Consider a 529 Plan as a Way to Save For College

As debate begins in Congress to make permanent the tax exclusion for earnings used for educational purposes from 529 college savings plans, it's worth reviewing what this investment vehicle can do for parents and their entire family to prepare for the rising cost of college.

What is a 529 Plan? 529 savings plans – named for the federal law that created them in 1996 – allow a parent, other relative or friend to open a tax-deferred college savings plan with as little as $25 to start in some states. One important note: A 529 college savings plan is NOT the same thing as a 529 prepaid college tuition plan. Prepaid tuition plans are just that – tax-deferred savings plans that allow you to save for tuition for in-state schools. All 50 states now offer their version of a 529 college saving plan, and you can usually access the details through your state treasurer's office.

What about these tax advantages? Asset growth in a 529 plan is tax-deferred. Under the tax law passed by Congress in 2001, any withdrawals from 529 plans after 2002 through the year 2010 are tax-free if used to pay for a beneficiary's college tuition, fees, books, supplies, and — for students enrolled at least half time — room and board. (Previously, withdrawals were taxed at the student's tax rate.) The 2002 federal tax law change also allowed account holders to roll over funds from one state's 529 plan to another state's plan once every 12 months, if they move or if they're unhappy with the current plan. One can transfer funds to another 529 plan at any time as long as the beneficiary is changed.

How can a whole family benefit? Everyone up and down your so-called "lineal family tree" – your parents, aunts, uncles, cousins and your siblings, your kids and yes, even you, can benefit from the tax breaks and educational rewards of these plans. In fact, if your child gets a full scholarship to Harvard, that means any close family member on the aforementioned list can use the money in that account to go to school themselves – great for career-changers. Better still, parents, grandparents, siblings and friends can make deposits to these plans and get a tax benefit. One important note – all funds must be distributed to the initial beneficiary or transferred to another family member before the initial beneficiary turns 30.

Does my kid have to go to school in that state where the plan is? No.

How do I pick the right plan? Your financial planner can help you sort through the details of various state plans. There are various online services that now rank the offerings of each state's plan.

How much can I put in? Over $230,000 per beneficiary in many state plans.

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What about fees? They vary from state to state, and they're very important to watch. Most states have a no-load option in addition to advisor-sold plans, so review and discuss those alternatives.

Who picks the investments? Each state typically selects qualified, nationally known investment managers to create the plan choices in each state. Most state treasurers' offices feature direct links off their websites to their particular in-state plan with instructions on how to open accounts. The funds can be invested in a variety of investments from low-to-aggressive risk.

Who retains control of these funds? The parent or other family member who opens the account. That will keep your son or daughter from running off with the assets you worked so hard to save when they turn 18.

Do 529 Plan savings hurt financial aid? They could, depending on the school and how they value these assets. If your child qualifies for a fabulous financial aid package, don't be surprised if the school requires full disclosure of 529 funds—a portion of which could be deducted from that total aid package.

What happens if there's an emergency? You'll pay. The money in a 529 savings plan can only be used for higher education costs without negative tax consequences. If the money is used for any other purpose, the earnings are taxed at the account owner's ordinary tax rate and subject to a 10 percent penalty.

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Thinking about Adoption? Plan Your Finances First

Adopting a child is one of the biggest decisions you may ever make. It can also be a shockingly expensive decision that will have a huge effect on your future finances.

In some situations, you'll be paying the price of a four-year public college degree just to complete the adoption process.

Let's start by looking at those figures. The least expensive form of adoption comes from your local foster care system. Your cost could conceivably be zero since states often subsidize these programs to place these children. Meanwhile, agency and private domestic adoptions can range from $5,000 to $40,000 or more depending on agency and attorney fees, travel expenses, birth mother health and living expenses, state requirements and many other factors. International adoptions are typically the most expensive due to the cost of travel and the wide variety of fees and requirements imposed by the country handling the process.

All parenthood comes at a price. But with the help of a financial planner you can create not only a strategy to afford the adoption process, but a plan to save for the child's education and your retirement. Here's a way to start:

Create or review your financial plan: A financial plan is a written set of goals, strategies and a timeline for accomplishing those goals. For many individuals, it may be the first time they seriously consider their financial future in such black-and-white terms. But it starts with the basics – determining how much you really have in savings, debt, insurance and investments. Your planner can also help you understand how much the additional costs of adopting and raising a child will affect all those numbers. A financial plan is a living, breathing thing. It should be reviewed once a year.

