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Chapter **1**

Braving the New World of Education Savings

You may have just found out that you're pregnant. Maybe you're at the point where the college catalogs are beginning to accumulate on your dining room table. Or perhaps your family is somewhere in the middle, with your children out of diapers but not yet into calculus. Wherever your family falls in the age spectrum, one thing is certain: Either in your immediate family or in your extended one, we all want our children to receive the best possible education for them. That might mean public schools all the way, private schools at some point, trade schools, or apprenticeships. The options are endless, but so may be the potential cost.

And therein lies a problem: Although your child can receive a primary and secondary education without incurring significant added expense in your budget (unless you consider things like your local parents' group's fundraisers), there is very little that's free in the way of post-secondary education. For most of us, the privilege of helping your child obtain that degree or learn a trade comes with a hefty price tag. And, while I was convinced when my son was born that he'd receive full scholarships all the way, that is the exception and not the rule (and no, he wasn't one of the exceptions. Darn!). If you've already explored the costs of a post-secondary education, you know that the numbers often are large; if you haven't yet experienced the pleasure, rest assured that the amounts in question will likely

take your breath away. So far, we've only spoken about post-secondary education. In this book, we're also going to talk about private schools for grades K-12, apprenticeships, trade schools, and learning opportunities for differently abled children.

In solving any problem, you need to remain calm and focused on the task at hand. That's where this book may help — by making you methodically look at the current state of your education savings, helping you leave your misconceptions about saving at the door, and showing you ways to begin or increase savings. After you convince yourself that you're able to save something and you actually begin to put some money away, you've won a major victory; everything that follows will be easier. Just keep in mind that saving now will create opportunities and open doors for your children in the future.

Doing the Numbers

Up until now, crunching the numbers and figuring out what you think college will cost has usually been where you begin and end your exploration of the topic of how to pay for future educational costs. But after you resolve to start saving and you take the projected costs and create a plan to save for that amount, it's time to take this exercise a bit more seriously.

Figuring up the costs

Depending on the size of your family and your expectations, adding up the cost of a college education can be a fairly straightforward calculation, or it may become quite involved.



TIP

Be realistic about the capabilities and ambitions of your future student and your ability to pay.

Your straight-A student may have to scale back on their dreams of MIT if your budget, including amounts you can add from your current and future earnings, only goes as far as your local state college. (However, they may want to seriously consider applying for some scholarship aid as outlined in Chapter 17.)

Likewise, there's little point in saving for an Ivy League education if your child has plans to open their own auto repair shop. And clearly, the more children you're educating, the thinner your resources may be stretched per child. (Although, depending on how closely spaced your children are in age, this situation may actually work to your advantage if you need to apply for financial aid, as you will learn about in Chapter 18.)



Finding resources to help you save

No matter how late you may begin saving specifically for future college costs, the entire weight of doing so doesn't necessarily need to rest solely on your shoulders, nor do you need to begin to save from nothing.

Chapter 3 helps you find hidden assets you may have available to augment your education savings. It may also alert you to other resources you haven't even thought of — for example, family, friends, or even the student himself. Just because these are your children, you may not have to come up with the full amount of their education costs from your pockets alone.

Saving efficiently

Too many people equate saving for the future with current deprivation. For most people, living expenses currently equal (or even exceed income), and they may not have money left over in the family budget for saving. Clearly, if you fit into this category, you're not going to be able to save unless you make some changes in your life. Chapter 4 shows you some relatively painless adjustments that will maximize the amount of money you can shave from your current budget while minimizing the effect on your life.

Exploring Section 529 Plans

Most believe that saving money is a good thing, and the federal government is prepared to back up that philosophy with a variety of savings programs that contain built-in tax incentives, some of which you may already be using (tax-deferred retirement plans, anyone?). One of these types of incentive savings plans is the Qualified Tuition Program, or Section 529 plan, which is designed solely to save for college or any other type of qualified education, either tax-exempt or tax-deferred, depending on a number of factors. Like almost everything else the government cooks up, though, Section 529 plans aren't as simple to navigate as everyone selling these plans would have you think. Chapter 5 gives you the tools you need to understand how these accounts work and how you can best make them work for you.

