RAYMOND JAMES

Grading your education savings options

A guide to the key features of education savings plans to help you make an informed choice.

When it comes to saving for a child's or grandchild's education – perhaps even for your own – you have options. Here's a quick introduction to five common savings accounts to help you decide which education funding strategy is right for you.

529 SAVINGS PLAN

A 529 savings plan is a flexible, state-sponsored savings account that can be used to cover qualified primary, secondary and college/post-secondary expenses in the United States and some foreign locations. These plans typically invest in portfolios of mutual funds. In addition, fixed income options may also be available, depending on the plan provider. Earnings in 529 plans are not subject to federal tax and in most cases state tax, as long as you use withdrawals for eligible education expenses, such as tuition and room and board. However, if you withdraw money from a 529 plan and do not use it on an eligible education expense, you generally will be subject to income tax and an additional 10% federal tax penalty on earnings.

As with other investments, there are generally fees and expenses associated with participation in a 529 plan. There is also a risk that these plans may lose money or not perform well enough to cover education costs as anticipated. Most states offer their own 529 programs, which may provide advantages and benefits exclusively for their residents. Investors should consider, before investing, whether the investor's or the designated beneficiary's home state offers any tax or other benefits that are only available for investment in such state's 529 plan. Such benefits include financial aid, scholarship funds and protection from creditors. The tax implications can vary significantly from state to state.

CONTRIBUTIONS

- Up to the maximum account size (varies by program over $500,000). Lifetime gift tax exclusion may be impacted.
- No limit on the income to contribute
- No age limitation to contribute
- Annual federal gift tax exclusion is $19,000 for 2025

DEDUCTIONS

- No federal deduction for contributions (state deductions vary by plan and account owner's state of residence)

WITHDRAWALS

- Account owner controls withdrawals
- Proceeds must be used to cover expenses[1] for primary, secondary and college/post-secondary programs in the US and qualifying foreign programs

TAXATION

- Account earnings are tax-deferred
- Qualified withdrawals vary by the account owner's state of residence
- Nonqualified withdrawals are taxed on the federal and state levels at the account owner's or beneficiary's rate, depending on to whom the 529 plan provider directs and reports the distribution
- 10% penalty on earnings for nonqualified withdrawals

OTHER

- Plans are assets of the account owner
- Reduces federal aid by 2.6% to 5.64% of the 529 plan's value[2]
- Plan beneficiaries can be changed[3]
- 529 plan funds are removed from the donor's estate[4]

529 PREPAID PLAN

These plans offer many of the same features and options as a 529 savings plan with one important distinction – they allow you to purchase a certain percentage of tuition credits for in-state postsecondary programs over time that is guaranteed to be equivalent to the same percentage of tuition in the future.

CONTRIBUTIONS

- Vary by type of contract
- No limit on income to contribute
- No age limitation to contribute
- Annual federal gift tax exclusion is $19,000 for 2025

DEDUCTIONS

- No federal deduction for contributions (state deductions vary by plan and account owner's state of residence)

WITHDRAWALS

- Account owner controls withdrawals
- Proceeds must primarily be used for tuition/fees from in-state postsecondary programs; in many cases, proceeds can be used for out-of-state tuition, but rates may not be equivalent

TAXATION

- Account earnings are tax-deferred
- Qualified withdrawals vary by the account owner's state of residence
- Nonqualified withdrawals are taxed on the federal and state levels at the account owner's or beneficiary's rate, depending on to whom the 529 plan provider directs and reports the distribution
- 10% penalty on earnings for nonqualified withdrawals

OTHER

- Plans are assets of the account owner
- Reduces federal aid by 2.6% to 5.64% of the 529 plan's value[2]
- Typically, plan beneficiaries can be changed (see specific plan rules)
- Typically, 529 plan funds are removed from the donor's estate (see specific plan rules)

UGMA/UTMA

These options, established under the Uniform Gifts/Transfers to Minors Act, enable you to transfer ownership of assets to your child without needing to establish a more costly trust. UGMA investment options include cash, bank accounts, stocks, bonds and mutual funds; UTMA options may also include real estate, limited partnerships, fine art patents and royalties.

CONTRIBUTIONS

- No annual limit. Lifetime gift tax exclusion may be impacted.
- No limit on the income to contribute
- No age limitation to contribute

DEDUCTIONS

- Not tax-deductible

WITHDRAWALS

- Control of withdrawals transfers to child upon age of majority (or later if state law permits)
- Proceeds used are available to any types of expenses for child's benefit

TAXATION

- Accounts are taxable; Kiddie Tax: Under age 19, any investment income over $2,700 taxed at parent's federal rate[7]
- No withdrawal penalties

OTHER

- Accounts are assets of the beneficiary
- Reduces federal aid by 20% of the UTMA/UGMA value
- Plan beneficiaries cannot be changed
- Typically, plan funds are removed from the donor's estate unless the donor dies while acting as custodian

COVERDELL ESA

Formerly known as the "education IRA," this savings alternative is a trust or custodial account used for education expenses. Investment options may include a wide range of securities.

