EDUCATIONAL BENEFITS GROUP

Providing solutions to make college an affordable reality

Tuition Rx

The Top Ten College Funding Strategies

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To: Ronald W. Them, President
National Association of Professional College Advisors

RE: Tuition Rx Booklet

Dear Ron,

After reviewing the content, it is my opinion that the strategies presented in the Tuition Rx booklet appear to be accurate and within the guidelines of the various education tax and financial rules and regulations. It is also my opinion that it should be mandatory reading for any parent or financial advisor who is looking for ways to fund college and retirement at the same time.

Regards,

Rick

Rick Darvis, CPA

Tuition R_x

The Top 10
College Funding Strategies

The following is a reference guide that demonstrates the top 10 financial strategies that families can use to cut costs and increase cash flow for college expenses. These strategies can help families of all income levels make any college an affordable reality. Financial advisors can also use this handy guide to help their clients develop specific strategies to help fund the cost of college.

Introduction

The State of Today's College Costs

The dream of providing a college education for their children is becoming out of reach for many American parents. The cost of college is higher than ever before and a family's ability to afford a college education depends on many factors. Those factors include the cost of the college, the family's income and assets, the family's size, and the availability of financial aid. Although the costs associated with attending college can be great, the cost of not going to college can be greater and significantly reduce the student's lifetime earning potential.

As a result of today's sky rocketing college costs, most families must rely on a variety of resources to pay college expenses. One of these sources is the government grant. Unfortunately, there are not enough government grants to go around and students must often create a tremendous debt burden to obtain a cherished degree. We are now witnessing a generation that is straddled with up to $100,000 in debt before they get married, own a home, or even begin their careers!

This dilemma is most often caused by the lack of financial planning. Many families find that there is simply not enough paycheck at the end of the month to save for a college education. They don't understand that there are many financial strategies available to them that have been proven effective in reducing the cost of college. Consequently, financing a college education often becomes a shared burden that can span three generations; grandparents, parents and children. Families who do not implement the proper planning for college are also more likely to have to withdraw funds from their precious retirement savings, making their own dreams of the future more unstable.

College Planning vs. Retirement Planning

"How old will you be when your last child graduates from college?" Consider the following data from Statistical Abstracts:

<u>Aging baby-boomer population</u>

– 1980 - 20% of total births were to women over age 30
– 1996 - 35% of total births were to women over age 30

Today, married couples are waiting longer to have children and as a result will have fewer years to "catch up" with their retirement savings once their last child graduates from college. Many parents finance college expenses without considering the effect on their retirement goals. Random withdrawals from a retirement fund to help cover college expenses can force parents to work longer than they had expected for retirement, or live on less during their golden years.

Furthermore, this dilemma increases as income rises. The following table demonstrates the real cost of college to a family:

College Is Paid With After–Tax Dollars

Federal Tax Bracket	Public $64,000	Private $128,000	Elite $192,000
25%*	$ 91,428	$182,857	$274,285
28%*	$ 95,522	$191,044	$286,567
33%*	$103,225	$206,451	$309,677
35%*	$106,667	$213,333	$320,000

Note: The above data includes an assumed 5% state tax rate

Since a college education is paid using "after tax" dollars, the amount the family must earn to pay college expenses increases as their tax bracket increases. In other words, a family must first pay the IRS before they pay the college.

Now let's take a look at how college expenses can affect retirement goals.

College Dollars Spent vs. Retirement Dollars Lost

Years	*Public $64,000*	*Private $128,000*	*Elite $192,000*
15	$203,008	$406,016	$621,712
20	$298,304	$596,608	$913,556

Note: The above data assumes an 8% investment rate in after tax dollars

This booklet outlines the top 10 college-planning strategies, in descending order. There are long-term planning strategies for families with younger children and short-term strategies for families with students in high school. Families of all income and net worth levels will usually find that at least one of these ten strategies will offer them an opportunity to reduce their out-of-pocket educational expenses.

Strategy #10
Apply for Financial Aid

<u>Who Benefits Most?</u>
Families of all income and net worth levels.

<u>Potential Benefits?</u>
Lower income families can receive free money from all colleges.

Middle income families can receive free money from private colleges.

Upper income families can receive very low interest student loans from all colleges.

Every family should apply for financial aid, regardless of income. Even students from wealthy families can take advantage of a low cost Unsubsidized Stafford Loan. The interest rate for this student loan, during the academic year 2006-2007, will now be a fixed rate of **6.8%**! Few families can afford to pass up the opportunity to borrow money for college at this low rate.

Most students that attend college are eligible to receive some form of financial assistance. Considering that there is a wide variety of financial aid available, the fact is that there are plenty of opportunities that exist for families and their students. Here's a brief outline of how the financial aid system works:

General Rule of Thumb

Families with income less than $75,000 will most likely qualify for some form of *need-based* financial aid, if the student attends a <u>public</u> college or university.

Families with income less than $125,000 will most likely qualify for some form of *need-based* financial aid, if the student attends a <u>private</u> college or university.

How the Student's Need is Calculated

Financial aid comes in the form of grants, scholarships (free money), loans, and college work-study and is based on the student financial need or the student's merit. Strategy #10 covers only **NEED BASED AID**.

To calculate the student's financial need, the financial aid administrator of the college first establishes the cost of attendance then he or she subtracts the **Expected Family Contribution (EFC)**, which is the amount the college expects the student and parents to contribute.

Cost of Attendance
- <u>Expected Family Contribution</u>
= Financial Need

Cost of Attendance (COA)

The COA used for the Financial Need calculation is considered the full cost of attendance, including:

- Tuition
- Room & Board
- Books & Supplies
- Transportation
- Personal Expenses

Expected Family Contribution (EFC)

The EFC calculation is computed using the parents' and student's income and assets. It also includes the number of family members in the household, the number of students in the family attending college (parents are not included), the amount of taxes paid by the family and various living allowances that are available to the parents and student. The Expected Family Contribution remains constant, regardless of the Cost of Attendance (COA) of the colleges. As a result, the family's financial need increases, as the price of the college increases.

Planning Tip: Normally, the first $3,000 to $5,000 of Financial Need is filled with student loans. The college will fill the remainder with work-study, grants and scholarships, or leave the family with the obligation to pay the balance. It is important to ask the college if they will fill 100% of the student's need *before* the student applies for enrollment. This will prevent any misunderstanding that may result if the college only fills a portion of the student's need and will give you the time to adjust your finances to cover the short fall.

The Financial Aid Process

The first step of the financial aid process for every student and family is to determine the **EFC.** The EFC is determined after the Student and Parents' complete the Free Application for Federal Student Aid **(FAFSA).**

There are three important points that families must understand when completing the FAFSA financial aid form.

1. The FAFSA cannot be filed until after **January 1** of the student's senior year of high school. Furthermore, it must be filed each year the student is seeking financial assistance

2. The Federal Methodology Formula that calculates the family's EFC is based mainly on the parents' and student's **income and assets.**

3. The EFC is **directly** related to the amount of financial assistance the student can receive.

Once the family completes the FAFSA, it is sent to the Needs Analysis Company to calculate the EFC and the result is reported to both the college(s) and the family on the **Student Aid Report (SAR)**. A paper copy of the SAR is then sent to the student's home address about thirty days after the FAFSA has been completed.

