Education Planning for Parents

By Amit Patel, CPA/PFS, CFP®

One of the best investments parents can make is in their children's educational future. The question that many parents face is whether they will have enough money to support

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their children as they head off to college. We all know that college education costs are soaring and with the current economic environment, parents are more concerned than ever on how to fund their children's goals. The good news is that there are a multitude of funding options available to parents such as prepaid tuition accounts, education IRAs, trusts, and 529 plans.

As part of the planning process, parents will have to factor in their child's age, institution preferences, availability of grants, scholarships, loans and their personal finances. Obviously, the earlier you start, the more flexibility you have in terms of your funding options and investment risk.

One of the most popular funding options is the 529 college savings plan. These are state-sponsored plans that allow parents to invest in a pool of stocks and/or bonds that can potentially generate higher investment returns over a period of time. Section 529 plans are also tax efficient. They allow savings to grow on an income tax free basis and withdrawals from the plan are generally tax-free if they are used for qualified educational expenses. Parents are also exempt from gift taxation on their contributions to the plan (up to the IRS annual exclusion amount). Section 529 savings plans also allow remaining account balances to be transferred to siblings and other family members if certain requirements are met. The primary disadvantage to these plans is investment risk. Since the plan assets are invested in equity and debt securities, there is a possibility that investments may lose value. This could be particularly detrimental if your child is just about to begin college.

Another popular funding vehicle for parents is the Coverdell Education Savings Account, also known as education IRAs. These savings accounts allow you to set aside $2,000 annually toward your child's education. Education IRAs share many of the same tax features found in 529 plans. Account earnings grow on a tax-deferred basis and withdrawals for qualified educational expenses are tax-free for children under the age of 30. Contributions to these accounts will also be exempt from gift taxation. The primary disadvantages to these accounts relates to investment risk and the low annual contribution amounts. A $2,000 annual contribution will generally not provide enough savings for those parents who have children that are a few years out from college. Additionally, those parents who have higher incomes will generally be phased out from participating in education IRAs.

There are many other educational funding options available to parents such as trusts and prepaid tuition accounts. Parents beginning the planning process should work closely with their financial advisor to develop a comprehensive plan to help meet their funding objectives.

Amit Patel is a licensed Certified Public Accountant and Certified Financial Planner™ practitioner with A.P. Accounting & Tax Services in Sanford. His practice areas include tax planning, financial planning and business consulting. To learn more about A.P. Accounting & Tax Services, visit www.apflcpa.com.