

Saving for College 101



According to Collegeboard.org's college cost calculator, tuition and fees for a four-year public university in 2035 will be \$222,000. For a private university, the total cost could hit \$437,000. These numbers are staggering, but with careful planning you and your children will be better prepared to face these high costs.

529 Tuition Plans

For many families, Section 529 plans are sensible and tax-savvy ways to meet future education expenses. They are offered in most states across the country. Pennsylvania has two types: the 529 Guaranteed Savings and 529 Investment plans. The money invested in both options grows free of federal and state income tax, and withdrawals from these plans are tax-free at the federal and at the Pennsylvania state level when beneficiaries use them for college expenses, including tuition and other related costs. The Tax Cuts and Jobs Act of 2017 allows tax free withdrawals of up to \$10,000 per year for tuition at elementary and secondary public, private, or religious schools. There are no income restrictions, and anyone can open a 529 plan with as little as \$15 to start. Contribution limits may vary from state to state. The maximum investment limit for Pennsylvania 529 college savings plans is \$511,758. Unlike most accounts, 529 plans cannot be jointly owned, so a single account owner must be identified for each account. It is important to note

that Pennsylvania 529 plan funds can be used at higher education schools nationwide; they are not limited to Pennsylvania only.

The 529 Guaranteed Savings Plan is a prepaid tuition plan. This lower-risk plan is designed for individuals who want to buy credits at a specific institution or at a certain tuition level (i.e., the private four-year college average, or the Ivy League average) at today's prices, and use those credits in years to come. You can change your targeted tuition level at any time, and the plan will adjust itself. There is a \$15 minimum each time a contribution is made. If a beneficiary chooses to go to a school outside the plan list, generally the fund administrators determine how much tuition your investment would buy, on average, and give that refund in cash, minus administrative fees. Because these plans restrict school selection, their appeal is generally limited to those fairly certain of their school selection.

The 529 Investment Plan is the more popular of the two types. These types of plans are sponsored by individual states and administered by investment houses. In Pennsylvania, the account is administered by The Vanguard Group. Typically, these funds allow you to choose your investment from a pool of mutual funds, depending upon how aggressively or conservatively you decide to invest. There is a \$25 minimum each time a contribution

is made. Certain plans offer special advantages for in-state investors, so it's important to take a look at your options.

What Is the Tax Treatment?

The Pension Protection Act of 2006 made permanent the federal tax-free treatment of withdrawals for qualified expenses from all 529 plans. In some states, in-state residents also receive a state tax deduction or credit on contributions. Pennsylvania allows, within limits, a deduction for a contribution to a 529 plan, and exempts rollovers, earnings, and distributions on all qualified tuition programs from state income tax. The difference in the federal tax treatment is that some prepaid tuition plans only allow for withdrawals for tuition, while others allow for other expenses such as room, board, books, and other equipment required for enrollment or attendance. When looking at different state plans, be sure to take this into consideration.

What Are the Contribution Restrictions?

In most states, anyone is eligible to participate in the plan, regardless of where they live. Some states, however, require either the student or contributor to be a resident. There is generally a difference in contribution levels between a college savings account and the prepaid tuition plan. The maximum investment

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limit in Pennsylvania is \$511,758 per beneficiary. For prepaid tuition plans, the maximum contributions are generally based on the current age of the child and the average cost at in-state universities.

Can You Change Beneficiaries?

If a beneficiary decides not to go to college, the designation on a 529 plan can be changed without income tax consequences to family members of the original beneficiary. There are gift-tax consequences, however, if the new beneficiary is of a younger generation than the original one. If a new beneficiary is not an option, and the account owner closes the plan, he or she is subject to federal and state income tax and a 10 percent penalty on earnings.

What Are the Financial Aid Implications?

While colleges and state and federal governments may help pay for some of a child's education costs, the primary share falls to families. This portion is called the expected family contribution (EFC). Two methods are used to calculate EFC. The federal methodology is used to determine federal financial aid eligibility. Some schools also use this method, while others use an institutional methodology for eligibility for nonfederal financial aid. College savings accounts are viewed as an asset of the contributor under the federal methodology, so the financial aid officer could count up to 5.7 percent of the account balance when developing your child's financial aid package. The institutional methodology also views college savings as a parental asset, which can be assessed at a rate between 3

percent and 5 percent, depending upon the total net asset amount. The federal methodology views prepaid tuition plans very differently. This money is viewed as an outside resource, similar to a scholarship. Potentially, financial aid need could be reduced dollar-for-dollar. The institutional methodology views prepaid plans the same as college savings accounts – as a parental asset – and can be assessed at a rate between 3 percent and 5 percent. Under state law, a Pennsylvania 529 account does not affect eligibility for higher education financial aid provided by Pennsylvania. For federal higher education financial aid purposes, a 529 plan is treated similarly as a savings or taxable investment account.

Choosing the Right Adviser

Saving for college is important, but so is retirement planning and reducing debt. Be sure that you and your children are ready for the financial challenges that may arise in the future.

If you elect to work with a financial adviser, it is important that you find one who you feel comfortable working with, who looks at your overall financial goals, and who understands tax laws. Here are some key points you will want to discuss with candidates:

- What are your qualifications?
- What is your educational background?
- Do you have any special designations?
- What are your areas of expertise?
- What is your investment approach?
- How often will you look at my portfolio?
- How are you compensated for your services? (Note: Most CPAs do not work on commission, but are paid on a fee basis.)
- How much can I expect to pay for your services?

The right adviser will get to know you and then use that information with the financial knowledge he or she possesses to present the best options available to you.

The PICPA offers resources for a variety of financial topics.

- ▶ Personal Finance
- ▶ Small Business
- ▶ Tax Help
- ▶ Fraud Prevention
- ▶ Retirement



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