NORTH DAKOTANS
SAVING FOR
EDUCATION

Savings Tools
for Education

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Where to Keep Education Savings Funds

Choosing where to keep money saved for education is an important piece of the overall education savings plan. When making a decision, consider the rate of return, tax breaks, safety and the accessibility of the funds.

The following list highlights the many savings options; each comes with its own pros and cons. Family situations are unique and different savings options will work for each situation. Become familiar with the basics of each and then make an informed choice.

- **Cash locked in your home safe –** This is the old "money in the mattress" choice. Money saved in a piggy bank also would fit in this category. This option really has no advantages. The money does not grow, it may be stolen (even from a safe!) and the cash is too easy to reach and spend on other expenses.
- **Regular savings account –** This is an account you can open easily at any bank or credit union for a minimum deposit of anywhere from $10 to $100. Interest rates are averaging .25 percent to .50 percent. These accounts allow you easy access to your money and the federal government (FDIC) insures them, but they pay a very low rate of return.
- **Money market savings –** This is an account you can open at your bank, credit union or investment company. Minimum balances required usually are $500 to $1,000. Rates of return also are a bit higher at an average of 2 percent. The accounts are insured if they are at a bank or credit union. You will have easy access to your money, and the rate of return is low for long-term savings.
- **Certificates of deposit (CDs) –** This is an account purchased from a bank or credit union for a fixed amount of money, time and interest rate. Minimum deposits range from $500 to $1,000, length of terms range from three months to seven years and interest rates range from 1.5 percent to 4.35 percent, depending on the amount of money deposited and the length of time chosen. You pay a penalty for withdrawing money before the CD is due. These accounts are insured. The money is not easy to withdraw, so we are less likely to use it for other expenses. However, the rate of return is low, especially on the shorter terms and you can't add money to the account on a regular basis.
- **U.S. savings bonds (Series EE and I) –** When you purchase a U.S. saving bond, you are loaning the government money and it agrees to pay you an interest rate for using your money. You can purchase U.S. savings bonds at your local bank or credit union, or some employers allow a payroll deduction plan to buy U.S. savings bonds. Two types of U.S. savings bonds are available today.

  Series EE – You purchase an EE bond for half of the face value of the bond. They are available in denominations ranging from $50 through $10,000. The government guarantees your bond will reach full face value in 20 years. However, the earnings rate is variable and your bond may reach full value in less than 20 years. The interest rate for EE bonds changes semiannually on May 1 and Nov. 1. (Bonds bought before May 1997 have a different interest rate structure.) To find the current EE bond interest rate, link to www.publicdebt.treas.gov/sav/savmktrt.htm.

  Series I bonds – You purchase I bonds for the full face value, and like the EE bonds, they are available in denominations ranging from $50

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through $10,000. The I bond earnings rate is a combination of two rates: a fixed rate of return and a variable semiannual inflation rate. The fixed rate remains the same throughout the life of the I bond, while the semiannual inflation rate is adjusted May 1 and Nov. 1 of each year. This allows an element of protection against the current rate of inflation. For current I bond earnings rates, link to www.publicdebt.treas.gov/sav/sbirate2.htm.

Education bond program - This program allows interest to be completely or partially excluded from federal income tax when the bond owner uses the bond proceeds to pay qualified higher education expenses at an eligible institution in the same calendar year the bonds are redeemed.

- The bonds need to be in the parent's name if they are to be used for a child's education expenses.
- The bonds need to be in the adult's name if they are to be used for the adult's own education expenses (anyone over the age of 24).
- The owner (parent) must be at least 24 years old when the bonds are purchased.
- Series EE and I bonds issued after 1990 may qualify for the education expense tax exemption.

For more information on using savings bonds for education, follow this link, www.publicdebt.treas.gov/sav/saveduca.htm.

- **Coverdell education savings account (education IRA) –** This is a trust or custodial account set up for a designated beneficiary for the purpose of paying qualified education expenses. The beneficiary must be under 18 years of age when the account is established. Anyone (not just relatives) may set up an account for a child, but no more than a total of $2,000 per year may be contributed per child. The funds grow tax-differed and withdrawals are tax-exempt if used for qualified education expenses. Unlike other tax advantaged education programs, the Coverdell education savings account can be used for public, private and religious elementary, secondary or post-secondary education. The account could be used throughout a child's education years. Contributions may be made until the beneficiary reaches age 18 unless there are special needs. The beneficiary becomes the owner of the account at age 18. The funds in the account must be distributed completely by the time the beneficiary reaches age 30, and if not used for education expenses, the earnings will be subject to a 10 percent penalty and income tax. The contribution limits to a Coverdell education savings account are reduced when a contributor's adjusted gross income is more than $95,000 ($190,000 if filing a joint return). Because of the limit on contributions, starting this type of account very early in a child's life is important. The account owner may choose how the funds are invested.