Financial Aid Strategies

The following are a few strategies that can increase the student's ability to receive financial aid. Some of these strategies **may not** be appropriate to the family's individual financial situation and in many cases; these strategies should be done several years in advance of the student(s) attending college. The family should also thoroughly evaluate the appropriateness of each strategy, taking into consideration the following:

- Will a particular strategy restrict my access to investments or funds needed to pay college expenses?
- Will changing my finances cause a negative side effect; such as, tax penalties, increase in tax liability, or otherwise defeat my family's financial goals for the future?
- Is the implementation of a particular strategy practical in my circumstance?

Each of the following strategies may have a different effect on your family's personal circumstances. You should consult your own financial professional, accountant, or other financial consultant for help.

Assets in the student's name are assessed at a higher rate than assets in the parents' name. The student's assets are accessed at a flat 20% rate and the parents' assets are assessed at a rate of 5.6%. If your family will qualify for financial aid in the future, you may want to avoid saving for college in the student's name.

Families must also be cautious of the timing of one-time income gains and losses from the sale of investment assets. The timing of a gain or loss from the sale of an investment can affect your financial aid in a big way. For example, if you sell an asset that results in a capital gain, the gain can reduce your financial aid eligibility. On the contrary, a loss on the sale of your investment can increase your financial aid eligibility. Consult your financial advisor on the appropriate timing of selling your investments.

If you are self-employed or run a part-time home based business, there are many tax planning strategies that can reduce your tax liability and provide additional dollars (Tax Scholarships) to cover educational expenses. Always get proper guidance from a tax professional.

Be careful where you invest your money. The new College Savings (529) Plans are great tax-free savings vehicles, but the financial aid ramifications can be devastating. While 529 assets are assessed at the parents' rate of 5.6%, the withdrawal of these 529 funds to pay for college could be assessed dollar for dollar as a **resource** on the entire value of the account (principal and gain).

Example: Johnny's parents will contribute $10,000 to a 529 Plan for Johnny's college expenses. Assuming this fund will grow in ten years to $20,000, Mom and Dad will have saved $500 in taxes by saving in the 529 Plan (tax-free), instead of an UGMA account in Johnny's name ($20,000 – $10,000 x 5% capital gains tax). However, if Johnny qualifies for financial aid, the entire $20,000 could be assessed as a resource with a dollar for dollar assessment rate upon the withdrawal of the 529 monies. That's could result in a loss of $20,000 in financial aid versus a $500 tax saving. You will read more on 529 plans later in this booklet.

Be aware of exempt assets. Insurance products, such as cash value life insurance contracts, annuities and other retirement investments are not taken into consideration in the financial aid formula. Do not include the values of retirement accounts on the FAFSA financial aid forms.

Note: Even though you do not have to count the value of a retirement account (401-K, Simple IRA, Keogh, etc.) as an *asset* on the FAFSA, any contributions that you make during the year to your retirement account will be treated as *untaxed income* in the financial aid formula.

A Primer on College Loans

Over the past two decades, students have increased their dependence on loans as a source of college funding. According to a report issued by the College Board, **the largest portion of all financial aid is given out in the forms of loans.** However, many of these student loans have low rates of interest and can be advantageous to maintain, in limited amounts. The student may qualify for one of the following loans:

Perkins: This need-based student loan carries an interest rate of 5% and is available directly through the college. The maximum yearly amount is $4,000 per year, depending on the school. The principal is deferred and the government pays the interest while the student is in school.

Stafford Loans: There are two versions of this student loan, the Subsidized Stafford Loan (need based) and the Unsubsidized Stafford Loan (non-need based). The Federal government pays the interest and the principal is deferred on the Subsidized Stafford loan, until the student leaves college. The Unsubsidized Stafford loan allows the student to defer the principal payments, but the student must begin paying the interest immediately, (in some instances the principal and interest could be deferred). Every student can qualify for the Unsubsidized Stafford loan, regardless of family income levels.

PLUS Loans: (**P**arent **L**oan for **U**ndergraduate **S**tudents). This is a college loan in the parents name and the parents must undergo a credit check for this loan. PLUS loans have a fixed rate of interest capped at 8.5% and can be used to meet 100% of the Cost of Attendance (less any other financial aid). Payments on PLUS loans begin when the money is disbursed to the family.

The bottom line: Planning ahead and understanding how the financial aid system works can save your family thousands of dollars and keep unnecessary debt down to a minimum. However, you should <u>NEVER</u> try to manipulate the laws of the financial aid system illegally. Remember, if you do not qualify for need-based financial aid, there are hundreds of other strategies (other than financial aid) that can cut college expenses.

Strategy #9
Education Tax Strategy

<u>Who Benefits Most?</u>
Families with income levels below $90,000. Families with income levels between $90,000 and $110,000 can receive partial benefits.

<u>Potential Benefits?</u>
Families can receive an additional $2,000 tax credit by properly applying four academic years of tuition and expenses over a five year tax period.

The Education Tax Laws of 1997 and subsequent Economic Growth and Tax Relief Reconciliation Act Of 2001 allows many taxpayers a significant opportunity to recoup some of their higher education costs with tax credits, such as the Hope Credit and Lifetime Learning Credit.

Hope Credit

The Hope Credit is available for <u>each student</u> in a family. The maximum credit is $1,500 per student. Students can claim this $1,650 tax credit in both their freshman and sophomore years, if they have a minimum of $2,200 in qualified educational expenses (tuition and fees) in each of those years.

To claim the maximum Hope Credit the family's adjusted gross income must be below $90,000 ($45,000 for single taxpayers). It is phased-out at $110,000 in adjusted gross income ($55,000 for single taxpayers).

Lifetime Learning Credit

The Lifetime Learning Credit must be applied against the qualified educational expenses of the entire family. Starting in the year 2003, the maximum credit is $2,000 per student. The family must have a total accumulation of $10,000 in qualified educational expenses (tuition and fees) for all their students, in each year they claim the maximum $2,000 Lifetime Learning Credit.

The family can claim this $2,000 tax credit each and every year they have a student in college. However, they cannot claim the Lifetime Learning Credit for the same expenses in the same year that they claimed the Hope Credit.

To claim the maximum Hope Credit the family's adjusted gross income must be below $90,000 ($45,000 for single taxpayers). It is phased-out at $110,000 in adjusted gross income ($55,000 for single taxpayers).

Note: Both the Hope and the Lifetime Learning Credits cannot be claimed for the same qualified educational expenses (tuition and fees) that are covered by a grant or scholarship (tax-free money). Furthermore, the tax credits cannot be claimed for the same qualified educational expenses (tuition and fees) that are paid for with monies from a tax-free College Savings (529) Plan or a Coverdell Educations Savings Account.

Planning Tip: Families can receive an additional $2,000 tax credit by properly applying four academic years of tuition and expenses, over a five year tax period. If the student attends a private college that has tuition and fees (qualified expenses) above the $10,000 Lifetime Learning Credit threshold, then the family can realize an extra $2,000 tax savings, over the student's four-year academic period.

Example:

Tax Year	Type	$ Credit	Tuition & Fees
1	Hope	$1,650	$2,200
2	Hope	$1,650	$2,200
3	LLC	$2,000	$10,000
4	LLC	$2,000	$10,000
5	LLC	$2,000	$10,000
Total		**$9,300**	**$34,400**

Regardless of the family's ability to claim the maximum dollar amount of education tax credits, families whose adjusted gross income falls within the income phase-out limit can claim a significant tax saving by using this five-year strategy.

