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Consider Prepaid Tuition Plans for College Savings

If you're currently investing for your children's college education or are planning to do so in the near future, you may want to consider a state-sponsored prepaid tuition plan. Generally speaking, these plans, which are now available in many states, allow you to pay tomorrow's tuition bills at today's tuition rates. In addition, they are exempt from federal income tax and are often exempt from state and local taxes as well; however, favorable state tax status may be limited to a state's own plan.

Since these plans work, in part, as insurance against rising college costs, there is some degree of speculation involved. Parents come out ahead if the tuition costs rise faster than the average and would do worse if college costs did not rise as fast. Historically, tuition costs have risen, keeping pace with inflation and sometimes outpacing the inflation rate. The other hidden benefit is that grandparents and other relatives -- who may be unsure as to what they should buy as gifts -- can also contribute to the plan.

Do Your Homework

Each state's plan works a bit differently, and the newer plans offer additional flexibility. Essentially these plans allow parents (and relatives) to "buy" tuition for the child at a fixed price. You either pay in full or pay in installments and you are guaranteed that your investment will keep pace with rising college costs. Depending upon the number of years you have until your child first enters college, your costs may vary.

Prior to signing up for a pre-paid tuition plan be sure to ask -- and get answers to -- the following questions:

- Is the plan transferrable? To whom, and under what circumstances?
- What costs are covered (i.e., qualified) for tax purposes?
- Can out-of-state residents participate?
- What happens if you stop paying?
- What happens if your child goes to a private (not state-run) college?

Despite their benefits, these plans are not for everyone. For starters, the returns on these plans may not stack up to returns you might receive from other investments such as stocks, especially if your child has five or more years before starting college. However, if you did not start thinking seriously about investing for college until your child entered high school, stock investing may not be the best option due to your relatively short time frame before you will need the money and the inherent risk of principal loss.

One of the most-cited drawbacks to these plans is their lack of flexibility. If your child chooses to go to an out-of-state or private college, he or she may receive only some of the benefits. Or, if you want to transfer the account balance to a sibling, some plans may disallow it. Further, if your child decides not to go to college at all, or for whatever reason you choose to withdraw money for some other expenditure, you may face very strict refund policies. Many plans impose a heavy penalty for withdrawing money for any reason other than college tuition. Although newer plans now offer more flexibility than their earlier counterparts, there are restrictions imposed on how and when you can transfer funds, should your child decide to go to an out-of-state or private college.

Tax Implications

Congress has expanded the tax advantages of these plans to include, among other provisions, the addition of room and board to the category of qualifying expenses, and some state plans offer additional tax advantages.

Assets held in prepaid tuition plans are attributed to the account owner, not the beneficiary (student), which results in a lower impact on need-based financial aid. Additionally, parental assets in retirement plans and the net market value of the family's primary residence are not counted as assets for need-based financial aid.

Although prepaid plans may not fit every family's needs, they offer benefits to many. It may be to your advantage to learn more about these options.

Another Option: CollegeSure® CDs

If your state does not offer prepaid tuition plans, the College Savings Bank in Princeton, New Jersey, offers a range of college savings options including a variable-rate CollegeSure® certificate of deposit (CD). CollegeSure CDs offer an annual percentage yield equal to the prior year's college inflation rate as measured by the College Board's Independent College 500® Index. As a result, the value of your assets could increase at the same rate as college costs. Available in maturities ranging from 1 to 22 years, they pay interest annually each July 31. However, CollegeSure CDs are subject to a maximum interest rate, which is determined in part by the rate in effect the first year you purchased the CD.

See the CollegeSure® Certificate of Deposit Terms and Conditions