- **Section 529 plans –** Each state can create "qualified state tuition programs" to assist families in saving for their children's future education. Congress established the regulations for these accounts in 1996. The IRS governs the accounts under section 529 of the Internal Revenue Code. Therefore, they often are called 529 plans. Two types of plans are available: a prepaid tuition plan and a savings plan.
  - The **prepaid tuition** plan is a state-operated trust allowing parents to place funds in the trust based on current tuition rates in return for an agreement that the trust will pay the tuition expenses at a state institution when the child attends a post-secondary school. This is a guard against the expected rise in tuition expense over the years. North Dakota does not have a 529 prepaid tuition plan.
  - The **savings plan** is a state-sponsored mutual fund with special tax provisions. An adult can sign up for the program and place funds in the plan for a future student. The money will grow until it is needed for education expenses. The contributions are not tax-exempt, but the earnings grow tax-deferred and will be tax-free if they are used for qualified education expenses. Some states also offer a state income tax exemption for 529 plan earnings. However, North Dakota does not offer this benefit. North Dakota's 529 plan is called **College Save**, which Morgan Stanley manages.

A parent, grandparent, relative or friend may be established an account for a designated beneficiary. An account can be opened with as little as $25, and the account owner can contribute any amount annually or as a lump sum until the total reaches a limit of $269,000. The owner may contribute up to $55,000 per beneficiary to a 529 plan in a single year without triggering the federal gift tax. No income limitations are imposed on those who contribute.

The owner of the account is allowed to choose how the funds are invested from a number of managed investment portfolios that the plan offers. Since North Dakota does not offer a state income tax break on the earnings from the College Save plan, savers may choose a 529 plan from another state if they find it offers a better return.

If the beneficiary does not use the funds for qualified education expenses, the account may be transferred to another family member without a penalty. The funds may be withdrawn for other uses but a 10 percent penalty and income taxes will need to be paid.

For more information about the North Dakota College Save program, link to www.collegesave4u.com/.

For more information on comparing all state 529 plans, link to www.savingforcollege.com.

- **Regular investment account –** Parents also may choose to invest the money they are saving for education in a variety of bonds, stocks or mutual funds. Any returns received will be subject to income or capital gains taxes, but at the time of actually paying for qualified education expenses, the parents may be able to take advantage of the tax benefits of the Hope Scholarship, lifetime learning credit and higher education expense deduction.
- **Roth IRA –** Some may choose to save their education funds in a Roth IRA. The contributions are not tax-deductible, but the earnings grow tax-free. In 2005, contributions may be $4,000 per year to a Roth IRA. Once the Roth IRA has been in place for five years, withdrawals can be made for higher education expenses penalty-free, but not tax-free, if the owner is not over age 59½. However, withdrawals from a Roth are treated as being taken from contributions first so little or no tax may be owed since no tax is imposed on withdrawals of contributions. If the child does not need the funds for education, the account can be saved for other goals. Income limits are imposed on who may open and contribute to a Roth IRA.

The choices for where to place education savings are numerous and varied. One size will not fit all; many families will find a combination of accounts the best option. Take your time and make an informed decision.

Tips for Easier Saving

- Start saving early. (However, it is never too late to start!)
- Create a specific goal and write it down. Check it periodically and measure your progress.
- Set up a special education savings or investment account separate from other family accounts.
- Save on a regular basis; weekly, biweekly, monthly or whatever works best for your family.
- Start small if you have to, but save as much as you can.
- Use payroll deduction if you can to move your funds directly into a savings or investment account.
- Increase the amount you save each year.
- Reinvest all interest, dividends or capital gains.
- Identify areas of your spending plan where you can cut back and redirect funds to savings.
- Saving money is a good habit to acquire. This would be a great time to involve your children and teach them about saving. They may be able to contribute small amounts, too.

Resources

North Dakotans Saving for Education
www.ag.ndsu.nodak.edu/money/index.htm

Savings Bonds for Education
www.publicdebt.treas.gov/sav/saveduca.htm

North Dakota College Save Plan
www.collegesave4u.com/

Saving For College
www.savingforcollege.com

Student Loans of North Dakota
www.mystudentloanonline.com/index.jsp