Note: If the above $34,400 in tuition & fees were paid for using a grant or scholarship, or with monies from a College Savings (529) Plan or a Coverdell Educations Savings Account, they would become taxable (not tax-free) because the family elected to take the Hope Credit or Lifetime Learning Credit during the same period, for the same qualified education expenses!

Strategy # 8
Company Educational Assistance Programs

Who Benefits Most?
Business owners who employ children that are 21 years of age, or older.

Potential Benefits?
The business owner can deduct $5,250 of undergraduate, or graduate, school expenses. Furthermore, this benefit is not considered as income to the student, or the business owner.

In 1978, employers began offering educational assistance programs to their employees. Under these programs, amounts paid, or expenses incurred, by employers for educational assistance to employees are excluded from the employee's gross income [IRC Sec. 127(a)(1)].

Employers are not required to offer educational assistance to employees. However, with increased technology in the workplace, the continuing education of employees is necessary to ensure the employer will stay competitive in the market place. Many employers recognize this and choose to offer educational assistance benefits. These benefits may take several forms, including formal educational assistance plans for employees; formal scholarship plans for employees and/or their dependents; and tuition reduction programs offered to the employees (and/or their dependents) of college and universities.

However, there are some very specific IRS regulations that must be followed in order to qualify for this benefit. To be qualified, an Educational Assistance Plan must meet the following requirements [IRC Sec. 127(b)]:

1. It must be a separate written plan of the employer. The terms of the program (i.e., eligibility, benefit requirements, and claims procedures) must be set forth in a separate document specifying the details of the tuition assistance that qualifies for the exclusion.
2. It must be used for the exclusive benefit of employees. The term "employee" may include retired, disabled or laid-off employees, employees on leave (e.g., in the U.S. Armed Forces), and self-employed persons. However, the program cannot benefit employees' spouses or dependents, unless they are also employees of the employer.
3. It must be nondiscriminatory. This means the plan must meet an eligibility test and a 5% concentration test.
4. Reasonable notice of the availability and terms of the educational assistance program must be provided to all eligible employees.

The self-employed businessperson can also set up an Educational Assistance Program. The courses need not be job-related and benefits cannot exceed $5,250 per employee during a calendar year. The advantages of these programs can be substantial for both the self-employed businessperson and the employee. They are as follows:

- The employee does not have to report the amount of the educational assistance as income on his tax return.
- The employer and the employee are not responsible for any payroll taxes on this type of employee compensation.
- The employer receives a current tax deduction for the education assistance paid.
- The employer does not have to fund this program, as is the case in other types of employee benefits.

The self-employed business owner can also provide this fringe benefit for their own children, if they employ them in their business. In order to qualify for this fringe benefit, the following tests must be met:

(1) The child must be a legitimate employee of the business,
(2) The child must be age 21, or older,
(3) The child must <u>not</u> own more than 5% of the business and,
(4) The child must <u>not</u> be a tax dependent of the parent owner.

If the self-employed business owner meets these stipulations, he may be able to write-off one or two years of undergraduate college costs, or $5,250 - $10,500.

> **Planning Tip**: The Economic Growth and Tax Relief Reconciliation Act Of 2001 increased the Employee Assistance Plan benefits to include <u>graduate school expenses</u>, starting in the year 2002. This means a self-employed business owner (medical doctor) can now employ his child and deduct $5,250 for each year of graduate school. This can result in significant tax savings that can be used for college expenses over the student's academic career.

Note: Benefits received from an Employee Assistance Plan can have negative financial aid consequences for the student. The family should always engage the services of a financial professional who understands the complicated regulations of these Section 127 Educational Assistance Programs.

Strategy #7
Farmers – Gifting Crops

Who Benefits Most?

Middle and upper income farm families.

Potential Benefits?

Farmers can shift their ordinary income tax liability to the student's lower capital gains tax liability. The result can yield more than $6,000 in tax savings per year that can be used for college expenses.

A little-known IRS Private Letter Ruling (Rev. Ruling 55-531) provides farmers with an extraordinary income/asset-shifting strategy that can be used to increase cash flow for college expenses. It allows the farmer to gift $24,000 (annual exclusion for joint gifts) in grain/tobacco/other crops, etc. each year to his child (student) and shift his ordinary income tax liability to the student's lower capital gains tax liability.

If the farmer were to sell his crops, the sale would be treated as an earned income event, subject to ordinary income taxes. However, if the farmer (and spouse) gifts the crops to the student, the student can then treat his sale of these gifted crops as a capital gain.

Harvested crops in the hands of a farmer can become a capital asset if the purpose for holding the crops changes for the following reasons:

- If the farmer gives or bequeaths crops to the student who is neither a farmer, nor a dealer in grain, the grain is considered a capital asset when possession is in the student's hands.
- If the farmer changes his purpose for holding the grain to an investment purpose, then it will be considered a capital asset. If this investment crop is held for a period of one year, then it becomes a long-term capital asset.

There is a considerable advantage to giving crops to someone (student) in a lower tax bracket.

- The amount of income realized from the sale of the crops by the student is the difference between the cost and the sale price. Since the crops acquired by the student are a gift, the student's cost basis is zero (Internal Revenue Code 1014).
- The farmer can deduct his cost of producing the crops as long as those crops were held for one year prior to gifting the crops to the student (Rev. Ruling 55-531).
- The farmer's holding period can be combined with the student's holding period for long-term capital gains purposes, if held for one year (Internal Revenue Code 1223).
- The gift removes the value of crops from the farmer's earned income and the farmer will not have to pay income taxes, or self-employment taxes.

Example: The farmer (and his spouse) will ordinarily pay 45% (25% federal, 15% self-employment, 5% state) tax on the sale of his grain. However, if this grain is gifted to the student and then sold one year later, only a 5% capital gains tax would be due by the student. This equates to a tax saving of $9,600 ($24,000 x 40%) per year, which can cover much of the student's expenses at a local public university.

To successfully shift income from the farmer to the student, the student must have control of the crops before any arrangements are made for the sale of the crops. There should be sufficient time between the date of the gift and the sale of the crops to demonstrate to the IRS that they are not one transaction. Furthermore, the crops must be stored totally separate from the farmer's other crops.

The following is a sample "Declaration of Gift" document that can be used to substantiate the legal gift of crop transaction:

Sample Declaration of Gift

I, (farmer's name), of Louisville, Kentucky, own the crops (soybeans, etc.) stored in a separate 3,000-bushel steel bin located on my farm at the above address. I desire to give this property to my children (grandchildren) and to carry out my purpose, I do hereby give and deliver these crops to:

Name of student(s)

As tenants in common, the property is described as follows:

All the crops located in the 3,000 bushel steel bin labeled (name on the bin) located on my farm at 5200 Walker Road, Louisville, Kentucky.

Furthermore, I give (Student's name) rent-free use of this bin for as long as he desires. To complete this transfer, I am giving all the keys to the lock on the bin to (Name of custodian) as agent for (Student's name), a minor child.

It is distinctly understood by me that it is my purpose and intention to vest all incidents of ownership of said property to (Student's name) from this time forward.

______________________________ ____________

Signed Date

Strategy #6
Small Business Owner

Who Benefits Most?

Small business owners who employ both their spouse and their children.

Potential Benefits?

