COLLEGE SAVINGS 101

Paying for college requires significant savings and, for most families, financial aid such as grants, scholarships, and student loans. Here's a guide to the best practices and smartest savings vehicles for getting your kid through school.

COLLEGE SAVINGS COMMANDMENTS

Retirement comes first
Before you save a penny for the kids' college, max out your savings in a 401(k) or IRA. Money in these accounts isn't counted as an asset when determining federal financial aid. As much as you want to be generous, remember: Your child can borrow for school; you can't borrow for retirement.

Tell them you're saving
Research shows that children with savings accounts earmarked for higher ed are more likely to attend than kids who don't have such accounts.

Kids contribute
If your high schooler works (best to keep that to 15 hours a week during the school year), have her set aside a chunk of her earnings. Paying some of your own education costs is a predictor of a high college GPA.

THE 411 ON 529s

The mother of all college savings accounts is the 529. Here are the ins and outs, and two additional options:

WHO
Usually, you, the parent, are the account owner and your kid is the beneficiary. But 529s can also be held by dependent students for themselves, or by other relatives, such as grandparents, with students as beneficiaries.

WHEN
As soon as your child is born, open a 529 and start regular automatic contributions. Invest in low-cost index funds that capture the diversity and the average annual return of the entire stock market.

WHAT
A 529 allows parents to save and invest for their kid's college—up to $500,000, depending on the state sponsoring it. They tend have low minimum contributions (about $25), but you can put in up to $15,000/year without being subject to federal gift tax.

WHERE
Every state but one (c'mon, Wyoming!) offers a 529, two-thirds offer state tax breaks, and a dozen match contributions, too. If your state offers no special benefits, shop around.

HOW
Get plan info and ratings at savingforcollege.com and morningstar.com.

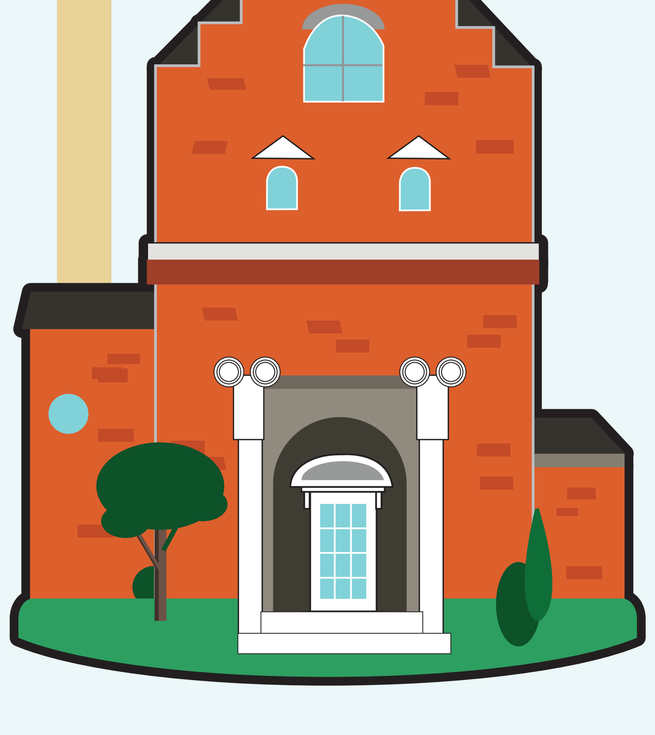
WHY
You pay no federal taxes if you use 529 money for higher ed expenses. And the money you put aside has minimal impact on the amount of financial aid your kid can get, because it's considered a parental asset. Kids are expected to contribute 20% of their money; parents are asked for only up to 5.6% of theirs.

D'OH! 529s are not foolproof. A few words of caution.

- Use 529s for qualified college education expenses only (not for flights, activity fees, or sorority dues). If you don't spend your 529 money properly, the earnings are subject to income tax and a 10% penalty.
- It's smartest to hold all college savings in parent-owned accounts from the beginning. Money tapped from 529s held by non-parents (grandparents, aunts/uncles) counts as student income, which hurts your case for financial aid.
- As your kid nears high school, you'll want to gradually shift to safer investments like money market funds—that way you won't run the risk of a stock market slump slashing your savings before it's time to pay tuition. Note that you can change your 529 investments just twice a year.
- Opt for a "direct-sold" 529 plan over an "advisor-sold" (or "broker-sold") one. The fees are lower.

MORE PLACES TO SAVE

Custodial account
The good: Some of the interest in these bank or investment accounts (sometimes called UTMAs or UGMAs) is tax-free.
The bad: As soon as your kid turns 18, she controls the money, not you. What's more, they take an outsized bite from financial aid.



Bank account
A plain Jane savings account is the lowest-risk and most accessible place to park your college savings, but it has no tax advantages and pays the lowest interest. If you go this route, check bankrate.com for online banks with the highest interest.