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FUNDING THE FUTURE: DESIGNING YOUR FAMILY'S COLLEGE SAVING PLAN

Saving for college is a very individual experience. You will want to consult with your favorite lawyer and your trusted CPA before you carry out any of the ideas I'm about to discuss.

Wall Street makes a lot of money by scaring young parents witless with overstated estimates of what college will cost. They are inflating the costs to make you feel confused and scared so that you will rush to them for advice. Common sense indicates that Harvard and Stanford and medical school will cost a bundle. Fresno State and CSUMB will cost much less. Yet Wall Street creates an atmosphere of guilt and fear by suggesting that you are not a perfect parent if you don't pre-save explicitly for junior's Ph.D.

Another complication emerges when you look at the relative value of a college education. After two decades of watching my clients struggle to send kids to college, I would argue that some educations are worth the cost, and some are not. As I study my successful clients, I note that college is a tremendous pre-indicator of future financial success.

However, it appears to me that where the tyke attends college is much less important. Coaxing the wunderkind into a lifelong habit of creative thinking and life management is much more important than where he or she goes to school.

In a nutshell, here is my plan for sending a child to college:

1. **Raise mature, money-wise, ethical children with superb GPA's. The money to go to college will to some degree follow.**
2. **Make yourself and your family as wealthy as possible as soon as possible. The best college plans won't work if you can't bring yourself to save or conserve. The details of how you save are much less important that the fact that you save in the first place.**
3. **Relax. Creativity and enthusiasm trump a big college fund any day of the week. You don't know where your prodigy will attend school, or what the major will be. So you'll never know how much you need to save until it's too late. Hence my rule #2: make yourself and your family as rich as possible, as soon as you can.**

There are several options to save for college: the **529 Plan**, the **Educational IRA**, also known as the Coverdell, the **custodial account**, and simply **saving in your own name**. These all have benefits and disadvantages.

The **529 Plan** is a federally approved program managed by the states. These plans allow you to contribute after-tax money, have it grow tax-free, and then use that money tax-free to pay for important college costs.



Some states have good plans, but some are mismanaged, and some are overpriced. The 529 Plan is attractive when you want to front-load the plan with a big chunk from Grandmother. For example, Grandmother could contribute \$60,000 to a 529 Plan and spread that contribution over five annual \$12,000 gift tax deductions.

You don't have to use your own state's plan. The best plans, according to Morningstar, are Alaska's T. Rowe Price College Fund, Nebraska College Savings, Virginia College America, and the Utah 529.

So why am I not using a 529 for my own children? 529's are fairly restrictive about what you can use the money for. You can pay for college tuition, room and board, and that's about it. If you take the money out early or misapply it, you face taxation of the gains as ordinary income and an additional 10% penalty. And, let's face it, I'm a control freak. I like to have more control over the money under management, and I want more flexibility to spend the money for my children's benefit. For example, if I'm able to pay for the children's college out of pocket, I want the money I've saved to finance their first houses.

If you aren't going to put a big chunk away for your ankle biter, but instead will save smaller amounts through the early life of your child, you might prefer an **Educational IRA**, which is also called a "Coverdell" account. You can only contribute a maximum of \$2,000 per year to a Coverdell, although the maximum is increasing.

An Educational IRA also offers the benefits of more flexibility, more control of your money, and greater transparency. In other words, you have more choices and you can see what's going on. This savings plan will also allow you more spending flexibility than a 529. For example, you'll be able to use these funds for high school or education abroad. Check out Vanguard or T. Rowe Price on-line for investment choices.

Before the Coverdell and the 529 Plans were glints in a Congress-person's eye, there was the **custodial account**. A custodial account allows you to transfer money to a minor but retain control until the child is age 18. The advantages of the Uniform Gift To Minors Account, or "UGTMA", are increased flexibility and the ability to spend on behalf of the child without outside constraints. The disadvantage is that there are no tax deferrals, except you can transfer the tax exposure to the child. The great flexibility of this account is balanced by the fact that your genius theoretically owns the money once he or she turns 18. Picture your 18-years-and-one-day-old prodigy in a new Corvette. I'm trying to convince my 15-year-old daughter that our 1995 Windstar minivan is very, very chic.

Parents who are making too high an income to qualify for financial aid often forget the creative possibilities of student loans. Assuming that your child is enrolled in an educational process which will lead to a higher income, these loans may make a great deal of sense. Co-sign them with your child. After all, who is in a better place to repay a debt after graduation: a newly minted lawyer or a parent in his or her later earnings years? This is also a great gut-check to ensure that the student takes his or her education seriously. Besides, you can always help repay the debt if your family income allows.

Which brings us back to our final savings gambit, which is frequently forgotten: simply **saving for you**. Of course this choice gives you the most control, and you'll be able to guide your early-adult child if he or she goes to grad school. Also, if he or she goes to school later, as an adult, your assets are not the child's assets. This would open up more opportunities for your student to qualify for financial aid as an independent adult.

In an emergency, consider using your own IRA to fund your child's core educational needs. According to IRS Code Section 72(t)(2)(E), you will pay ordinary income on the withdrawal, but not the normal 10% penalty for an early distribution. Using your own IRA will give you the advantage of total control over the money. Of course, the disadvantage will be that you are hollowing out your own future retirement. Obviously you will want to consult your CPA before doing this. Such a choice would be most effective when you are able to save the maximum your IRA allows, but your child's college plans are dubious or in flux.

One of the mistakes I have seen parents make is to completely impoverish themselves in order to finance their children's educations. If the goal of life is to seek happiness, spiritual awareness, and success, then balance is a key component. As with everything, education is part of the larger life experience. Whatever helps the entire family to become more happy, healthy, rich, and strong will probably be in the best long-term interest of your child. 🎓

Steve Chang CPA contributed to the facts of this article.

Steve Wozniak on Creativity

"The best things I've ever done happened when I lacked the resources and knowledge I needed to accomplish my goal beforehand."

- Steve Wozniak, Co-Founder, Apple