnings grow tax-free forever, with no time limit on when savings must be spent.[6] When used for qualified college expenses, funds remain free of federal and state taxes.[7]

Since they were created by the Internal Revenue Service in 1996, 529 plans have become an increasingly popular choice for education funding. While each of these options has its own benefits and drawbacks, 529 plans offer some unique benefits that other options simply don't have. Primarily, the tax advantages referenced above are significant and have become increasingly valuable as the costs associated with » college have skyrocketed. Some states even allow the account contributor to receive a state income tax deduction.[8] 529 plans also offer age-based investment options, allowing the investment mix to automatically transition from aggressive to more conservative as the child gets closer to starting college.[7] Furthermore, with no deadline for when savings must be spent, it's possible to pass any excess funds on to future generations.[6]

As of 2013, the total assets in 529 plans around the country exceeded $200 billion.[8] Even so, there are still some common questions about 529 plans.

Common Questions

1. Do I have to use my state's 529 plan? No. However, only your state can give you a state income tax deduction when you contribute to your child's or grandchild's account (not all states do). Each state plan is a little different, so consult with your advisor on the best option for your family. It's also important to consider how your state's 529 plan is ranked versus other state plans and whether it has limited options for investments. It's possible to find rankings online, but we suggest discussing this with your advisor.

2. Does my child have to go to college in the state that sponsors my 529 plan? No, you may use the funds for almost any accredited two- or four-year undergraduate program or graduate program in the U.S., as well as some in Canada. Most public and private institutions qualify, but it is always good to verify with your plan.

3. What if I put money in a 529 plan and my child doesn't end up going to college? You may transfer the funds to another beneficiary in your family (which is defined broadly). Alternatively, you may withdraw the money from the 529 as a non-qualified withdrawal, which would incur a 10% penalty and require you to pay income taxes on the earnings portion of the account. You will never have to pay taxes on the principal, since that was deposited with after-tax money.

4. Will I lose access to the funds if my child gets a scholarship? No, you may use the funds in your 529 to cover any difference between the scholarship amount and total costs. Any leftover balance in the 529 may be transferred to another beneficiary within your family without penalty. Alternatively, you may opt to withdraw the funds for non-college expenses. You're allowed to withdraw the amount equal to the scholarship and just pay taxes on the earnings with no penalty; any amount beyond that would incur a 10% penalty as well as earnings taxes.[6]

5. Are there estate plan benefits to contributing to a 529? Yes. However, each family's situation is different. You may contribute $14,000 per year, per person to a 529 plan and use your annual exclusions. Certain provisions allow you to frontload a plan with five years of contributions, and not have it count against your lifetime gifting limits.[6] This could amount to an initial $140,000 in 2015 if both spouses contributed to a beneficiary. Please consult with your advisor and tax accountant to find the plan that is most appropriate for you.

As our student loan debt has now exceeded $1 trillion, it is more critical than ever to give our next generation a head start without the burden of student loans. College saving is simple to start but can be difficult to maintain as your child or grandchild grows older. Saving in a 529 for a child's education is an efficient funding mechanism that can accumulate a nice nest egg by the time freshman year begins. So consider starting early with this systematic investment. Your heirs will thank you for a lifetime! ■

1 *Katherine Peralta, "Benefits of College Still Outweigh Costs, Fed Study Says," U.S. News & World Report, accessed 11/8/15, http://www.usnews.com/news/articles/2014/06/24/benefits-of-college-still-outweigh-costs-fed-study-says.*
2 *Michele Jamrisko and Ilan Kolet, "College Tuition Costs Soar: Chart of the Day," BloombergBusiness, accessed 11/8/15, http://www.bloomberg.com/news/articles/2014-08-18/college-tuition-costs-soar-chart-of-the-day.*
3 *The College Board, "Trends in College Pricing 2015," accessed November 6, 2015, http://trends.collegeboard.org/sites/default/files/trends-college-pricing-web-final-508-2.pdf.*
4 *"UGMA & UTMA Custodial Accounts," FinAid, accessed November 6, 2015, http://www.finaid.org/savings/ugma.phtml.*
5 *"Coverdell Education Savings Accounts," FinAid, accessed November 6, 2015, http://www.finaid.org/savings/coverdell.phtml.*
6 *"5 Ways to Spend Leftover 529 Plan Money," Saving for College, accessed November 6, 2015, http://www.savingforcollege.com/articles/20100122-5-ways-to-spend-leftover-529-plan-money?page=4.*
7 *CollegeInvest, accessed November 6, 2015, https://www.collegeinvest.org/why-collegeinvest/what-we-offer.*
8 *Savingforcollege.com, "Name the Top 7 Benefits of 529 Plans," accessed November 6, 2015, http://www.savingforcollege.com/intro_to_529s/name-the-top-7-benefits-of-529-plans.php.*

Index Descriptions

- The S&P 500 is widely regarded as the best single gauge of the U.S. equity market. It includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 focuses on the large-cap segment of the market and covers approximately 75% of U.S. equities.
- The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, red chips, and P chips. With 143 constituents, the index covers about 85% of this China equity universe.