

MONEY AND YOU



Investing in your kids, part I: Saving for college

[By Carrie Schwab Pomerantz]

What's the best way to invest in your children's futures? And I'm talking about financial investments, not the figurative - but even more important - investments we make of our time, our energy and our love. If you can afford to put money away for your kids, you have some choices to make. As is the case with most investment planning, understanding your goals will help you make the right choice. In this first article of two on the topic "Investing in Your Kids," I explore ways to reach the No. 1 goal of most parents today: paying for higher education.

NEWSFLASH: COLLEGE IS EXPENSIVE

Every September we're bombarded by stories of the high cost of higher education. And it's undeniably true that college is expensive and getting more so, especially at the elite private colleges, where a year's tuition, room, and board can easily top \$40,000. But don't be discouraged by the really big numbers; most students don't pay anywhere near that much.

According to the College Board, the average cost for tuition, fees, and room and board at a four-year private college for 2006-2007 was just over \$30,000. The comparable figure for a four-year public college was just under \$13,000. Plus, a huge number of families qualify for some form of financial aid (grants) and virtually any student can get a student loan.

Of course it's still a good idea to save and invest, as early as possible, for your children's higher education. Saving now will be cheaper than borrowing later. The government has created a tax-advantaged option called the 529 plan. Each state sponsors its own 529 plan, managed by professional investment companies, and you are free to invest in the plan you like, though check your state's plan to see if there are any state income tax benefits.

You make and control the investments, and the account is held in your name with the child as the beneficiary. You can start with very modest sums, particularly if you agree to make regular, automatic contributions. Most plans allow you to choose from a variety of portfolios that are either age-based, becoming more conservative as your child nears matriculation, or static (it's up to you to make changes).

A TAX-ADVANTAGED WAY TO SAVE

The big benefit: You pay no taxes on any investment gains or income as long as distributions are used for qualified higher education expenses. If a child doesn't use the assets, or doesn't use all of them, you can transfer 529 balances to another child or even to another family member with no tax penalties.

A lot of parents worry about whether 529 plans and other assets will hurt their children's chances of receiving aid. The answer is yes, but not as much as you might think. College financial aid calculations for need-based grants always take into account parental assets and student assets; however, they typically expect only a fraction of those assets to be used in any given year. Formulas vary, but in general I believe that the benefits of using 529 plans, the

investment potential for growth and their tax-advantaged structure, outweigh the risks of losing some financial aid. And to eliminate that concern, grandparents can open and fund a 529 account without any financial aid impact at all.

Another advantage is being able to put a lot of money into 529 accounts; most plans will allow you to contribute at least \$200,000 per child, including a lump sum of up to \$60,000 - or \$120,000 per couple - without triggering the gift tax. But even more modest contributions add up: If you could save \$3,000 annually in a 529 plan for the first 18 years of a child's life and earn an average of 7%, your kid would turn 18 with a little more than \$100,000. Although this may sound like a lot in terms of today's dollars, you also have to factor in the realization that college costs are rising approximately 5% to 8% a year. And of course there is always the possibility of losing money while invested in the plan.

Another federally legislated, tax-advantaged educational investment opportunity is the Education Savings Account (ESA), sometimes called a Coverdell account. ESAs function similarly to 529 plans, but eligibility is limited by income. Joint filers can earn no more than \$220,000 and single filers no more than \$110,000 to be eligible to open an ESA;



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contributions are limited to \$2,000 per year. However, ESAs do offer some advantages. You can invest ESA assets in any listed fund or security (typically 529 plans have limited investment options), and ESA withdrawals can be used for elementary and high school expenses as well as college. But for most people, the 529 plans offer a chance to save considerably more.

College may be the only financial goal you have for your child. Check back next week when I take a look at custodial accounts.

The tax laws surrounding custodial accounts (the "kiddie tax") have changed substantially in the last year; therefore, if you have a youngster in your life, be sure not to miss this installment.

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