College Savings and Tax Benefits

Introduction - Total college costs have continued to increase year-over-year, with tuition costs tripling over the last 60 years, even when inflation is considered. According to an annual survey of colleges conducted by CollegeBoard, the 2024-2025 average annual cost for tuition and fees was $11,610 for public in-state students and $29,910 when considering all costs to include room and board, meal plans, supplies, and transportation. For public out-of-state students it was $30,780 for tuition and $49,080 for total costs, and private nonprofit schools were the most expensive at $43,350 for tuition and $62,990 for total costs. With an average total cost of four years of college in the six-figures, even for public in-state students, the importance for early financial planning and proactivity for financial aid is even more evident. In this article, NovaPoint highlights some of the most commonly used tax-advantaged savings tools and tax incentives to prepare for this significant investment.

College Savings Accounts

529 Plans – a college savings account that earns tax-free growth and distributions if used for qualified education expenses that anyone can contribute, to include parents, grandparents, and other family and friends. Each account is specific to one child, although there are options to transfer funds to other siblings and relatives, defined by the IRS, either through a change of beneficiary or a rollover. Investment options include age-based portfolios that automatically shift to a more conservative model as the child approaches college, or a static portfolio that can include equities, bonds, a balance of equities/bonds, or principal-protected models acting much like a money market account. Total account balance limits to 529 plans are very high but vary by state, often the limits range from $350,000 - $550,000. To avoid gift taxes, any contributor can give up to $19,000 a year or an upfront five-year contribution of $90,000. The annual gift tax exclusion applies to each individual per beneficiary, so a grandparent could apply this for multiple grandchildren. Considering updates from the passage of the One Big Beautiful Bill Act (OBBBA), 529 plan funds can be used for:

- College tuition, fees, books, and room and board if enrolled at least half-time.
- K-12 tuition and more qualified expenses such as books, online coursework, standardized-test fees, tutoring, educational therapies, and more. The annual maximum for K-12 expenses will double from $10,000 to $20,000 in 2026.
- Expanded post-secondary uses such as credentialing and career or continuing education programs such as certificate programs, licensing, apprenticeships, and vocational programs. Although each state may have varying definitions of what qualifies.
- Unused funds can be rolled over into a Roth IRA for the beneficiary if the account has been opened for 15 or more years, limited to the annual Roth contribution limit if the beneficiary has earned at least that amount of income, and it is capped at a lifetime rollover of $35,000.

Coverdell Education Savings Accounts (ESA's) – another tax-free growth savings account option with broader investment options than 529 plans; however, with a much lower annual contribution limit of $2,000 a year per beneficiary. There are also income limits for contributions, whereas there are none for 529 plans. Additionally, funds must be used by age 30 or rolled over to another eligible family member.

UGMA/UTMA Custodial Accounts – while not specific to just education, these accounts offer other options to financially provide for a child beneficiary, but these funds irrevocably belong to the child who will then have full control of the account at the age of majority, which varies by state, but is generally 18 to 21 years old. These accounts are not tax-advantaged, and their growth is taxed annually much like a taxable brokerage account but under the "kiddie tax" rules until the age of majority. The main benefit of these accounts is that their flexibility can outweigh any lost tax benefits as the funds can be used for any expense that benefits the child, not just education.

Federal Tax Credits & Deductions for Education

American Opportunity Tax Credit (AOTC) – considered the most valuable educational tax credit, it is worth up to $2,500 per student per year for the first four years of postsecondary education. The credit is calculated as 100% of the first $2,000

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of qualified expenses, and then 25% of the next $2,000. Eligible expenses include tuition, fees, books, and supplies, but do not include room and board. There are income limits to being eligible to use this credit and you cannot be reimbursed from other sources or expensed from a 529 account when considering the expenses eligible for the credit.

Lifetime Learning Credit (LLC) – a tax credit limited to $2,000 per individual or joint tax return. The credit is calculated as 20% of up to $10,000 of qualified expenses, which are broader than the AOTC, to include graduate school and continuing education with no limit on the number of educational years. The LLC has similar income limits for eligibility.

Student Loan Interest Deduction – allows for a deduction of up to $2,500 of interest paid on student loans per year. This is an above-the-line deduction that can reduce your taxable income even if you take the standard deduction. There are also income limits for eligibility, but the limit is slightly higher than the AOTC and LLC income limits.

Other Funding Opportunities – If sufficient savings are not available to fund college costs, public and private loans offer another alternative. Look for our next article focusing on college loans and repayment plans. Scholarships and grants can also mitigate or completely pay for college costs, although be careful to discern what costs are covered and what your out-of-pocket costs could be. Lastly, for those already employed and seeking a college degree, employer tuition assistance, if available, could provide up to $5,250 per year tax-free from an employer to help defray costs. Some employer tuition assistance plans may even offer this benefit to the employees' dependents, pending your specific employer plan.

Final Thoughts – Considering various savings and investment options, tax credits and deductions, as well as scholarship and grant opportunities, the complexity comes to planning strategies that maximize all eligible options to provide the maximum savings and tax advantages to provide for not only college expenses, but K-12, graduate, and other educational pathways.

At NovaPoint, our investment, wealth management, and tax experts can help advise you on your optimal educational savings plan. If you want a trusted fiduciary partner to help manage your savings and tax treatments for educational expenses, along with meeting your other future financial goals, contact us here.

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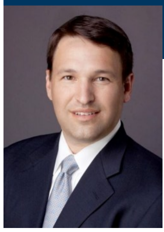
NovaPoint – Financial Planning and Wealth Management

The NovaPoint Team



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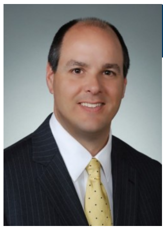

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