Following the rules



Section 529 of the Internal Revenue Code is long, complex, and not for the faint of heart. Still, savings accounts that fall under its regulations can be a fantastic way to save for future educational expenses. However, to make it work, you have to understand its requirements; there's little point in setting up one of these accounts

if you don't cross your t's and dot your i's just like the IRS wants. Remember, the IRS doesn't have a category of "close, but no cigar." Either your account will qualify under the regulations for tax deferrals or exemptions, or it won't. And if it doesn't, the consequences may be costly.

Making your money work for you

Creating a successful savings plan involves more than following the rules, although compliance with the rules is a big part. Chapter 6 shows you how to actually begin saving money and then put those savings to work for you.



REMEMBER

You're a big factor in determining whether your savings program flies or falls. Understanding the various ways your savings may earn money and the different investment options available is an important piece of creating the substantial savings you'll need to see your children through college.

Choosing the best options

Even when you understand the rules, manage to regularly save major portions of your income, and discover how to manipulate the investment choices to your best advantage, events in your life may require you to make sudden changes in your Section 529 plan savings accounts. Life happens, whether you're prepared or not, and often the last thing you want to think about when it does is the effect on your investments. Chapter 7 alerts you to some planning opportunities with your Section 529 plan accounts and how to make corrections to your college savings when your life doesn't exactly follow the course you originally laid out.

Checking Out Coverdell Accounts

If the world of tax-deferred/tax-exempt savings accounts were an ice cream parlor, Coverdell Education Savings Accounts (ESAs) might be rum raisin. Rum raisin might not be the most popular flavor, but it might be just what you want on a particular day. Not surprisingly, many people prefer Coverdell accounts when shopping for a place and a way to save money for college. Coverdell accounts provide a wider range of investment options and increased control over the account, and certain expenses qualify for tax exemption under Coverdell rules that aren't under Section 529 requirements. Whatever your reasons, Coverdell ESAs may be just the account flavor you want today.



Understanding the rules and regulations

Internal Revenue Code Section 530, covering Coverdell ESAs, follows hot on the heels of Code Section 529 (those government sorts are sticklers for going in order). In it, you find all the rules, regulations, and other assorted gobbledygook that govern these sorts of accounts.

But you actually don't have to dive into the tortured syntax of the Internal Revenue Code since I've already done that for you. In Chapter 8, you discover what rules you need to know to open an account, save money inside an account once it's been opened, and then make distributions from the account, tax-free or tax-deferred (depending on a number of factors), for qualified educational expenses.

Getting the most from your Coverdell account

You've probably discovered by now that successful savings involve far more than sticking your money in a passbook savings account at your local bank. And, while your investment options are seriously limited inside a Section 529 plan, you have far more latitude in investment decisions when you open a Coverdell ESA. Chapter 9 explores where you can open an account, what information you need to open that account, what sorts of investments you can put into an account, and how to decide what sorts of investments work best for you. Finally, we explain the nuts and bolts of what happens when you begin withdrawing from your student's Coverdell account to pay for qualified educational expenses.

Seeing if Coverdell accounts work for you

Saving now for future educational costs may seem like a no-brainer to you but negotiating the ins and outs of any tax-deferred/tax-exempt savings plan isn't quite so simple. And, not to put too fine a point on it, Coverdell ESAs, while a valuable weapon in the arsenal of college savings accounts, may not be the right choice for you. Chapter 10 gives you some insights into what's involved in effectively managing a Coverdell account for your student and what pitfalls to avoid. Finally, if, despite your best efforts, you unintentionally land in a pile of muck, you find some strategies here to turn lemons into lemonade and perform some damage control.

But Wait! There's More!



REMEMBER

People went to college and private schools long before the Internal Revenue Code, and parents and grandparents saved for those costs even when tax deferrals and/or tax exemptions weren't around. You can save money in many other ways, some even specifically for college. Even though they may not be as tax advantageous as Section 529 plans and Coverdell ESAs, they may make perfect sense in your overall savings plan. And if you're not able to save enough to cover the full cost, all is still not lost: Various scholarships, grants, and loan programs are available to cover any shortfall you may have between what you've saved and the cost of your child's education.

Rediscovering U.S. Savings Bonds

Whether you're able to save only relatively small amounts, you're uncertain about your potential student's future plans, or you love the safety and security found only in U.S. Savings Bonds, you may find that this is an attractive way to save for future college expenses and still take advantage of some tax exemptions on the interest earned on your bonds. Chapter 11 explains how you may be able to use certain U.S. Savings Bonds to pay at least some of your child's post-secondary educational expenses tax-free. It shows you who may invest, how you may invest, and how to allocate and report your taxable and tax-exempt earnings when you redeem your bonds.