The small business owner can reap considerable tax and financial aid benefits that may then be used to supplement their retirement fund.

Paying for college is difficult enough for families, let alone contributing to retirement during college years. However, here is a strategy that small business owners can use to do both. This strategy allows the small business owner to:

1. Deduct 100% of the family's medical expenses from the business and create a significant tax savings,
2. Increase the financial aid eligibility for any children attending college.
3. Increase the small business owner's contributions to retirement by funding a SIMPLE IRA, using the money saved by the above two benefits.

The following is an example case study:

Example: Assume a family of four with one child in college. The small business owner has a sole-proprietor business with net income of $50,000. The small business owner hires his spouse and pays her $8,000 in wages, plus sets up a medical reimbursement plan (IRC Section 105) to pay for the family's estimated medical costs of $5,000 per year.

The parents are in the following tax brackets:

- Federal - 15%
- State - 5%
- Self -Employment - 15%

The small business owner also employs the two children. The college student (age 18) receives $2,500 in summer wages and the younger child (age 16) also receives $2,500 in summer wages.

The children are in the following tax brackets:

- Federal - 10%
- State - 5%
- 15% - Self -Employment

Planning Tip: IRC Section 105 provides a unique tax deduction for employee medical expense that is reimbursed by the employer. This fringe benefit is not considered taxable income to the employee, yet provides a tax deduction for the employer. If the employer also has a college-bound student on the plan, the result is a tax saving that can be used to pay college expenses.

Tax Savings Opportunity:

1. The child in college (age 18) must pay social security taxes; whereas, the younger child (age 16) is exempt from paying social security taxes if employed by a parent and under 18 years of age.

2. The medical expense is deducted on IRS Schedule C or F, which reduces parents' federal, state and self-employment taxes.

3. The SIMPLE IRAs are both deducted from IRS Schedule 1040, which reduces only federal and state taxes.

The total ***tax savings*** using the above strategy is:

- Wages to the child in college: $2,500 x 15% = $375
- Wages to the younger child: $2,500 x 30% = $750
- Medical expense deduction: $5,000 x 35% = $1,750
- Taxpayer's SIMPLE IRA: $7,000 x 20% = $1,400
- Spouse's SIMPLE IRA: $7,000 x 20% = $1,400

Total Tax Savings = $5,675

Financial Aid Opportunity:

1. The Federal Financial Aid Formula dictates that parents in the $50,000 income bracket make available 47% of their income to pay for college expenses, before financial aid is awarded.

2. The Federal Financial Aid Formula allows a $3,100 deduction from financial aid income as an Employment Expense Allowance, if the family has two working parents.

3. The Federal Financial Aid Formula dictates that retirement (SIMPLE IRA) contributions are added back to financial aid income; thereby eliminating any financial aid savings.

The total ***financial aid savings*** using the above strategy is:

- Parents' Adjusted Gross Income decrease for children's wages: $5,000 x 47% = $2,350
- Parents' Adjusted Gross Income decrease for medical expense: $5,000 x 47% = $2,350

- Employment Expense Allowance: $3,100 x 47% = $1,457

  Total Fin Aid Savings = $6,157

The resulting tax and financial aid savings of **$11,832** allows the family to contribute nearly $12,000 each year towards their SIMPLE IRA retirement plans during college years!

Strategy #5
Ed IRA - Roth IRA - 529 Plan

Who Benefits Most?
Families who do not qualify for financial aid or receive grants or scholarships from the private colleges, or from the federal or state governments.

Potential Benefits?
Potentially significant tax benefits for families who do not qualify for the Hope or Lifetime Learning tax credits.

The high cost of college has made it very difficult for families to save for college and retirement at the same time. The Economic Growth and Tax Relief Reconciliation Act of 2001 provided some help for parents who start saving for college expenses early by introducing tax-free savings vehicles in the College Savings (529) Plan and the Coverdell Education Savings Account (the old Education IRA).

The Roth IRA can also be an attractive vehicle to use for college because of the tax and penalty-free withdrawal of original contributions. Furthermore, the ability to use all three investment vehicles as a combination college/retirement savings strategy can provide more flexibility for parents than saving in only one vehicle. First, let's take a look at the advantages and disadvantages of each:

Education Savings Account

Advantages

- Tax-free accumulation and withdrawal of earnings for qualified education expenses.
- New contribution limit of $2,000 per year, per person.
- Can be used for elementary and secondary school expenses.
- Contributor has complete investment flexibility.

Disadvantages

- Contributors must have less than $190,000 in modified adjusted gross income ($95,000 for single filers) in order to qualify for a full $2,000 contribution. The $2,000 maximum is gradually phased out if your modified adjusted gross income falls between $190,000 and $220,000 ($95,000 and $110,000 for single filers).
- The beneficiary of the account must be under the age of 18 at the time of the contribution and under 30 years of age at the time of withdrawal.
- Account withdrawals cannot be applied to the same qualified educational expenses used to claim the Hope or Lifetime Learning credit, or the Education Savings Account.

withdrawals will be taxable. The tax law will not allow you to "double-dip" by claiming multiple tax breaks for the same expense.

- The contributor has little control of the investment because the Education Savings Account will eventually go to the child, if not used for college. You cannot simply refund the account back to yourself as allowed with most 529 plans.

College Savings (529) Plan

Advantages

- Tax-free accumulation and withdrawal of earnings for qualified education expenses.
- Contribution limits as high as $300,000 and up, per student.
- Contributors do not have income limitations or phase-outs.
- Account owners can withdraw the 529 plan funds and put back in their name (however, they then become taxable).
- Account owners can rollover the 529 plan funds into other family beneficiaries.
- Some states allow an income tax deduction for contributions to the 529 plan.
- 529 plan funds can be used for either undergraduate or graduate courses.

Disadvantages

- The account must be used for "qualified education expenses", or the earnings will be taxed to the account owner at his ordinary income tax rate.
- Contributor has limited investment flexibility within the account.
- Account withdrawals cannot be applied to the same tuition and fees you use to claim the Hope or Lifetime Learning credit, or the 529 plan withdrawal will be taxable. The tax law will not allow you to "double-dip" by claiming multiple tax breaks for the same qualified educational expenses.

Roth IRA

Advantages

- Contribution limits per year, per person increase from $3,000 in 2004 to 4,000 in 2005-7, and 5,000 in 2008-11
- ***Contributions*** can be used elementary, secondary, undergraduate or graduate courses, or the entire amount of the Roth IRA can be used for retirement

- Withdrawals are assumed to come from the original contributions first (FIFO) and the earnings are only taxed if withdrawals from the Roth IRA exceed the original contributions

- Tax and penalty-free withdrawal of original contributions

- The contributor has complete investment flexibility and control over the account

- The Roth IRA account is considered a retirement account and is not counted in the financial aid formula.

Disadvantages

- Contributors must have less than $190,000 in modified adjusted gross income ($95,000 for single filers) in order to qualify for a full $2,000 contribution. The $2,000 maximum is gradually phased out if your modified adjusted gross income falls between $190,000 and $220,000 ($95,000 and $110,000 for single filers).

- Withdrawals of the "earnings' portion of the Roth account, prior to age 59 ½, will be assessed ordinary income taxes and penalties.

- Rollovers from other retirement accounts to the Roth IRA will be taxed at ordinary income tax rates on the entire amount of the deductible contribution. Non-deductible contributions are not taxed.

