Planning Options to Help Families Fund a Child's Education

There are a variety of strategies available to fund a child's education, including Section 529 plans, Coverdell Savings Accounts, and trusts. This article describes, in a summary table, the important features of these strategies.

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Saving for college costs is a priority for many clients. The 2001 Tax Act made Section 529 plans more flexible. Tax-free rollover rules and tax-free transfers between plans were liberalized so that if the Section 529 plan balance cannot be used by the particular beneficiary for education costs, then the account owner can transfer the plan benefits to another beneficiary until the amounts are used appropriately. The definitions of family members and qualified higher education expenses were expanded. These substantial advantages have made Section 529 plans the "darling" of media articles on planning for children and college costs.

Despite the many advertised benefits, however, Section 529 plans are not the only planning answer. For many client situations, they are not the ideal answer.

To help clients see the "big picture" necessary for planning, many of the details—even key details—must be overlooked at the initial phase of planning. The following summary chart provides a tool to help clients consider and compare many of the options. The objective is not to be thorough or even in some instances fully precise, but rather to focus the client on the many strategies and factors to consider. This chart can then be used as the starting point to a more comprehensive client-oriented analysis.

A few examples illustrate the diversity of proper planning, which too often is overlooked by clients and the media articles that they read:

- A client adversely affected by the stock market decline, and feeling pressure to pay for current private elementary school tuition bills, may prefer the flexibility of a Coverdell account to pay for pre-college expenses.
- A client fearful of a job loss, as a result of the economic decline, may be better off saving in a custodial account to assure wide availability of funds for any need of the child, in the event future circumstances necessitate.
- A client fearful of a job loss following a depletion of savings may be better off saving in his or her own name if asset protection issues are not paramount, to assure even wider availability of funds if needed in the future.
- A wealthy client whose grandparents will likely pay the costs of a child's education may not need a Section 529 plan, and may use a trust as part of a comprehensive plan to reduce future estate taxes.
- A client of moderate wealth concerned about an estate tax but unable financially to make substantial gifts may use a family limited partnership (FLP) or limited liability company (LLC) to reduce estate taxes by reducing each spouse's ownership to a less than 50% non-control position. In such instances, gifts of moderate percentages of the FLP/LLC to the children would decrease each parent's ownership below a 50% control position.

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- A client who likes to time the markets as an investment strategy might prefer a trust in order to have more flexible investment options than Section 529 or Coverdell plans permit.
- If a child has or may have special needs, a Section 529 or Coverdell plan would likely be inappropriate.
- In a divorce situation, a trust with an independent trustee (such as a bank or trust company) might be the best option. This would safeguard the abuses that either ex-spouse as an "account owner" of a Section 529 plan might inflict.

The key point is that clients often need assistance in taking a broader view of college savings planning; the following chart can be used as a practice aid in this regard.

EXHIBIT 1
Comparing Planning Options for Minor Children and Other Heirs

Structure and Format/ Characteristic	Parent Retains and Invests Funds	Custodial Account (UGMA/ UTMA)	Trust for the Benefit of a Minor	FLP/LLC Interest	Coverdell Savings Account (Education IRA)	Section 529 College Savings Plan
Parent's Income Limit	None.	None.	None.	None.	Right to contribute phased out at Income from $95,000-$110,000 (Married, $190,000-$220,000).	None
Creditor Protection	Full exposure to parent's creditors. Not exposed to child's creditors.	No exposure to parent's creditors. Exposure to child's creditors.	Protected from parent's creditors as a completed gift. Protected from child's creditors by spendthrift clause (perhaps, except for necessaries) so long as asset is held in trust, subject to trust distribution standards.	Protection against child's and parent's creditors via barrier of agreement and state law (e.g., assignee versus substitute partner/ member).	Completed gift, which should be protected from parent's claimants.	Completed gift but can be used by account owner/ parent to discharge a parent's legal obligation of support. Account owner may be able to retrieve funds subject to 10% penalty. Query: might the account owner's creditors assert this? Child's creditors should not have access,