Saving for education the old-fashioned way

It may seem strange to even think this, but the trade-off for taking advantage of the income tax breaks available through Section 529 plans and Coverdell ESAs is that you're guaranteeing that you will use that money to pay for qualified educational expenses. If only all of life were so certain and so sure.



REMEMBER

Many of you may be hesitating over how much to save in these plans — or whether to save at all — because of your great uncertainty over your child's future plans. When you save in traditional investment and savings accounts, you eliminate that uncertainty because you're not tied to using your savings in any one way. Of course, in exchange for that freedom to spend your savings as you will, you lose any opportunity to defer or exempt tax on your earnings, but if your world is an uncertain place, you may find that's a small price to pay.

In Chapter 12, you find out about different types of investment accounts, different options of account ownership and their consequences, ways to invest and manage a personal investment account, and, finally, the taxation of investment income.

Putting your faith in a trust fund

For most people, the phrase “trust fund” brings to mind visions of great wealth and privilege; in other words, it has nothing to do with you. And that picture couldn’t be further from the truth. If you save money in any form, then you’re a potential candidate to create and fund a trust. Chapter 13 explores some different types of trusts and explains why a trust may actually make sense for you as an education savings tool.

Saving in your retirement accounts

Using retirement funds to pay for college usually isn’t the best savings strategy to pay for these costs. In certain limited circumstances, however (such as when parents are older or you face unplanned educational expenses), it may make some sense to access funds from a retirement account to pay qualified educational expenses. Chapter 14 explains the tax consequences when you use so-called retirement savings to pay for educational expenses and alerts you to some major considerations you need to consider.

Accessing your home equity

If you (or you and the bank) own your home, you may be sitting on a larger nest egg than you ever considered. A combination of rising home values and shrinking mortgage loan balances has created a large pool of equity for many people, equity that may be made available to fund educational expenses. Chapter 15 illustrates how you may use your house to help put one or more children through college.

Using cash value stashed in your whole life insurance policies

You may have been paying premiums for years on whole-life policies without ever considering the considerable cash value accumulated inside the policy. And, if you took out those policies because you wanted to make sure that the money would be there, in case you weren’t, for your children to go to college, this cash value can be used to help your child go to the school of their choice. Chapter 16 will show you how to use this particular tool to provide benefits after your death and as a savings tool during your life.



TIP

Identifying sources of free money

Not every potential student is an academic genius or a future first-round NFL draft pick, but you don't necessarily need to conclude that your child won't qualify for scholarships and grants.

Chapter 17 describes many sources of outright scholarships and grants. Some carry no strings whatsoever for your student (other than actually attending college), and others require some sort of payback, either upfront or after your child completes their education.

Borrowing to fill in the gaps

You're obviously reading this because you don't want to have to resort to borrowing money to pay for your children's college costs. And hopefully, you'll never have to touch the pages of Chapter 18. Still, it's not the end of the world if you do. This chapter explains the types of financial aid available and assesses the costs. It also peeks at some of the benefits and downsides of borrowing money for college.

Maximizing Your Savings, Minimizing Your Tax

This book is, at its heart, about successfully saving and investing money for future education costs on the one hand and minimizing taxes on the other. And if that were the beginning and end of the matter, you'd be looking at a fairly straightforward task, one in which, if you followed all the rules, you'd achieve the desired result at the end of the game.

Unfortunately, you don't live in a vacuum, and many forces impact your ability to save adequately, achieve reasonable investment returns on your savings, and limit the amount of income tax you'll pay on those investment returns. You're operating on a field that is rarely level and that shifts and shimmies through no fault of your own. As a result, you need to be aware of how large and small changes, whether they result from government policy, market forces, or changes in your family's projected college cost needs, will affect your savings programs. And you need to be prepared to move with those changes — to adjust your savings programs to account for these other factors.



REMEMBER

At the end of the day, your success will depend not only on how often you make deposits into your education savings plans or how large the deposits are but also on how well that money works for you. Your goal is not to achieve a large balance in one or more college savings accounts. Your goal is to watch your children begin their adult lives with good educations and marketable skills while hopefully reducing or completely eliminating college debt.