Planning Tip: The new contribution limits allowed by the passing of the Economic Growth and Tax Relief Reconciliation Act of 2001 now provides long-term savers with the unique opportunity to combine the Roth IRA, the College Savings (529) Plan and the Education Savings Account into one college/retirement savings strategy. In this case, funds can be available for a myriad of purposes, including (but not limited to) elementary, secondary, undergraduate or graduate school expenses.

Example: Johnny's parents own a successful clothing store and plan to send Johnny to a private college when he graduates from high school in ten years. The cost of this particular school in ten years will be approximately $100,000. To fund Johnny's education, they decide to contribute $2,000 per year ($20,000) into a College Savings (529) Plan, $2,000 per year ($20,000) into an Education Savings Account and a total contribution of $41,000 into a Roth IRA, over the ten-year period.

If each investment grows at an annual rate of 7%, Johnny's will have a total of $100,134 to fund his education expenses in ten years **($29,567** in Coverdell funds, **$29,567** in 529 funds and the original contribution of **$41,000** to the Roth IRA).

Below is the calculation:

Year	ESA	529 Plan	Roth IRA	Roth Contribution	Total
2002	$ 2,140	$ 2,140	$ 3,210	($3,000)	$ 7,490
2003	$ 4,430	$ 4,430	$ 6,645	($3,000)	$ 15,505
2004	$ 6,880	$ 6,880	$10,320	($3,000)	$ 24,080
2005	$ 9,501	$ 9,501	$15,322	($4,000)	$ 34,324
2006	$12,307	$12,307	$20,674	($4,000)	$ 45,288
2007	$15,308	$15,308	$26,401	($4,000)	$ 57,017
2008	$18,520	$18,520	$33,600	($5,000)	$ 70,640
2009	$21,956	$21,956	$41,302	($5,000)	$ 85,214
2010	$25,633	$25,633	$49,543	($5,000)	$100,809
2011	$29,567	$29,567	$58,361	($5,000)	$117,495

"Rates of return are hypothetical, are not representative of any one investment and are for illustrative purposes only."

Strategy #4
Tax Efficient Investments

Who Benefits Most?
Families of all income and net worth levels.

Potential Benefits?
Better investment control and flexibility. Can reap the same tax-free benefits as a 529 plan, without losing the ability to claim the Hope and Lifetime Learning tax credits. Has less negative financial aid consequences than the 529 plan.

Considerable fanfare followed the passing of the Economic Growth and Tax Relief Reconciliation Act of 2001. Beginning in 2002, parents can now use the College Savings (529) Plan and the Education Savings Account to save for their children's college (and even elementary and secondary school) expenses on a tax-free basis.

While the earnings from contributions to these college saving vehicles are tax-free, there are potential pitfalls regarding withdrawals from these two funds that people tend to overlook; such as:

The Hope and Lifetime Learning Credits cannot be claimed for the same qualified educational expenses that are paid with monies from a College Savings (529) Plan or an Education Savings Account. As demonstrated in the example in Strategy #9, monies withdrawn from the College Savings (529) Plan or an Education Savings Account cannot be considered "tax-free", if the family elected to take the Hope Credit or Lifetime Learning Credit during the same period for the same qualified education expenses.

Families can avoid the above pitfall altogether by investing in tax-efficient investments. The account owner also has more investment control and flexibility with tax-efficient investments. The major advantage of investing in the Education Savings Account and the 529 Plan is the tax benefits. The Education Savings Account and 529 Plan are both tax-free, while regular investments are assessed at capital gains tax rates (15%).

Planning Tip: Tax efficient investments can be used as a savings vehicle to control the tax liability, until the investments are distributed for college. The parents' capital gains tax (15%) on these tax efficient investments can then be reduced to 5%, by gifting the funds to the student when his education expenses become due. If enough money has been gifted to the student to provide the majority of his own support, he can claim the dependent tax exemption. This also allows the student to claim the Hope and Lifetime Learning Credit and reduce his 5% capital gains tax to zero.

An example of this strategy will be provided later. The following is a comparison between the College Savings (529) Plan and Tax-Efficient Investments:

Investment Control

College Savings (529) Plan

- Investment Control is limited
  - Must be used for “qualified” educational expenses to get the tax-free benefits.
- Withdrawals for any other reason will trigger adverse tax effects and penalties

Tax-Efficient Investment

- You have total control of your money
- You determine exactly when, and how much, to withdraw from the investment (Exit strategy control)

Investment Flexibility

College Savings (529) Plan

- Must be used for college expenses during the college years
- Many states have limited investment options
- Many states use standardized age-based portfolios that control your rate of return
- Subject to many different Federal and State regulations

Tax-Efficient Investment

- The investor has many investment options.
- Can be used to fund:
  - K-12 education expenses
  - College expenses
  - Graduate school expenses
  - Retirement
  - Emergency funds

Tax Benefits

College Savings (529) Plan

- Must be used for “qualified” educational expenses or the account owner is subject to ordinary income tax and penalties
- Tax penalties can trigger additional interest charges and a notice from the IRS.

Tax-Efficient Investment

- Taxed at lower capital gains (15%) rate, regardless of the reason for withdrawal
  - Gifts directly to the child (grandchild) for college or K-12 expenses can be taxed at the child’s 5% capital gains tax rate
- The student can claim his own tax exemption and further reduce his taxes

Financial Aid Opportunities

College Savings (529) Plan

- Withdrawals cannot be used to repay student loans
- Withdrawals may be treated as student resource by some colleges, which can reduce the student's financial aid eligibility dollar for dollar.

Tax-Efficient Investment

- Withdrawals can be used to repay student loans after graduation, thereby avoiding the financial aid "trap".

Tax efficient investments can be used to:

1. Maintain complete control and flexibility of your investment,
2. Reduce your taxes to nearly zero,
3. Qualify for financial aid,
4. Qualify for the Hope and Lifetime Learning Credits, and/or
5. Use the investments for retirement.

The following example will demonstrate how to achieve this:

Example: Mom and Dad earn over $300,000 a year and will contribute $10,000 of the earnings each year into a tax efficient investment, to cover both Johnny's education and their retirement. This college/retirement fund grows from $100,000 to $200,000 in ten years. Johnny then decides to attend a private college that costs 24,000 per year. To cover this cost, Mom and Dad decide to gift $24,000 to Johnny each year. The $24,000 gift will allow Johnny to cover over 50% of his yearly support and he can therefore claim his own tax exemption. Johnny's income each year will be $8,700:

$ 12,000 - from the gift ($24,000 x 50% ($200,000 – $100,000)
\- $3,300 - tax exemption
= $8,700

As a result, Johnny's tax liability on this income will be $435 ($8,700 x 5% capital gains tax). Johnny can also claim the Hope and Lifetime Learning credits each year and this $435 tax can be further offset to zero. Mom and Dad would have paid $1,800 ($12,000 x 15%) in taxes each year would they have not gifted the tax efficient investments (and shifted the income) to Johnny. The result is a tax saving of **$7,200** ($1,800 x 4) over a four-year period.

Strategy #3
Institutional Aid

Who Benefits?
Families of all income and net worth levels.

Potential Benefits?
Students who market themselves correctly can receive as much as a 40% of the tuition cost in institutional aid, thus lowering the cost of a private college within the same range of a public university.

