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College Prep: Higher Education Financing Strategies for Proactive Families

An essential but sometimes overlooked component of a family's financial plan is preparing for the costs of their children or grandchildren's higher education. Even for well-resourced families, managing the growing expense of college can be challenging, which is why adopting a proactive, long-term approach early on is crucial.

The Rising Costs of Higher Education

For the 2024–2025 academic year, tuition and fees at private U.S. colleges increased by 5.5%, reaching an average of $43,505 per annum. By comparison, public colleges saw more modest cost increases, with in-state tuition up 2.2% to $11,011 and out-of-state costs rising by 2.4% to $24,513.[1]

The growth in tuition and fees—particularly at private institutions—underscores the need for strategic, long-term planning. Proactive families can optimize tax-advantaged savings vehicles and strategic gifting options.

Strategies for Education Planning

Having a plan in place with a disciplined but flexible approach to funding should go a long way to alleviating the burden of the future costs of a college education. Below are some strategies to consider.

529 Plans

529 plans are a powerful choice for education savings. Funds within the 529 plan grow on a tax-deferred basis and withdrawals for qualified education expenses are tax-free. Historically, 529 plans were available only for higher education costs. Recent changes allow up to $10,000 per year to be used for K-12 tuition. Funds may also be used at vocational schools and for some apprenticeship programs.

As of 2024, up to $35,000 of unused funds in a 529 plan can be rolled over to a Roth IRA if the 529 plan has been open for at least 15 years, although contributions made within the past five years and their earnings are excluded. The owner of the Roth IRA must be the same as the beneficiary of the 529 plan. The annual Roth contribution limit ($7,000 in 2025) applies, so reaching the $35,000 limit may take multiple years.

Contributions to a 529 plan are considered a gift and are subject to the annual gift exclusion ($19,000 in 2025), however, superfunding of a 529 is permissible. Superfunding allows for five years of contributions ($95,000 in 2025) to be front-loaded into a single year. A married couple could contribute $190,000 on behalf of a beneficiary. It's important to note that a gift tax return will need to be filed in each of the five years. Also, any additional gifts to the beneficiary during the five-year period would count against the donor's lifetime federal gift and estate tax exclusion amount.

Coverdell Education Savings Accounts (ESAs)

ESAs provide another, although more limited, avenue for education funding. The maximum annual contribution is $2,000 per beneficiary. ESAs can cover educational expenses from elementary school through college—and they might be a complementary option for families who would like to plan for both early and higher education costs.

Unlike 529 plans, income limits apply to ESA contributors. Allowable contributions phase out between $95,000 and $110,000 for single filers and between $190,000 and $220,000 for joint filers.

Uniform Gift to Minors Act (UGMA) & Uniform Transfers to Minors Act (UTMA)

UGMAs and UTMAs are custodial accounts that allow adults, often a parent or grandparent, to transfer assets to a minor. The UGMA and UTMA are similar in structure and intent with the UTMA having a wider range of permissible assets, including real estate.

While custodial accounts can be very flexible and easy to establish, they do come with certain considerations. Control of funds in the UGMA or UTMA automatically transfers to the child when they reach the age of majority (typically 18 to 21, depending on the state). Unlike 529 plans and ESAs, income earned within the custodial accounts does not accumulate on a tax-deferred basis. The somewhat complicated “kiddie tax” may apply, which would tax any unearned income above $2,700 (2025 threshold) at the parents’ marginal income tax rate.

Section 2503(c) Trusts

A 2503(c) trust (named after IRS Section 2503(c)), also known as a minor’s trust, is another vehicle to receive gifts for the benefit of a child. Gifts to the trust may qualify for the annual gift exclusion. Distributions of principal and interest for the benefit of the child are permitted at the trustee’s discretion. Once the child reaches age 21, the trust must terminate with all assets remaining in the trust distributed to the beneficiary. If significant assets remain in the trust at age 21, full distribution may not be desirable. Thoughtful drafting of the trust document could allow the trustee to give the beneficiary a window upon reaching 21 to withdraw the funds. If the assets are not withdrawn within the specified time frame, the trust would remain in force.

For tax purposes, the trust is considered a separate taxpayer, and any income retained by the trust will be taxed at the trust’s compressed income tax brackets. Income distributed to the beneficiary may be subject to the kiddie tax.

Section 2503(b) Trusts

A 2503(b) trust, (named after IRS Section 2503(b)) also known as a mandatory income trust, is similar to a 2503(c) trust but with some significant differences. It is often established for a minor child although there is no age restriction. The trust is required to distribute all income to the beneficiary at least annually. The principal does not need to be distributed. Also, unlike the 2503(c) trust, there is no requirement that assets be distributed at the beneficiary’s age of 21. Income distributed to the beneficiary will be taxable to the beneficiary. Again, kiddie tax rules may apply.

Grandparents and Direct Gifting

Perhaps the simplest yet very effective option is to pay tuition directly to the educational institution. These direct payments are not considered gifts for tax purposes, so they are not subject to the annual gift exclusion. This option works particularly well for grandparents who want to support their grandchildren’s educational aspirations while utilizing effective gift and estate planning strategies.

Additional Considerations

Families with college-bound students should also be mindful of the non-financial aspects of college preparation that are often overlooked due to the student’s young age. Having important documents in place for the student—such as a will, power of attorney, and healthcare proxy—can provide peace of mind for difficult or unforeseen events.

Additionally, once a child turns 18, parents will need Health Insurance Portability and Accountability Act (HIPAA) authorization to access their child’s medical records. Under the Family Educational Rights and Privacy Act (FERPA), students must grant permission for parents to view their educational records.

Protecting Your Child’s Future

Given the rising cost of higher education and the wide range of available savings options and tax deferral strategies, developing a comprehensive, long-view financial plan can make a meaningful difference.

From tax-efficient 529 plans to the nuanced control offered by trust structures, choosing the right path forward can help your family meet its educational and financial goals. Because no two families are alike and because the strategies highlighted above vary in complexity, consultation with knowledgeable professionals is strongly advised.

We encourage you to contact your dedicated Webster Private Banker or Eileen Cahill, Senior Managing Director, Financial Planning, to explore the options that best suit your family’s goals and objectives.

1 See the Average College Tuition in 2024–2025: https://www.usnews.com/education/best-colleges/paying-for-college/articles/paying-for-college-infographic

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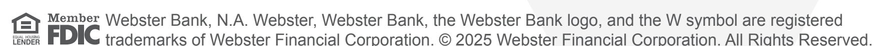
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