

- I. Tax System and Financial Aid System Incentives – will typically benefit from one more than the other
- II. Median Income 50% higher for college graduates (increases upon masters and doctoral degrees)
 “MILLION DOLLAR GIFT” - between \$300,000 and \$1,000,000 increase in lifetime earnings along with numerous intangible benefits of education
- III. One of three biggest investments in life behind Retirement and Home ownership
 – however the inflation rate for education is currently averaging about 5 to 7% annually
- IV. Create – Education Vision
 Assess – Personal Situation
 Protect – Obstacles that can prevent funding (premature death, Etc.)
 Invest – Leverage Assets for tax and economic benefits
 Enjoy – Realize the Dream/Access the Money

- CREATE
- public school vs. private school
 - house or dorm
 - % child will pay for
 - work during school?
 - Other children?
 - Financial aid

- ASSESS
- cost
 - time frame till time of goal and length of years
 - price tag

A. Expected Family Contribution EFC – from personal savings and non-subsidized loans

- age of oldest parent
- number of children
- number in college
- income and assets
- child’s income and assets

B. Assets not included – non assessable assets

- Annuities/ Life Insurance
- Home equity
- Retirement Plans

C. Assessment Levels – Child’s assets 35%, parents 5.6%

D. Strategies- whose name to put college savings in

E. Grants

- Pell – undergraduates only
- SEOG – exceptional financial need
- State

F. Scholarships

V. Low Interest Loans

1) Stafford (formerly Guaranteed Student Loans) - subsidized and unsubsidized
- interest on **subsidized** is paid by the government during while student is in school or deferment status – based on need and limited to \$2,625, \$3,500, \$5,500, \$5,500 for years 1 – 4 with 23,000 total

- **unsubsidized** – 8.25% interest (10 year repayment plan)

2) Perkins – government funded, low-interest, do not have to be repaid until 9 months after graduation

3) PLUS – allows family with good credit history to borrow up to \$6,625 year one and \$7,500 beyond year one at 9% interest rate cap

VI. Credits – Became available as a result of the Tax Payer Relief Act of 1997

1) Hope - \$1,500 per year per student for the first two years of qualified college expenses

2) Lifetime Learning Credit – 3rd & 4th year, graduate school, professional courses

- cannot be taken in the same year for the same student
- student must be at least ½ time
- covers tuition and related expenses, **not** room & board, books, etc.
- expenses must be for yourself, spouse or dependent
- credit phased out at Adjusted Gross Income (AGI) of \$40,000 if single, and \$80,000 if MFJ

VII. Custodial Accounts – UTMA/UGMA – parent manages the money for the benefit of a child, who is the taxpayer on the account (child's SS# used) – Issues to Consider:

UTMA – Uniform Transfers to Minors Act – Age 21 (Tennessee now uses UTMA)

UGMA – Uniform Gift to Minors Act – Age 18

- 1) Control – Irrevocable Gifts to the child
- 2) Tax – Exempted amount \$700 (1998), child's rate of 15% tax based on \$700 (1998)
- 3) Financial Aid – assessed at 35% for EFC purposes

VIII. Investments Options

- 1) Mutual Funds (stock/bond and money market options) – should be matched to:

- a) Time Horizon
- b) Risk Tolerance
- c) Tax Situation
- d) Adjusted/rebalance as the goal nears

- 2) EE Bonds – From \$25 to \$5,000 (mature at twice their issue value)

- tax free interest when used for tuition and fees
- need to be bought in parent's name
- must redeem them in same year of their usage
- must have been issued after 1989
- 1997 tax-free provision phases out when AGI reaches \$52,500 for single and \$78,350 for Married Filing a Joint Return

- 3) (Cash Value) Life Insurance – death and college funding needs can be met with single vehicle -excluded from Federal Financial Aid Calculations – Types include:

- Whole Life (guaranteed fixed cash value)
- Universal (fixed cash value with flexible premiums and death benefits)
- Variable Universal Life (adds investments/variable accounts to cash value)

- 4) Education IRA – earnings grow tax free if used for qualified post-secondary education expenses - money not used can be transferred to another child (as long as under 18) – CAVEATS

- if not used for education subject to 10% penalty
- phased out at AGI of \$95,000 for single and \$150,000 for Married Filing a Joint Return

IX. Distribution Strategies – general rules of distribution

- child's assets first – to lower Expected Family Contribution
- tax issues – rebalancing based on time horizon/portfolio drift
- when to liquidate – systematically to accrue additional return
- how much to spend (competing forces/opportunity costs)

X. Other issues/funding methods for education

1) Withdrawals from 401(k) – Actual & Opportunity Costs

- Taxable Event
- 10% Penalty if taken before 59 ½
- Sacrifices Retirement

2) Loans from 401(k)/403(b) – Opportunity Costs

- Stifles account via reduction of funding through loan payback
- Leads to increase in taxable income if funding reduced
- Account “receivable” placed in fixed accounts with lower potential earnings

3) Home Equity Loans – can be much cheaper in economic sense (factors such as deductibility of interest and rates compared to other student loans available should be considered)

4) Capital Gain vs. Ordinary Income – Investment Options for many favor Individual Stocks and Stock Mutual Funds (especially in UTMA in earlier years)

- capital gain treatment after 12 month holding period
- results in “shifting” of ordinary income to capital gain income

5) State Prepaid Plans – typically “indexed” vehicles with little “real” growth opportunities

- works better for less disciplined savers or more conservative investors