The nation's private colleges continue to provide considerable institutional aid for good students, according to an Institutional Aid Executive Summary released by the National Association of College and University Business Officers. Because private colleges receive little or no support from state tax dollars, many private colleges must offer institutional aid to stay competitive with the lower cost state colleges.

Institutional aid comes from the private colleges' own institutional funds and is given to students in the form of merit grants and scholarships. Regardless of the family's income level and qualification for need-based financial aid, the private college will also provide good students with considerable institutional aid to help attract them to its institution.

Institutional aid allows private colleges to compete for the best students. In many cases, this institutional aid will lower tuition costs into the same price range as a public university. Students looking for a quality college education should always apply to private colleges to determine if they qualify for institutional aid.

It is important for the parents to ask for information from each private college about the various merit grants, scholarships and other incentives available, as they differ from college to college.

Positioning the Student

Institutional aid is not guaranteed. Students wishing to be considered for institutional aid must position themselves correctly to be recruited by private colleges. Proper positioning begins early in high school and involves the following seven factors:

1. Good Grades
2. Good SAT/ACT test scores
3. A solid resume of achievement
4. Apply early in the academic year
5. Apply to schools that recruit the same students
6. Apply to schools that have a low yield factor
7. Apply to 6-8 colleges

Good Grades

Good grades are self-explanatory. The presumption is that good grades in high school will mean good grades in college and ultimately graduating from college and becoming an alumnus. A student should have a minimum of a 3.0 GPA in high school to be in the running for a tuition discount.

SAT/ACT Test Scores

The SAT/ACT college prep test scores are merely qualifiers, but colleges have no other way to compare the academic abilities of a student from Ohio with a student from California. A student should have a minimum of 24 (36) ACT or 1850 (2400) SAT test score to be in the running for institutional aid.

Solid Resume of Achievement

Throughout their high school years, students should build a solid resume of achievement and list any civic groups or community service projects that they were involved in. This will demonstrate to the colleges that the student is well rounded and is active in student affairs outside of normal studies. Treat this exactly the same as preparing a resume for a job! Send a resume with the application to each school.

Apply Early in the Academic Year

Apply to the various colleges early in the senior year of high school (September-December). The rule of thumb here is the earlier the better! Remember, once a particular school begins to fill the upcoming year's freshman class, the need for a private college to offer institutional aid diminishes.

Apply to Schools that Recruit the Same Students

Private colleges compete with each other for the same students and are more likely to give significant institutional aid if they know the student is also applying to a competitive school.

> **Planning Tip:** If the student wishes to attend a particular Christian college, he should also apply to other Christian colleges within a radius of 200 miles. The student can also achieve the same effect by applying to other colleges in the same academic or athletic division or conference, as the college he wishes to attend.

Apply to Schools that Have a Low Yield Factor

$$\text{Yield} = \frac{\text{Number of students actually enrolled}}{\text{Number of student admitted}}$$

Look to apply to colleges that have a high amount of student's that are admitted, but a lower number that actually enroll. Enrollment is key to a college's survival. Many colleges select students for admission to their school only to have them enroll and attend another. Private colleges have a constant battle to fill seats every year. The second tier private colleges are even more challenged because they must compete with the low cost of public universities and the popularity of the elite private (Ivy League) schools. As a result, the student has a high probability to receive institutional aid from private colleges with a low enrollment yield percentage.

Apply to 6-8 Colleges

Students should apply to a minimum of 6-8 colleges. At least four should represent private colleges that compete with the student's first choice college. Applying to several colleges gives the student the opportunity to receive institutional aid from one college and use that award to ask for a similar, or better, award from the college the student would prefer to attend.

Strategy #2
Tax Capacity Model

Who Benefits?

Middle and upper income and net worth families.

Potential Benefits?

Potentially significant tax savings and cash flow accumulation for families who can shift income and assets to the student's lower income tax bracket.

There are many income tax strategies that are education-related that upper income families can use to help fund future college costs. Since college costs are paid with after-tax dollars, strategies that can lower income taxes, gift taxes, and estate taxes will significantly increase the family's disposable income available to pay for college expenses. Families in the 35% Federal income tax bracket for example will pay almost 50% in taxes, once social security and state taxes are included. At this 50% rate, the family must earn $36,000 in order to pay for a $18,000/yr. public university education and $80,000 for a $40,000/yr. private college degree!

Income shifting to children in a lower tax bracket is a very effective tax strategy to accumulate funds for future college costs. Income shifting can be accomplished by moving income-producing assets from the parents or grandparents to the student's name. Income generated from these assets is then taxed at the child's lower income tax rates and the family receives a significant tax savings.

Shifting income and assets over an extended period of time to take advantage of the student's lower tax bracket is a unique, innovative and legal method called "Tax Capacity". Tax Capacity can be used by upper income families to achieve considerable tax savings, which can be used to increase the amount of funds available for college. However, one should always consult their CPA or financial advisor prior to implementing the Tax Capacity Model.

The Tax Capacity Model can be separated into three time frames:

- Birth through age 17, the Kiddie tax years
- College years

Methods of Income/Asset Shifting

Parents can shift income (and the related assets) in one of three ways:

- Parents own appreciated and marketable assets, which are capable of transfer to the child by gift, followed by a sale by or on behalf of the child.

- Parents with proprietorships or other businesses can pay compensation to the child during teen years.

- Parents with no appreciated assets, or family compensation opportunities, can shift after-tax dollars to the child as early as possible by annual gifts, so that growth and earnings on the investments are taxed at the child's rates rather than parental rates.

Shifting by Gifting Appreciated Assets

A gift of appreciated assets from the parents to the child is a popular way to also shift the income of those assets to the child. Using this method of income shifting, the parent can keep control of the asset until it is needed for college.

> **Example:** The parents have taxable income of $350,000. This income level makes the parents ineligible to claim a tax exemption ($3,300 in 2006) for their child. The family's financial advisor suggests that they give $24,000 of stock (which has appreciated by $18,000 in four years), to the child. The following year (the first year of college) the child can sell the stock and use the investments for his college expenses. Since the $24,000 gift of stock will provide over half of the student's annual support, the student can now claim the $3,300 tax exemption on his tax return.
>
> By gifting the appreciated stock, the student will have taxable income of $14,700 ($18,000 gain - $3,300 exemption) and pay only $1,470 of income taxes (10% x $14,700). The student is now eligible to claim the Hope and Lifetime Learning credits, which can reduce his tax liability to zero for the four years the student is in college.

As a result, the parents' capital gain tax of $2,700 (15% capital gains rate x $18,000 gain) on the $24,000 stock sale will be reduced to zero resulting in a $2,700 per year tax saving.

Shifting Income by Compensating the Child

Parents with a business or rental can pay compensation (wages) to the child and achieve tax benefits that can be used to pay for college expense. The wages paid to the child is considered earned income and is not subject to the Kiddie tax rule.

Sole proprietors, or husband-wife partnerships, can pay their children (under the age of 18) for services performed for the business, without incurring a Social Security or self-employment tax. This method of shifting income can create extra cash flow for college expenses as long as the parents' income tax bracket is greater than the child's tax bracket.

> **Example:** A parent owns a sole-proprietorship business. The parent decides to hire his 15-year-old child to clean the business premises. The child is paid a reasonable wage of $4,000 per year and encouraged to save these earnings for future college costs. The child's taxable income is zero ($4,000 wages - $5,150 standard deduction); therefore there is no tax due on the wages. If the parent is in a combined 40% tax bracket (federal 35% + state 5%), the $4,000 in wages will save $1,600 (40% x $4,000) in taxes each year.