Know your tax advantages: Families adopting overseas can get some tax relief. Parents are entitled to a one-time tax credit of $10,630 in 2005 for adoption expenses. Though the credit can't be reduced by the alternative minimum tax, qualifying expenses include paperwork costs, court costs, attorney fees and all travel expenses including meals and lodging. There are income limits – the credit disappears for individuals with modified adjusted gross incomes of $159,860 and for couples, $199,450.

Ask what your employer can do for you: If you're working at a family-friendly company, it's often considerably easier to apply for leaves of absence or work schedules that make more sense when you've got a young child at home. Some companies may offer to reimburse some portion of their workers' adoption expenses. If you know of a company in your field that provides these benefits, it might make sense to start looking for a job there well in advance of the start of the adoption process.

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Get rid of your high-interest debt: A major decision like adopting a child is a good reason to take a "clean slate" approach to debt. Before you can build a reserve fund, it's wisest to pay off your credit cards first.

Make sure you have a will: If you die without a will, you won't have a clear path of guardianship for your child, nor will your assets be properly directed to support that child. Any good adoption attorney will insist that you develop and file a will as part of the adoption process.

Check your insurance options: In today's health insurance environment, the addition of a child to a policy can bring tremendous additional cost – sometimes without the guarantee of the best coverage. Before you start the adoption process, check with your employer or your independent insurance provider to make sure you have the best coverage for what you can afford. Also look into medical savings accounts with your planner if you decide to take a high-deductible policy to keep premiums low.

Build your reserve fund: When a baby, toddler or older child comes into the house, money flies out the door at a velocity most childless people have never seen. Children always cost money and sometimes unpredictably so, but it pays to build your savings before they arrive so you won't overuse your credit cards. Also, it's possible that a birth mother's health may take a turn during the pregnancy, so that's an expense that needs to be anticipated.

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Back to School: Teaching Your Kids Financial Literacy

Crippling consumer debt and bankruptcy are now common everyday occurrences in America, and that makes it all the more surprising that children don't get money management training in school. Until that changes, it's up to you.

The back-to-school season is a good time to talk to your kids about money, particularly as they're starting school. As you plan for your family's future, it makes sense to get specific about the financial values you want to teach your child.

Here are some initial steps to help you teach your kids the value of money.

Determine the right allowance: As early as kindergarten or first grade, your kid is going to have to start paying for things, even if it's one container of milk a day. You need to understand how much money your child will need for basic school expenses. Decide whether they need to earn an amount for extras – toys and candy, for instance – then stress why working for treats is important.

Take a look in the mirror: Do you drive a bigger car than you can afford? Every time you go to the store, do you pull out a credit card to pay? Do you and your spouse or partner fight openly about money at home? Your child hears all of this. Children learn all-important lessons by example – make sure the money messages you're sending are the right ones.

Buy a piggy bank: Young children need this tried-and-true symbol of saving. They need to know there's a place to put pocket change they don't spend, and they are free to tap it only to accomplish a goal that the both of you discuss. This isn't about buying stuff. It's about setting goals.

Don't miss an opportunity for a lesson: Watch your child's behavior – see what he or she wants to buy. Ask them how they plan to pay for things. This is your window on whether your money messages are getting through. "I want" and "I need" are always opportunities for you to teach. Some pretty serious money issues can come out of the mouths of babes. Listen for them.

Have them open a savings account: Open a savings account for your child. Make sure they keep their bankbook or monthly statements in a safe place, and make sure they deposit funds at least once a month to get in the habit. You might also consider mutual funds geared toward children – the best ones have great educational value.

Handle money mistakes carefully: A child is going to make mistakes with money – they'll lose it, spend it on the wrong things or possibly give it away to others. A child needs to be taught sense and caution with money, but not fear. A little self-reflection on how you were taught about money might come in handy here.

Adjust the conversation as they age: As children become teens, they want more autonomy with their spending. You need to match that trust with accountability. If you deposit money in an account for them to spend on essentials and treats, talk about what you are willing to pay for in addition and make those agreements ironclad. Kids will always come to you with their hand out, but they need to know where you'll say "no."

Be open about your investments: Kids are sponges. They know if their parents have investments just by watching what's in the mail. Start talking about why you buy stocks, bonds or mutual funds to help pay for their education. If your child asks you to buy a book or subscribe to a magazine or newspaper so they can learn more, don't think twice – just do it.

Talk about college early: Even if you plan to pay your child's entire tuition, you need to talk about the financial investment college represents long before they go. You can also talk about whether your child will have to pay any expenses on his/her own and how he'll/she'll earn them. The massive investment college represents presents a great opportunity to discuss what the most important things in life really cost.

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