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2nd Edition

529 & Education Savings Plans

for
dummies[®]
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Save for the best possible education for your family

Explore the benefits of K - college savings plans

Learn to use the US tax code to your advantage

Margaret Atkins Munro EA

Author, *Estate & Trust Administration For Dummies*, co-author, *Taxes For Dummies*

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by Margaret Atkins Munro EA

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Introduction

Welcome to *529 & Education Savings Plans For Dummies*, the practical reference for those who are thinking about and planning for all types of education in the future for themselves or those nearest and dearest to them and who want an explanation of all the options — pro and con — that can help them save for it.

Education. Whether you've had an abundance of it or feel that you're missing a few courses here and there, you've read all the information, looked at the charts and graphs, and know that people with the best educations land better jobs and earn better pay than those who don't. So, of course, because you want the very best for yourself and your family (you do — that's why you're reading this), you want everyone you know, including yourself, to have that opportunity.

That is until you look at the price tag. You're already paying for food, housing, and clothing (not to mention phone, cable, insurance, and everything else under the sun, including dog grooming) and maybe even stashing a little bit into your retirement plan. And then, you sneak a peek at the projected cost of private school or college for the year in which your student expects to begin. And just as you never look at the least wrinkled car in a car crash, your eye automatically drifts to the highest number on that chart of projected costs. And you begin to see stars.

There's no question: Education costs continue to soar, even when the rest of the economy stagnates, and this reality is not likely to change any time soon. Fortunately, everyone, including you, the various governments (federal and state), and the schools themselves, are in on this secret. Everyone can plan well in advance of that eventual first day of school — whether it's kindergarten or graduate school — and plot ways to get that child there and how to help you pay the bills when they come due. Consider this book to be your accomplice.

About This Book

The world of education savings plans is forever changing (or so it seems, as legislative leaders can't seem to resist continuously tweaking the laws). This is another way of saying that it also can be complicated and confusing for everyone, including professionals, financial planners, tax folks, and your local bank or brokerage.

In this one-size-fits-all world, the powers that be have recognized that all people don't save money the same way. Some save more, some save less, some can live with risk, and others can't tolerate any risk. Clearly, no two are alike, but you're all present or potential savers. Numerous options exist that make saving possible and desirable for everyone.

Piling savings option upon savings option has created opportunities for most people. But all the new options have also muddied the waters because choosing between Plan A and Plan B can be downright difficult when they seem so similar. So, many people may choose to opt out, admitting confusion and doing nothing because it's all so confusing, and no one wants to screw up a choice with so much riding on it.

And yet, it doesn't have to be that way. I'm here to tell you that it is possible to understand the costs associated with education, both right now and in the future. It's also possible to find ways to pay for those costs in the most advantageous manner for you, both from a personal and tax perspective. And you can't focus on the personal and ignore the tax implications, nor can you do the reverse. Both are essential components, and the most successful savings program considers both elements.

That's where this book comes in. It's designed to explain the strategies out there to help you save, save, save. There's no doubt that the bill will be large; there's also no question that, with planning, strategy, and purpose, you can achieve your goal and provide the means that will allow you and your family all the benefits of a quality, paid-for education.

529 & Education Savings Plans For Dummies is simply a way to find a reasonable solution to a seemingly unreasonable problem: saving for future education costs in the sanest, least stressful way possible. In keeping with the theme of stress reduction, you can use this book in a variety of ways:

- » **As a reference:** It's all here: the ins, the outs, the do's, and the don'ts. The world of education savings is one of very specific rules, and they're here, in all their glory, and they're all explained.
- » **As an advisor:** It's a case of the very good savings techniques, the merely okay savings techniques, and the truly ugly techniques (which you really want to avoid), and this book highlights them all. Indeed, what works for you may not work for your neighbor, but every savings option involves risks, concerns, and just-plain crystal ball reading. This book explores all the ups and downs and ins and outs.
- » **As a little light reading:** Amazingly enough, the topic of money can be mildly amusing, and education savings is no exception. Read this with an eye toward the absurd, and you won't go far wrong.

Parts of *529 & Education Savings Plans For Dummies* are about very specific situations you will most likely never encounter. Still, this book would be lacking as

a complete reference if I didn't include a lot of the minutiae in the text on the chance that someone, somewhere, may need to know what happens to a Section 529 plan in the event of a death of a plan owner, for example.

Also, as a caution, be aware that any projections in the book are just that: projections. I have no special hotline to the powers that determine rates of returns on investments, increases in tuition payments, inflation rates, tax rates, utility rates, or postage increases (which might be really useful). Increases and decreases may be greater or lesser over time — I have no way of really knowing. All the projections should provide you with is a picture of relationships between like numbers; don't read any more into my crystal ball projections than that.

Conventions Used in This Book

To help you navigate through this book, I use the following conventions:

- » Italic is used to emphasize and highlight new words or defined terms.
- » Boldfaced text indicates keywords in bulleted lists or the action part of numbered steps.
- » Monofont is used for Web addresses.
- » Sidebars, which look like text enclosed in a shaded gray box, consist of information that's interesting to know but not necessarily critical to your understanding of the chapter or section topic.

