College Costs Keep Going Up,
But You Don't Need An Advanced Degree To Find Ways To Save For It.
Just Check Out These Financing Options.

College Costs 101: A Short Course

CONGRATULATIONS ON YOUR NEW BABY! Have you started saving for college yet?

It's not too early. Children do grow up quickly. And higher education costs increase every year, at twice the inflation rate by some estimates.

The College Board's latest study found that in 2005 – 06 the average cost for one year at a public university was $15,566. Double that to attend a private school.

The good news is that despite those daunting numbers, you have several ways to come up with college cash. Before examining those strategies, though, you need to do a bit of groundwork.

Factor in Financial Aid

While it's wise to start saving for college as soon as possible, you also need to be aware of how financial aid might fit into or alter your plans.

"Three things affect financial aid," said Erin Hilton, a certified financial planner and CEO of Hilton Financial Group. "Number one is the student's wealth, the money that's held in the student's name. Next is the parents' income. Lastly, the parents' wealth.

"If the student does qualify or thinks that they'll qualify for financial aid, you'll want to reduce or basically have no child income."

Knowing just how financial aid will affect your child's college funding can be a bit of a guessing game, especially when you're trying to plan while your child's still a toddler.

Hilton suggested going to the Free Application for Federal Student Aid website (www.FAFSA.gov) and filling out the form, required to qualify for federal and state aid, as if your child is college age. Completing a mock one will give you an idea of what you need to consider as you start your savings efforts.

Now about those savings. Here are some of the more popular strategies.

529 Savings Plans

The consensus choice among families and financial planners, earnings in these plans grow tax-deferred and distributions are tax-free.

Another appealing aspect of 529s is that they are set-up by an adult who names the child as the beneficiary. Since it's not in the youth's name, it won't have as great an impact on aid applications.

"Any time the child is the owner of an account, when you submit a financial aid application, they take up to 35% of that amount into consideration," said Barbara Jackson, a principal with Jackson, Anciso & Frank. That percentage will drop to 20% next year, Jackson noted, but it's still substantially more than the 5.6% weight given to assets in a parent or guardian's name.

If you want to keep the plan totally out of the financial aid computation, Hilton suggested that the grandparents open the account.

The accounts do have a few drawbacks. The money can be used only for qualified school expenses. There's also a limit on how much one person can add to an account. The contribution is restricted to the annual gift tax exclusion amount, which for 2006 is $12,000 per person. The IRS will decide in a few months whether the amount should be increased for 2007.

$12,000 a year is sufficient to cover most contributors' largesse, but if you're able to give more to your favorite student's account, there are ways to do so. Make a lump sum deposit of up to $60,000 and have it treated as if it was made over five years. A married couple can each give that lump sum, doubling the contribution and immediately boosting the account's earning and compounding power.

If you want to stay within the annual gift limit, remember that it's per person. So a student's two sets of grandparents can contribute $12,000 each, totaling $48,000 in one year, to the savings plan.

Coverdell Education Savings Accounts

These accounts are also established by an adult with the child as the beneficiary, keeping the student's assets within acceptable financial aid parameters.

Like a 529, anyone can contribute to the account. However, a Coverdell has a few more restrictions. Only $2,000 a year is allowed from all contributors, not $2,000 from each. Also, if you make a lot of money, you can't contribute. In 2006, the earnings limit was $110,000 for single individuals, double that for couples who file joint returns.

On the other hand, Coverdell spending rules are more flexible. While most tax-favored education accounts must go toward higher education costs, you can use Coverdell money to pay expenses from kindergarten to college, allowing you to use the funds, for example, to buy your junior high student a new computer.

Custodial Accounts

Before 529 plans were created, adults regularly set up investment accounts in a child's name and acted as custodians of the funds until the child reached legal age. Established under the Uniform Gifts for Minors Act (UGMA) or the Uniform Transfer to Minors Act (UTMA), these accounts also offered some tax benefits.

Those tax breaks, however, were recently reduced. Where previous account earnings were taxed at the

Story by S. Kay Bell
Photo courtesy of The University of Texas

On Paying For Your Child's Education

child's lower tax rate between the ages of 14 and 18, they now are taxed, for the most part, at the adult's higher rate until the child turns 18.

The news isn't totally bad. Up to $850 in account earnings this year are tax-free. The next $850 is still taxed at the child's rate. But once the earnings exceed $1,700 (the amount could be increased next year to reflect inflation), then the so-called "kiddie tax" kicks in, taxing the money at the parents' rate. If you opened one of these accounts for your child and the earnings are below or not much more than the limit, the tax costs might not be too severe.

Plus, these accounts offer more spending flexibility. The money can be used for anything as long as it benefits the child. That option is part of the reason why Jackson established an UGMA account for her granddaughter.

"Maybe she can use it to get a car or go to Europe," said Jackson. The vehicle can ensure she's able to get back home for visits between semesters and the world travel is definitely an educational experience, even if it's not technically recognized as such by the IRS.

On the downside, these accounts can cause financial assistance trouble since they belong to the child.

Raiding Retirement Funds

Although most financial advisors counsel against it unless it's an emergency, your retirement account can help pay for college.

IRA money, from either a Roth or traditional account, can be withdrawn to pay qualified education expenses. With a Roth, there's no penalty for taking out contributions since you already paid taxes on them. In the case of a traditional IRA, you'll owe taxes on your distribution, but not the usual early withdrawal penalty.

You can borrow from your 401(k), but you'll have to pay back the money. Still, it might be an acceptable short-term answer if a tuition bill is looming and you don't have any other resources.

If you do raid your retirement savings, make sure your child gets a good education that will lead to a well-paying job, since your withdrawals could mean you'll be depending on him or her for help in your Golden Years. ★

Six Often-Overlooked Ways to Help Cover College Costs

1. **Set up a payment plan.** Many colleges now offer tuition payment plans. The programs vary by school, but they basically let you budget your payments to better fit your finances. Some allow for installments made over several months, others want a lump sum per semester. Check with your school to see if it offers such an option.

2. **Find a fixed-rate school.** Some universities offer this option, where the price you pay for freshman year will be the price you pay in subsequent years. This is different from prepaid plans set up by states (and no longer available in Texas). Here, the school administers the program.

3. **Ask for direct help.** Direct in this case means directly to the school. While there's an annual limit on how much an individual can give without facing tax consequences, it doesn't apply when the money goes directly to the school. So when your rich uncle offers to help out, have him write that big check to the university instead of to you.

4. **Get your boss to pitch in.** Some companies offer a tuition reimbursement plan. For students who work while in school, this can be a great help and even make up for a salary that might be a little less than you'd like. So be sure to ask about such a benefit when you go job hunting.

5. **Go to summer school.** Some colleges lower tuition for summer sessions. It might not be fun giving up your traditional school break, but it could offer substantial savings.

6. **Seek out scholarships.** Unlike student loans, scholarships do not have to be repaid. And while there are requirements, either academic or based on areas of study, many scholarships go unawarded each year because no one applies for them. The Institute for Higher Education Policy estimated that scholarships awarded in 2003 – 2004 totaled more than $3 billion, with the average undergraduate scholarship coming to $1,982. Check with your university about its scholarship program and application process. You also can get an idea of the various scholarships out there at FinAid.com or conduct your own search at FastWeb.com, CollegeAnswer.com and ScholarshipExperts.com.