In addition to the tax saving benefits of hiring a child, the child would be eligible to save for college by using his earned income to purchase an IRA (either Roth or regular IRA). The tax-deferred growth of an IRA can provide a substantial accumulation of funds by the time the child attends college.

Shifting by Giving Assets that Earn and Grow

Families that do not have appreciated assets, or the opportunity to compensate the child through a business, can use an alternative strategy to shift after-tax dollars to the child. This can be done using annual gifts of money to the child that will grow until needed for college and be taxed at the child's tax rates. Tax efficient investments (Strategy #4) is one of the vehicles that can be used to defer income until college years, allowing the family to utilize the following techniques to create a zero tax liability:

1. The child claims his or her own personal exemption.
2. The child, as a nondependent, receives a full standard deduction.
3. The child may claim either the Hope Credit or the Lifetime Learning Credit for tuition expenditures.

   Example: Dr. Smith is a 45 year-old physician who earns $150,000 per year and has not saved for his son Johnny's (age 11) college education. The doctor is the sole shareholder and employee of an S-Corporation. The cost of Johnny's college education is estimated to be $150,000. Dr. Smith's financial condition is as follows:

Assets	
Savings & Investments	$ 40,000
Home Value	$300,000
Rental Property	$100,000
Medical Practice	$150,000
Retirement	$250,000
Total Assets	**$840,000**
Liabilities	
Credit Cards	$ 5,000
Loans – Med School	$ 40,000
Home Mortgage	$200,000
Total Liabilities	**$245,000**
Net Worth	**$595,000**

In this example, Dr. Smith wants to keep his savings and investments for emergency purposes and does not want to borrow from his retirement to send Johnny to college. The rental property (value of $100,000) provides a yearly income of $10,000 and is fully depreciated. Dr. Smith earns too much money to qualify for financial aid. To maximize his ability to save for Johnny's education, Dr. Smith takes the following financial steps when Johnny is 11 years old:

1. Dr. Smith takes out a second mortgage of $20,000 and purchases Treasury Bonds that will earn 5% interest.

2. Dr. Smith employs Johnny in his business at a salary of $3,000 per year, then $4,000 in his senior year of high school.

3. Dr. Smith will fund an Education Savings Account for Johnny through his S-Corporation, in the amount of $2,000 per year. The corporation will receive a $2,000 deduction and Johnny will receive an additional $2,000 in income, each year.

4. Dr. Smith and his wife will gift 20% ($20,000) of their rental property each year for five years, beginning when Johnny turns 14 years old. This gift will allow Johnny to receive the full $10,000 of income (cash flow) from the rental property when he turns 18. Furthermore, Dr. Smith will have eliminated $100,000 from his estate.

Using the Tax Capacity model, Johnny will accumulate $114,252 in funds by the end of high school. The rental property will also provide an additional $10,000 in cash flow for each year of college, until he graduates. The final result will be $154,252 in available funds for the estimated $150,000 cost of college. Furthermore, Dr. Smith will save $27,590 in taxes, which is the same as receiving $27,590 in scholarships. (Note: This model could have been initiated in earlier years to help pay for Johnny's private elementary and secondary school expenses.)

The following **Exhibit 1** demonstrates the above Tax Capacity example:

Exhibit 2-1

Year		2002	2003	2004	2005	2006	2007	2008	2009	
Age of Child	Notes	11	12	13	14	15	16	17	18	TOTAL
Child's Wages *(Includes corp. Education IRA contribution)*	A	5,000	5,000	5,000	5,000	5,000	5,000	5,000	6,000	41,000
Rental Income	B				2,000	4,000	6,000	8,000	10,000	30,000
Interest/Dividends		1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	11,200
Regular IRA Deduction		(2,000)	(3,000)	(3,000)	(3,000)	(4,000)	(4,000)	(4,000)	(5,000)	(28,000)
Standard Deduction		(4,700)	(4,700)	(4,700)	(4,700)	(4,700)	(4,700)	(4,700)	(4,700)	(37,600)
Personel Exemption									(3,000)	(3,000)
Taxable Income		(300)	(1,300)	(1,300)	700	1,700	3,700	5,700	4,700	13,600
Tax Rate		10%	10%	10%	10%	10%	10%	10%	10%	
Tax Liability before HOPE Credit		-	-	-	70	170	370	570	470	1,650
HOPE Credit									(470)	(470)
Net Tax Liablity		-	-	-	70	170	370	570	-	1,180
Taxes parents would have paid	C	2,240	2,240	2,240	2,940	3,640	4,340	5,040	6,090	28,770
Tax Savings		2,240	2,240	2,240	2,870	3,470	3,970	4,470	6,090	**27,590**
Accumulated Funds:	D									
Rental Income *(Invested in 529 Plan with 7% earnings)*					2,140	6,570	13,450	22,952	35,259	35,259
Treasury Bond (5%)		20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Corporate Education IRA		2,140	4,430	6,880	9,501	12,307	15,308	18,520	21,956	21,956
Child's Regular IRA contribution		2,140	5,500	9,095	12,941	18,127	23,676	29,614	37,037	37,037
Total pre-college funds		24,280	29,930	35,975	44,582	57,004	72,434	91,086	114,252	114,252
Rental Income - Age 19										10,000
Rental Income - Age 20										10,000
Rental Income - Age 21										10,000
Rental Income - Age 22										10,000
Total funds available for college										154,252

"Rates of return are hypothetical, are not representative of any one investment and are for illustrative purposes only."

Strategy #1
Personal Residence Loans

Who Benefits?
Families of all income and net worth levels.

Potential Benefits?
The family can pay for educational expenses, pay off their mortgage sooner than expected, and accumulate additional funds for retirement, without changing their present financial lifestyle.

A personal residence loan can be a tremendous source of cash flow for college expenses when the family has not saved for college and have no other resources to tap. Although many parents do not want to mortgage their home to pay for college costs, it may be a better source of funds than borrowing from their business assets or their retirement accounts. Even families that have saved for enough money for college should consider borrowing on their home equity to pay for college costs, when the following reasons apply:

Assets are tied up in high-yield investments
There are advantages of not accessing high-yield investments to pay college expenses, especially if there is a considerable spread between the interest earned on the investment and cost of the loan. A 2% spread on $25,000 is equal to $500, which results in the same benefit as a $500 scholarship. There are also other costs that must be considered when selling an investment, such as income tax and capital gains tax.

Assets are tied up in a business
If your family owns a business and the assets are tied up in income producing capital, it may not be feasible to sell, or borrow against, those capital assets. The earning power of those assets may be much greater than the cost of the loan.

Your assets are tied up in retirement accounts
You should never access your retirement accounts to fund college costs. The cost is simply too great. Removing money from your retirement funds can cost you taxes, penalties and interest. You may not have enough time to make up for this loss of cash flow. Furthermore, you can always borrow money for college expenses, but not for your retirement.

Tax benefits
A personal residence loan is one of the few investment vehicles whose interest charges are tax deductible. Families in high income tax brackets can take maximum advantage of this tax write-off. Parents, whose income is too high to take advantage of the student loan interest deduction, can use the interest on a mortgage loan to provide an itemized tax deduction.