Foolish Assumptions

The world of money and taxes is rife with assumptions, foolish and otherwise. Here are some of the assumptions I've made about you:

- » You're not aware of the variety of ways to save for education available to you, or you're aware but baffled by the number of plans or the way the plans work.
- » You may have some idea of how much sending Junior to college will put you back, but you need more details.
- » If you've been saving for college and now find out that you can pay for private school tuition with your plan, you probably feel as though you're not saving enough.

- » You can't walk into a bookstore or surf the Internet without buying every book you see with a snazzy, eye-catching, strikingly-appealing, jaw-droppin', good-looking, yellow-and-black cover.
- » If you're not yet saving for any form of education, you may feel that you don't have room in your budget for that expense. After paying your monthly living costs, you may have nothing left to save.

If you identify with any of the above, *529 & Education Savings Plans For Dummies* gives you the information you need to start saving or kick your savings into high gear.

How This Book Is Organized

This book takes all the different components of education savings — from its necessity, through all the different sorts of savings plans, and finally to how to augment with grants, loans, and scholarships — and breaks them down into easily digestible chunks (okay, *parts*, if you want to get technical about it). Each part is comprised of a few chapters. The following briefly describes each part:

Part 1: Figuring Out the Cost of Education — and How to Pay It

There's no question; the number is huge, but how huge is it? Sounds like the start of a bad joke, eh? Well, it isn't a joke, but dealing with the big cash question doesn't have to be that bad. After a brief overview of the scope of the book, this part looks at the current and projected future cost of education, including primary and secondary schools, apprenticeships, vocational and trade schools, public and private colleges, two- and four-year institutions, and graduate and professional schools. It focuses on savings techniques, and finally, it lets you know who's available to make contributions to the savings pool.

Part 2: Piecing Together Section 529 Plans

A venerable member of the education savings plan sweepstakes, Section 529 plans offer seemingly unlimited choices and high contribution limits (at least if you listen to the people who are trying to sell you their particular plan). This part

dissects these plans, explaining how they work, why they work, and when they work — or don't — as the case may be.

Part 3: Uncovering Coverdell Accounts

Coverdell Education Savings Accounts (formerly known as Education IRAs) have now become real players in the education savings arena, and more and more financial advisors, banks, and brokerages are touting their benefits. This part explores them in full detail, showing their good and bad points and explaining how and when they might (or might not) make sense for you.

Part 4: Filling In the Gaps: More Ways to Save for Education

Saving for education has been around a lot longer than Section 529 plans or Coverdell accounts. So Part 4 examines some of the more traditional ways to save and shows situations where these tried and true methods still may make sense for you. But what happens when all else fails and your savings come up a bit short? This part explains how the world of financial aid works — loans, grants, and scholarships — and how the money you've saved for college may factor into financial aid decisions.

Part 5: The Part of Tens

It's the part you've hopefully come to know and love. The *For Dummies* Part of Tens — this time with an education-savings twist. Do you like easily accessible top-ten lists? Here you go. The whole point of so-called “education savings plans” is first, to save, and second, to pay as little tax on your savings as possible. The chapters in this part give you hints on saving successfully and tell you what you must do to dodge as many taxes as possible. The book includes one final element that's not technically a Part of Tens — it lists *way* more than ten things. But I thought I should let you know about the appendix, which gives you a more detailed look at the various Section 529 plans offered by each of the 50 states and the District of Columbia, plus one private prepaid tuition plan. The appendix gives you an apples-to-apples comparison of what is currently out there so you can make the best decision for your particular situation.

Icons Used in This Book

The icons you come across in this book identify information or words of caution that you may find especially helpful.



REMEMBER

You have a lot to remember when trying to slot your savings into the rules and regulations surrounding many of these education savings plans. This icon alerts you to important information you don't want to forget because it can often make the entire process of saving for education go a lot more smoothly.



TECHNICAL
STUFF

If you're the type of person who always needs to know more than the basics, check out the information next to this guy. It points out information that you don't absolutely need to know to save (but you can always use it to impress your friends).



TIP

Life is rarely straightforward, and saving for education may be even less so. When you see this icon, you'll find a strategy to help you get the most out of your savings or make it easier to put money away.



WARNING

This book is littered with ideas of what not to do if you want your education savings plans to succeed. When you find this icon, you've just landed on one of them.

Beyond the Book

If you want to go beyond this book, check out the Cheat Sheet, where I summarize the different college savings plan avenues available to you, from 529 plans, Coverdell accounts, Series EE and Series II savings bonds, and other savings vehicles.

Where to Go from Here

If you want to and have the time, you can read this book from cover to cover. This book gives you a great view of how much, how, and where to save money for education. But if you don't have the time or the interest, you may choose to hop around from topic to topic, skipping those that don't apply to you and paying more careful attention to those that do. That's one of the great things about *For Dummies* books. You can get in and get out wherever and whenever you choose. If the information you need to understand a certain topic is covered elsewhere, the text will direct you, so you don't need to worry that you're missing basic information by skipping over a portion of the book.

1

Figuring Out the Cost of Education — and How to Pay It

IN THIS PART . . .

The skinny on education savings

Get the down-low on education costs

Find out what resources are available

Discover the tax implications of funding education savings accounts

IN THIS CHAPTER

- » Figuring out what and how to save
- » Considering Section 529 plans
- » Taking a look at Coverdell Education Savings Accounts
- » Evaluating other savings options
- » Making the most of your savings

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



REMEMBER

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



WARNING

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.