Season 1 Episode 6 – Financing College: Interview with Financial Planner

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Speaker 1

It's time for Alabama Money with Cynthia White and Portia Johnson. We'll have financial tips from financial experts from across the state and extension specialists at Auburn University.

Shaw Pritchett

Hello and welcome to Alabama Money, where we talk finance, facts, fun and fast. I am your host, Cynthia White, regional extension agent at Auburn University. Today, we will be discussing financing college education. We have a special guest with us today, Charlotte Pritchett of Jackson Thornton Asset Management. Mr. Shaw, can you tell us a little bit about yourself and what you do?

Cynthia White

Your role at Jackson Thornton?

Shaw Pritchett

I'm a wealth adviser. We work with, you know, predominately high net worth clients, but really clients that have wealth of all degrees are trying to assemble portfolios and help them reach their financial goals.

Cynthia White

Today, we realize it's getting to the end of the school term and parents are kind of shuffling, trying to figure out how to finance that college education. And just in preparation, those that are trying to start a little bit early. We just want to give some advice and some tips to get the ball rolling. A little sooner. So we're going to start off and just go into helping them finance that education.

Cynthia White

How soon should parents start saving for the college education?

Shaw Pritchett

Well, in my experience, it's never too early to save, so it's always a good idea to get started when your child is early. Having said that, I'm a good example on my own that I probably did not get started early enough. I find it a little bit when my daughter was born. And then, you know, 14 years later, I kind of saw a light coming at the end of the tunnel. I knew that I'd have to fund college education. So I started then. Having said that, I think it's important to know college education is just like saving for retirement. That's a lot shorter time period. So you have a lot less time for interest to compound in your investments, but you should take every advantage you can of having that that opportunity to harvest a compound interest and to put the money in there as early as you can.

Cynthia White

So what are some ways are some tools that parents can use to save for their child's post-secondary education?

Shaw Pritchett

You know, I frequently see people saving for education using traditional savings or investment accounts that said, there's a couple of great options out there that people are using more frequently that I think are great tools. One is code section five 29 plan which I'll just refer to from here on out, is a five 29 plan. Also a Coverdale account and a five 29 plan and a Coverdell account are very similar. They're best created by the IRS code as savings vehicles. I tend to prefer the five 29 accounts because the contribution limits are higher to that. There's a $2,000 contribution limit to a Coverdale, whereas contributions to a five 29 plan are really just governed by the annual gift exclusions that are available to to anyone giving a gift to any other person. So I like it for that. Both options. You know, you make your contribution in any earnings and income grow tax deferred. And in both options, when you pull money out for qualified education expenses, the earnings are tax free. And that certainly is a big advantage of those accounts have over just a traditional savings account or investment account.

Cynthia White

So would you say that is how a parent should base Which one would be the best option for their child? Yeah, I.

Shaw Pritchett

Think, you know, college is expensive and so you really want everything to do every little thing you can to reduce friction and spending for that. And so, you know, not paying taxes is a great example of that. The other thing is, is it kind of if you open up an account and you do it, you can are forcing, you know, that savings. There are some penalties for taking it out for non educational purposes. Like you just take it out because you want to spend it. You've got to pay tax on it. You might end up having to pay an early withdrawal penalty or, you know, for for taking the money out.

Cynthia White

So I hear you referring to those penalties. Are there any other restrictions associated with those two things?

Shaw Pritchett

No. You can you can take the money out for at any point in time to spend it on whatever. But is is tax free if you spend it on qualified education expenses and that goes beyond tuition. It could include, you know, room of board computers, you know, books and the like. But, you know, you could take it out for anything if you're willing to pay the tax.

Cynthia White

Are there any additional pros and cons with those two accounts?

Shaw Pritchett

Yeah, I think that the tax effect is the biggest thing. I think I would say one thing, particularly to be aware of in Alabama, if you want to use the Alabama's college accounts plan, there is a great benefit in Alabama that in any in any one year you can deduct $10,000 for for your taxes against Alabama taxes, not against federal taxes. So that certainly is a great benefit. And you can even if you have balance and another plan in another state, you can roll it in there and take that duction in that one year limited to $10,000 a year. But if you're finding every year that continues to add up and then if you have you know different than in my experience but if you have multiple children, you know it's probably easy to get to $10,000 really quickly.

Cynthia White

So how does someone go about setting up each of these accounts Are there certain qualifications associated with each one?

Shaw Pritchett

I wouldn't say qualifications, but they're certainly, you know, you have to open up the correct account. You just can't open up a savings account and say, I'm going to call it a 529 account. A Coverdell. You would probably open that up with an investment company, you know, a broker or, you know, online broker or the like five 29 accounts or I don't know that there are any that are not like this, but I'm pretty sure every one of them is a state sponsored plan.