There are a wide variety of personal residence loans that can be used to fund college expenses. The family can use any combination of mortgage loans with fixed or adjustable rates to meet their intentions, including those with minimum monthly payments while the student is in college.

Planning Tip: The COFI (Cost of Funds Index) Loan is a little-known mortgage loan that can maximize cash flow for college years. The COFI loan has a minimum monthly payment option, for people who are interested in further reducing their monthly payment. This allows the family to maximize their cash flow and discretionary income during the college years. The family can pay the minimum monthly payment which can free up funds for alternative uses, or make larger payments for faster equity accumulation.

Many families find themselves with a shortfall of funds to pay the entire cost of college. To increase cash flow the family can either increase their amount of assets, or decrease their liabilities (debt).

Planning Tip: Families can use the same method used by many corporations to decrease liabilities and increase cash flow called **debt restructure** or **debt consolidation**. Companies do this by refinancing their assets and consolidating all their debts into one smaller payment extended over a longer period of time. This allows them to make their assets more productive and establish a new budget for expenditures.

Families can significantly increase their cash flow by applying the same debt consolidation methodology to their liabilities, such as home mortgage, car loans and credit card debt. By consolidating their debt payments into one lower cost payment, families can increase cash flow to pay college expenses, fund their retirement and even pay of their home mortgage earlier than anticipated once the student is out of college.

The theory behind debt consolidation is simple. Home equity is one of the family's main assets, yet home equity is a very unproductive asset. You can only increase home equity by one of two ways, 1) increasing the value of your home, or 2) decreasing the debt owed on it. Otherwise, the home equity asset remains dormant and unproductive until you sell your home. The only way to make home equity productive, during the time you own the home, is to borrow the excess equity and wisely use the increased cash flow for productive purposes; such as paying off your high interest installment loans or credit cards.

By refinancing the family's personal residence, the old mortgage and all other high interest/high cost debt can be paid off with a new, lower cost mortgage. The result is a lower monthly payment that creates extra cash flow that can be used to pay college expenses. There may also be additional tax deductions available with the new mortgage that can further increase your cash flow availability.

Example: The Smith family would like to send their children (Johnny – a senior and Sally – a sophomore) to college. Mr. and Mrs. Smith earn a total of $75,000 per year in income, but have saved absolutely no money to cover Johnny and Sally's educational expenses. Johnny and Sally plan to contribute to their own education by taking out student loans, but the Smith's will still need around $80,000 to fund the balance of both educations. The Smith's have few assets and considerable debt and estimate that they can only contribute $400 per month ($4,800 per year) from their current income towards educational expenses, without dramatically changing their present lifestyle. The Smith's decide to refinance their current $120,000 in debt (mortgage and high cost consumer debt) into a new, $134,400, 30-year mortgage.

	Before Consolidation		After Consolidation	
	Monthly Payment	Balance	Monthly Payment	Balance
Mortgage	$ 665	$ 84,500	$ 894	$134,400
Car Loans	$ 420	$ 22,500	0	0
Credit Cards	$ 220	$ 7,800	0	0
Furniture	$ 150	$ 5,200	0	0
Total	$1,455	$120,000	$ 894	$134,400

Using the Debt Consolidation example on the previous page, the Smith's will achieve a considerably lower monthly payment ($1,455 vs. $894) and increase their cash flow by $561 per month. They will also receive a lump sum cash amount of $14,400 from the new mortgage. This additional cash flow, combined with the student loans and the Smith's $400 per month contribution from current income, will allow the Smith's to:

1. Fund Johnny and Sally's educational expenses,
2. Pay off their new 30 – year mortgage in 13 years, and
3. Accumulate an additional $227,723 for retirement.

The Smith's will not have to change their current financial lifestyle or tap into their retirement fund in order to pay for their children's college educations.

The Cash Flow Analysis Table on the following page demonstrates the Smith's Personal Residence loan strategy. (Note: This model can also be used to fund Johnny and Sally's private elementary and secondary school expenses).

Cash Flow Analysis

	Cash Inflow		Cash Outflow						
Year	Annual Parent Contribution	Annual Student Contribution	Annual Mortgage Payment	Annual College Payment	Annual Net Cash Flow	Total Year- End Account Balance	Total Year- End Mortgage Balance	Total Estimated Year- End Home Value	Age of Oldest Parent
						7.00%	7.00%	2.50%	
0	$14,400	$0	$0	$0	$14,400	$14,400	$134,400	$168,000	
1	$22,260	$0	$10,730	$9,975	$1,555	$17,072	$133,035	$172,200	48
2	$22,260	$0	$10,730	$9,730	$1,800	$20,193	$131,571	$176,505	49
3	$22,260	$0	$10,730	$19,658	($8,128)	$12,909	$130,001	$180,918	50
4	$22,260	$0	$10,730	$20,172	($8,642)	$4,566	$128,318	$185,441	51
5	$22,260	$0	$10,730	$9,815	$1,715	$6,720	$126,513	$190,077	52
6	$22,260	$0	$10,730	$10,581	$949	$8,206	$124,577	$194,828	53
7	$22,260	$0	$10,730	$0	$11,530	$21,117	$122,502	$199,699	54
8	$22,260	$0	$10,730	$0	$11,530	$34,933	$120,277	$204,692	55
9	$22,260	$0	$10,730	$0	$11,530	$49,715	$117,891	$209,809	56
10	$22,260	$0	$10,730	$0	$11,530	$65,532	$115,332	$215,054	57
11	$22,260	$0	$10,730	$0	$11,530	$82,457	$112,588	$220,431	58
12	$22,260	$0	$10,730	$0	$11,530	$100,566	$109,646	$225,941	59
13	$22,260	$0	$10,730	$0	$11,530	$119,942	$106,491	$231,590	60
14	$22,260	$0	$0	$0	$22,260	$38,211	$0	$237,380	61
15	$22,260	$0	$0	$0	$22,260	$64,704	$0	$243,314	62
16	$22,260	$0	$0	$0	$22,260	$93,051	$0	$249,397	63
17	$22,260	$0	$0	$0	$22,260	$123,383	$0	$255,632	64
18	$22,260	$0	$0	$0	$22,260	$155,838	$0	$262,023	65
19	$22,260	$0	$0	$0	$22,260	$190,565	$0	$268,573	66
20	$22,260	$0	$0	$0	$22,260	$227,723	$0	$275,288	67
Total	$459,600	$0	$139,490	$79,932	$240,178	$227,723	$0	$275,288	67

Conclusion

Families of all income and net worth levels will usually find that at least one of the ten strategies presented in this booklet will offer them an opportunity to reduce their out-of-pocket educational expenses. There are also other important steps you can take to ensure that your child gets the best college education, for the lowest cost (and least amount of debt) possible.

These steps are :

1. Be sure your child's grades are on track. It's never too late to start. Colleges observe grade improvement, as well as the four-year average.

2. Be sure your child is properly prepared to take the ACT/SAT college entrance exams. Not only do these tests figure heavily in college admissions, they also determine which student will be first in line for grants and tuition discounts.

3. Never assume a college is too expensive, or that you can't find money for college. Colleges have money, especially private schools, and they will reward good students.

4. Get a reputable and knowledgeable financial planner, especially one who understands both the education tax opportunities and the college rules and regulations.

Most important of all, do your homework! It's every parent's responsibility.