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Education Savings Strategies

Saving for a child or grandchild's education can be a great benefit for both you and the beneficiary. The cost of education, however, is increasing at a dramatic pace. There are several options to consider when establishing an education savings strategy and it is essential to determine an appropriate savings rate. This will allow you to achieve your savings goals without potentially overfunding or underfunding for education expenses in the future.

COST OF EDUCATION

According to the College Board, the average cost for tuition and fees at four-year public institutions has increased almost 40% over the last decade. We expect these costs to continue to increase at an annual rate of at least 6%. Based on this assumption, projected costs in 10 years and 15 years are as follows:

Expenses for Four-Year Institution

Institution	Current Average Annual Costs	Projected Annual Cost in 10 Years	Projected Annual Cost in 15 years
Public In-State	$27,940	$50,036	$66,960
Public Out-of-State	$45,240	$81,018	$108,420
Private	$57,570	$103,099	$137,970
Average	$43,583	$78,051	$104,450

Assumes 6% annual inflation

529 SAVINGS PLANS

The most widely used education savings vehicle is the 529 savings plan. Each state offers at least one plan, but there is no requirement for attending an institution within that state. 529 plans are funded with after-tax dollars, the earnings are tax-deferred, and withdrawals used for qualified education expenses are tax-free. These qualifying expenses include tuition and fees, books and supplies, computers, and computer equipment. Room and board are also considered a qualified expense as long as the student is enrolled at least half-time. Additionally, the account owner remains in control of the assets in the 529 plan at all times and these funds are not includable in their gross estate.

Account owners also have the flexibility to change the beneficiary to a qualifying family member of the beneficiary at any time without tax consequences. Generally, there are also no gift tax consequences provided the old and new beneficiaries are in the same generation (e.g., siblings). Included as qualified family members of the beneficiary are:

- Siblings and stepsiblings
- Parents and stepparents
- Spouse
- Children (including adopted children)
- In-laws
- First cousins
- Aunts and Uncles

Withdrawals from 529 plans that are not used for qualified education expenses are taxed at ordinary income rates and assessed a 10% penalty on the earnings portion. If the beneficiary receives a scholarship, however, you can withdraw up to the scholarship amount from the 529 plan penalty-free (income taxes still apply to the earnings withdrawn). Additionally, 529 plan withdrawals must be taken during the **same calendar year** in which the qualifying expenses are paid otherwise the distribution may be considered a non-qualified distribution. In order to simplify record keeping and ensure accurate matching, you may want to make payments directly from your 529 plan to your student's institution.

Depending on the plan you select and your state of residency, you may receive a tax deduction or tax credit for a portion of the contributions you make to a 529 plan. As of January 1, 2020, the Oregon College Savings Plan replaced the state tax deduction with a refundable state tax credit. The credit is based on your filing status and adjusted gross income. The credit is the lesser of $170 for single filers and $340 for joint filers or a percentage of the amount contributed based on your adjusted gross income.

Currently, federal law allows you to withdraw up to $10,000 per year from a 529 plan for K-12 tuition expenses for each beneficiary. However, a number of states (including California and Oregon) do not conform to this federal tax law. If a state does not follow the federal law, the distributions taken out of a 529 plan for K-12 tuition expenses may be subject to state tax and a penalty. In addition, any previously claimed state tax deductions may be subject to recapture.

The SECURE Act of 2019 expanded the definition of qualified education expenses to include costs associated with registered apprenticeship programs and repayment of student loans. The act allows you to take a qualified distribution of up to $10,000 for the repayment of student loans. The $10,000 amount is a lifetime limit that applies to the 529 plan beneficiary and each of their siblings. Bear in mind that this is also a federal law so you should check your state's definition of qualified education expenses before making a distribution for student loans. Furthermore, any portion of student loan interest paid for with 529 plan assets will not be eligible for the student loan interest deduction.

UTMA/UGMA ACCOUNTS

UTMA/UGMA accounts are custodial accounts used to protect assets for a minor until the child reaches the age of majority. This can be age 18 but also age 21 or 25 depending on the child's state of residence. As the custodian, you can withdraw funds to be used for the expenses of the child. This can include expenses related to primary and secondary education expenses. All contributions to the account are considered a gift to the minor and will become the minor's money at the age of majority. For 2024, contributions to an UTMA/UGMA can be made up to the federal gift tax exclusion limit of $18,000 per donor per recipient without triggering any gift tax. Unearned income in excess of $2,600 (for 2024) is also taxed according to the parents' marginal tax rate.

TAXABLE INVESTMENT ACCOUNTS

Another option is to set aside funds in a taxable investment account that you have earmarked for education. The investments remain in your name, allowing you to maintain complete control of the account. Earnings and gains are taxable to you in the year realized, and the account is includable in your gross estate.

ABLE ACCOUNTS

ABLE Accounts provide individuals with disabilities and their families the ability to fund a tax-advantaged account to pay for qualified disability expenses. Similar to 529 accounts, ABLE accounts are funded with after-tax dollars, the funds accumulate tax-deferred, and withdrawals are tax-free when used for qualified expenses. Examples of qualified expenses include living, education, housing, transportation, personal support services and health, prevention, and wellness expenses.

Currently, you may contribute up to the annual gift tax exclusion ($18,000 in 2024). After the limit is reached, a designated beneficiary who works may also contribute his or her compensation up to the poverty line amount for a one-person household. However, a designated beneficiary is not eligible to contribute this additional amount if his or her employer has made a contribution to a 401(a) defined benefit contribution plan, 403(a) annuity contract, 403(b) annuity contract or 457(b) deferred compensation plan. Families may also rollover funds from a 529 plan to another family member's ABLE account up to the annual contribution limit. These provisions are scheduled to sunset on December 31, 2025.

Education Savings Plan Comparisons

	529 Plan	UTMA/UGMA	Taxable Mutual Funds
Contributions	After-tax dollars	After-tax dollars	After-tax dollars
Withdrawals	Tax-free if used for qualified education expenses	No tax on withdrawals	No tax on withdrawals
Taxation of Earnings	Tax-free if used for qualified education expenses	Earnings over $2,600 are taxed at the parents' marginal tax rate	Earnings and gains are taxed in the year realized
Maximum Investment	Depends on the state; many are in excess of $300,000 per beneficiary	No limit	No limit
Gift Tax Treatment	Subject to the annual gift tax exclusion; special provision allows for 5 years of funding at once	Subject to annual gift tax exclusion	Not considered a gift; direct payments of tuition to an institution are not considered gifts
Estate Tax Treatment	Value of the plan is removed from the owner's estate	Value of the plan is removed from the donor's estate, unless the donor remains as custodian	Value included in the owner's estate
Change Beneficiary?	Yes	No; contributions are an irrevocable gift	No beneficiary designated; assets remain the account owner's
Age Restriction	None; funds can be used for qualified expenses at any age	Custodianship terminates when child reaches age of majority (18, 21, or 25, depending on the state). Funds are then solely owned by the child	N/A. Assets remain the account owner's
Financial Aid Consideration	Counted as assets of the owner	Counted as the student's assets	Counted as assets of the owner
Investment Options	Menu of options provided by each state	As permitted under state law	No restrictions
Potential Penalties	10% penalty for withdrawals not used for qualified education expenses	Funds must be used to benefit the minor; funds become the minors at age of majority	No restrictions