Let Uncle Sam help pay for college

Higher-education costs may seem daunting, but federal tax breaks can ease the burden. Parents should consider all the options, from 529 and Coverdell plans to credits and deductions.

Congratulations on your new baby! Have you started saving for college yet?

It's not too early. Children grow up quickly, and college costs go up even faster. The good news is that you have several tax-advantaged ways to come up with college cash, thanks to Uncle Sam's generous tax breaks.

529 plans

Educational 529 plans get their name from the **Internal Revenue Code** section under which they were created. These plans are the overwhelming favorite of families and financial planners alike. Your contributions to a 529 plan are not deductible on your federal return, but the money invested in the plan accumulates tax-free. Even better, when you withdraw account funds to pay for qualified education costs, those distributions are not taxed.

College tuition grants for single mothers

Another appealing aspect of 529s is that they are set up by an adult who names the child as the beneficiary. Anyone can contribute to a 529 plan, such as the beneficiary child's grandparents. Because the money is not in the future collegian's name, it won't count against financial aid applications. If you want to make sure that parental ownership of the account also doesn't cause any financial aid problems, consider letting another relative (those doting grandparents, perhaps?) set up the plan.

All 529 plans are administered by states, and every state now has at least one. You don't have to limit yourself to your state's options, however. You can establish an account with any 529 program. But you might get additional tax advantages, such as a deduction on your state tax returns, by establishing a plan in your home state.

You also can change the beneficiary on the plan if the child for whom it was established decides against college or completes his or her education without using all the money in the plan. Simply roll over the plan funds without any tax penalty to a 529 for an immediate family member.

Coverdell education savings account

Coverdell education savings accounts, or ESAs, were once known as education IRAs because they operate in much the same way retirement accounts do. When the education accounts were expanded in 2002, they were renamed in honor of the late **Sen. Paul Coverdell** of Georgia.

Coverdell contributions aren't tax-deductible, but they and subsequent earnings can be withdrawn tax-free as long as they are used to pay eligible schooling costs.

Like 529 plans, Coverdell ESAs are established by an adult, with the child as the beneficiary. Also, as with 529s, anyone can contribute to the account, with the annual contribution deadline being the tax year's April filing deadline.

Most financial institutions can serve as home to a Coverdell account. There are some restrictions, however. Only $2,000 a year is allowed from all contributors, not $2,000 from each. Your contribution limit is reduced if your modified adjusted gross income is between $95,000 and $110,000 and you're a single filer, or between $190,000 and $220,000 if you're married and file jointly. If you make more than the limit for your filing status, you can't contribute to anyone's Coverdell ESA.

On the other hand, Coverdell spending rules are more flexible. Whereas with most tax-favored education accounts the money must be used for higher-education costs, Coverdell money can help pay education expenses from kindergarten to college, such as a new computer for a high school student.

And as with a 529 plan, if your child doesn't use all the Coverdell money, it can be rolled over to a plan for another family