So you would go to a state website again, and Alabama's Alabama's College Accounts plan, and you could just you could Google that, find it on the Web and you could open up an account online. Again, I had an account like that for my daughter, who is very easy to open, and they make it very easy to find. You can connect your bank account to that. You can set up monthly contributions, which I do recommend I mean, I think any way you can automate that would be wonderful. And actually, speaking of someone who used to plan to finance education, it was also really easy to get money out of it to fund that. And so there's this couple that gave you several they gave you several different options to pull money out. You know, you certainly write a check to send it to them or you can do a bank draft, either one of them. Yeah, it works. But in different states also have plans. And, you know, just because you live in Alabama doesn't mean you have to use Alabama's plan. Frances, when I first started mine, I use West Virginia's plan because it was a pretty low cost option and because the one of the mutual fund companies we worked with had a lot of their funds in that plan, and we recommended we receive recommendations that that would be a good one. But what I realized after I'd done it and a low ballot setting there for a long time, you know, I think that the tax benefits for an Alabama resident like me to use the Alabama plan kind of push it over the edge for me.

Cynthia White

So does there have to be, you reference to using one outside of the state of Alabama? So do that would there have to be ties to that state? Or is it just that if they identify a plan that is outside of Alabama and it seems like a better plan for that particular individual, they are able to utilize that particular plan?

Shaw Pritchett

Right. You can use an account or a plan in any state. And if you think that's better for you, you can certainly do that. I think the one thing that you don't get and use in other states plan is the tax deduction. So that is something that puts the Alabama plan in favor for an Alabama resident. But, you know, if you're listening to this and you're a Georgia resident, I mean, you know, there is also a tax credit in Georgia, a tax deduction in Georgia that probably tilts it in favor of the Georgia plan. As opposed to the Alabama plan. You know, different states are different and not everyone offers a tax deduction. But I think you could really use whichever way you think works best, if you like, the investment options or, you know, if the cost is different or if you just like working in another state, you can you can use that plan.

Cynthia White

Well, that is some excellent information. We do recognize that it is ideal for every parent to start as early as possible. But like you previously noted, sometimes we do get a little bit behind the ball. So in those cases, are there plans or advantages to certain plans that work better for those individuals? They start a little bit late.

Shaw Pritchett

No state plan probably works better than the other, but I would say certainly if you're starting a bit like you don't want to use the Coverdell as your only example, your only source anyway is having a $2,000 limit. Having that limit, which that say, the annual gift exclusion that you could make, which is $17,000 in 2023. I mean, you know, you can see clearly the difference for you able to be able to make up lost time in that. I do think another great advantage of a five 29 plan with making the contributions is say if you're fortunate enough to where you know as a parent you have the ability to do this or you have grandparents that want to contribute and you can front and load contributions to a five 29 plan and so you can make five years of contributions at once and then report those on a get tax return. And as I mentioned the 17,000 year contribution limit that's for one individual so that's what you can make to each of your children but if you're married you and your spouse could make double that or 34,000. So yeah that $34,000 a year if you're going to front end loaded this $170,000 a year that you can put into a plan for your child and you know and my thing is like you know depending on the education experience that they're going to have but you know most of the ones that we run across you could probably do that one time and you've likely funded education for your child as long as you do it early enough and earnings work for their all their needs.

Cynthia White

Are there any additional tips or just advice that you might want to give some of our listeners on trying to finance and their education?

Shaw Pritchett

I think as far as other tips, I think there's a couple of things just about some of these accounts. First, I think a function of the five 29 account that I didn't mention that is like if you have like if if you've got a young child and you fund that and say you fund it with a lot of money or say or even better say you have a child that is very gifted and then you have another child that's not as gifted, but you're saving for both. And then you find out that, you know, I don't need to pay for college for this child. Because they've got a lot of scholarship money. You can transfer money between these accounts tax free. And and so that's a that's a great benefit of that five 29 plan. I think another thing that that you know an option you could use that that not necessarily something I'd recommend but I think a Roth IRA you know if you have a Roth IRA that you're finding for retirement. Yeah there are some there are some ability to access that you know I don't want to say tax free but maybe penalty free to fund that is not what I recommend because it's not really what it's designed for. And what I really don't want people to sit there and say, oh, I'll just rob this account that I've been saving for my retirement, for my child's education, because it really has a good chance of putting your retirement way behind the eight ball right there.

Cynthia White

Thank you so much. I think you've given some really good information for our listeners, hoping they'll be able to start a little bit early or make whatever preparation is necessary. I think you've definitely given them some tools and little advice that they'll definitely need and be able to use. Again, I am Cynthia White, and this has been Alabama Money, where we talk finance back fun and fast.

Speaker 1

This has been a production of Alabama extension at Auburn University.