Children Financial Planning: 2 Practical Savings Opportunities for Your Growing Family

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Now that you have decided to grow your family, a myriad of new children financial planning and savings opportunities come into play. Sometimes sorting through the universe of options, opinions, and even the planning vernacular can be somewhat daunting (Coverdale's, UVLIs, Crummey Trusts, oh my!). And of course, the holiday dinner table is always a hotbed of unsolicited personal, political and financial advice, with one relative singing the praises of cash value life insurance, another EE savings bonds, and that eccentric cousin who always pushes the old 'cash in the mattress' and gold buried in the backyard strategy. While all may have some merit, the important thing is to get started early, articulate clear goals, and take action. While more advanced and even multi-generational strategies/structures may become available and appropriate as your family's planning and finances evolve, initially we suggest considering two simple, yet powerful, savings options outlined below. Any disciplined savings account or structure will not only help secure your new addition's financial future but also provide a forum to pass down financial lessons and values, whether inherited and instilled by your family or self-learned through your life experience.

1. Section 529 Education Savings Plans (529 plan)

A 529 plan is a tax-favored savings plan primarily used to accumulate funds for higher education. These investment accounts have become a favorite of many education savers because their earnings and appreciation grow tax-free. Also, contributions can be made not only by parents but other family members and may qualify for state income tax deductions in certain jurisdictions. When making contributions, you have the option to gift to five times the federal annual gift tax exclusion all at once and elect for the gift to be treated as if made ratably over a five-year period. State transfer tax rules vary and may influence whether you utilize your resident state or an out-of-state 529 plan. Distributions from a 529 plan are tax exempt, provided the distributions are used for qualified expenses such as higher education tuition and K-12 expenses up to $10,000 per year. Furthermore, up to $10,000 can even be used to pay down student loan debt (recently added by the Secure Act of 2019). However, when using a 529 plan to pay down student loan debt, this may limit your ability to claim the student loan interest deduction for Federal taxes.

2. Uniform Transfer to Minors Act (UTMA) / Uniform Gift to Minors Act (UGMA) Savings Accounts

UTMA or UGMA accounts act as simple statutory trusts for your child until reaching the age of maturity. Deposits to these investment accounts are irrevocable in nature, which means that once you deposit assets, they can no longer be withdrawn by the parent, and all contributions and appreciation accrue for the sole benefit of your child. Once the child attains the age of majority, 18 or 21 depending on your state, the account is retitled into their individual name and becomes fully accessible. Unlike the 529 plan, these accounts are not tax-free and may require an income tax return for the minor child if the income meets the IRS's filing threshold. While parents have the option to include the minor child's income on their individual tax return, they may be subject to the 'kiddie tax' – which subjects account income to the parents' higher marginal tax rate.

As your lives and the tax law continues to evolve, fully planning for your child's financial future will inevitably include more options and alternatives. It will always be a customized and evolutionary process. In the meantime, if you have any questions or would like to learn more about these or other savings strategies, please feel free to contact us.

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