CONTRIBUTIONS
- $2,000 per year per beneficiary
- Income contribution limit $95,000 to $110,000 for single filers, tax $190,000 to $220,000 for married filers
- Age limitation: contributions stop when child turns 18

DEDUCTIONS
- Not tax-deductible

WITHDRAWALS
- Account owner controls withdrawals; beneficiary has legal right to be named account owner at age of majority
- Proceeds must primarily be used to cover expenses for college/postsecondary programs in the US; some foreign programs and expenses[5] from elementary and high school also qualify

TAXATION
- Account earnings are tax-deferred
- Qualified withdrawals are tax-free
- Nonqualified withdrawals are taxed at the account owner's rate
- 10% penalty on earnings for nonqualified withdrawals

OTHER
- Plans are assets of the account owner
- Reduces federal aid up to 5.64% of the Coverdell plan's value if the parent is the account owner[2]
- Plan beneficiaries can be changed if the beneficiary is under age 30[3]
- Plan funds are removed from the donor's estate[4] Roth IRA

ROTH IRA

You can withdraw funds, tax-free in certain circumstances, from a Roth IRA to pay qualified higher education expenses. While this may seem like a viable savings option, remember that you will be spending your retirement savings. Investment options include a wide range of securities.

CONTRIBUTIONS
- The lesser of $7,000 or 100% of earned income plus $1,000 for those age 50+
- The income phaseout on contributions is $150,000 to $165,000 (single and head of household), $236,000 to $246,000 (married filing jointly) and $0 to $10,000 (married filing separately).[7]
- No age limitation to contribute

DEDUCTIONS
- Not tax-deductible

WITHDRAWALS
- Account owner controls withdrawals; beneficiary has legal right to be named account owner at age of majority
- Proceeds must primarily be used to cover expenses for college/postsecondary programs in the US and qualifying foreign programs

TAXATION
- Withdrawals of contributions are tax-free
- 10% penalty on earnings waived for qualified higher education expenses
- Earnings taxed as ordinary income (unless certain other requirements are met[6])

OTHER
- Withdrawals for education are treated as income for federal financial aid
- Plan funds are not removed from the donor's estate

[1]Primary and secondary tuition expenses only

[2]In most cases, if the student's grandparent is account owner, the asset will not be included in the financial aid formula, but withdrawals from a grandparent-owned 529 may affect the income portion of the formula. This pertains to the federal student aid formula. Other types of financial aid may have different rules.

[3]There are no tax implications as long as the "new" beneficiary is a member of the original beneficiary's family and from the same generation. A family member of a designated beneficiary is a son, daughter, grandson, granddaughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, father, mother, stepfather, stepmother, niece, nephew, aunt, uncle, first cousin, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law, spouse or the spouse of any of the foregoing individuals. For this purpose, a child includes a legally adopted child, and a brother or sister includes a brother or sister by half blood. If the new beneficiary is a family member from a younger generation, the transaction may subject the original beneficiary to gift taxes and generation-skipping transfer taxes. The beneficiary may be changed to a non-family member; however, this is not a tax-free transaction.

[4]If the contributor front loads the contribution (e.g., $75,000 contribution in a single year), then dies within the five-year period, a prorated portion of the contribution may be included in the contributor's estate.

[5]Tuition, fees, academic tutoring, special needs services, books, supplies and other expenses which are incurred in connection with the enrollment or attendance at a public, private or religious school and expenses for the purchase of computer technology or equipment or internet access to be used by the beneficiary during any years the beneficiary is in school.

[6]Tax-deferred. Tax-free only if the five-year requirement is met and the withdrawal is for death, disability, attainment of age 59 1/2 or are taxable at the account owner's rate. 10% penalty on earnings and any conversion amounts withdrawn unless some other exception to the penalty applies. Distributions from a Roth IRA come out of the account in the following order: contributions, conversion amounts, earnings. Exceptions to the 10% penalty are: death, disability, attainment of age 59 1/2, first-time homebuyer, qualified higher education expenses, substantially equal payments, medical bills greater than 7.5% of AGI, and medical insurance premiums after losing a job. Favorable state tax treatment for investing in a Section 529 savings plan may be limited to investments made in a Section 529 plan offered by your home state.

Roth IRA owners must be 59 1/2 or older and have held the IRA for five years before tax-free withdrawals are permitted.

The income phaseout on contributions is $138,000 to $153,000 (single and head of household), $218,000 to $228,000 (married filing jointly) and $0 to $10,000 (married filing separately).

[7]https://www.forbes.com/sites/markkantrowitz/2022/11/22/new-2023-irs-income-tax-brackets-and-phaseouts/#:~:text=The%20Kiddie%20Tax%20thresholds%20are,for%20three%20or%20more%20children."

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