Course Overview

College financing is a wealth preservation/asset protection issue. Anyone, anything, or any entity that can take your money is a creditor. As most people know and as you will find out in this educational module, college expenses represent one of the largest creditors to parents who choose to pay for their children's education and to the children themselves if their parents are not paying for it. For parents who choose to pay for some or all of their children's college expenses, doing so will have a dramatic effect on their ability to fund for their own retirement.

College Planning and Funding is also a highly complex specialty. In fact, some nationally known CPA's who have become college financial experts have said it is more difficult than tax research and preparation. While this may or may not be true, there are an overwhelming number of academic, financial, and tax strategies to help lower the costs of funding a loved one's education. This module will provide you with an overview of basic concepts and strategies. Additionally, this module will explore, in detail, the various ways to build a savings fund for college expenses and will dispel a few myths that are held as truths in certain financial planning and college planning circles. This module will not in and of itself make you a college-funding expert, but it will make you more knowledgeable than most other advisors; and it will allow you to have an intelligent discussion about this very important subject matter with your clients.

Financing College - A Wealth Preservation Challenge

For most families, the reality of paying for college comes as a rude shock. Only 5% of American families have saved over $5,000 by the time their student is ready to enter college or trade school. Four years on campus can cost anywhere from **$64,000 to $196,000** for one child; and, only 20% of entering students even graduate in four years. Suddenly, parents and students are faced with the unpleasant choice of putting their retirement savings and life goals on hold. In most cases, they cannot pay the entire costs of college, and are often driven into excessive borrowing to pay for college since they are unaware of other alternatives. Many students are saddled with tens of thousands of dollars in student loans by the time they graduate which has a negative and a long-lasting affect on a student's ability to live a financially prosperous life (including the ability to start saving for retirement).

Most financial planners view college funding as a retirement and lifestyle funding competitor because it is difficult for the average family to pay in-full for both. Ideally, families start saving when their children are young. Today, it's tough to start a new family because of the costs. Starting a family and creating a household can soak up most of the available dollars from a single or even joint household income. If there are extra dollars, many parents will have to choose between funding for their own retirement or funding for their children's college education.

For those who have enough money to fund for both, the question then becomes: What is the wisest way to fund for college education in the most economical manner and one with the least amount of risk?

Conventional wisdom is that a 529 savings plan will be the 'silver bullet' to slay this monster. In reality, these tax-advantaged investments have underperformed expectations, and are subject to serious market and some tax risks. Although they are sold as diversified investments, they typically do not diversify broadly enough (just ask parents who had money in 529 plans between 2000-2002 and again in 2007-2009). Once it comes time to pay, parents may find that, however early and however much they sacrificed, they still fall short of paying for college with this savings tool.

Fortunately, there are good alternatives for college savings, and there are many possible strategies for those parents who were unable to accumulate sizeable savings in advance. This module will not explain each of the many hundreds of different strategies which are generally the domain of College Financial Planning Specialists. Instead, it offers an overview of the key concepts, explain the basics of the college aid system, and identify major ways to save and pay for college.

Finally, after going through this module, you should understand the process and vocabulary of the financial aid system and be able to work intelligently with clients and other advisors on this subject matter.

Many non-financial decisions and actions have a direct bearing on the ultimate cost of education. Those will be explained generally here as a way to lower the required costs and should build credibility with clients and school personnel alike. Most advisors know very little about education funding, except for 529's and tax credits. Learning this material will put you well ahead of most advisors in this country when dealing with college funding strategies.

Two different problems: Saving for college and paying for college.

Saving for college typically refers to accumulating funds in the early years prior to the child starting college and usually involves using a tax-deferred vehicle or various tax-savings techniques. Tax savings are dollars not paid to the government and are, therefore available to grow for use in later years to pay for college. Given enough time and growth, these sums can become sizeable.

However, the cost of college has also been raising at a rapid rate, sometimes two to three times the rate of wage growth (as a percentage). For most families, unless they begin to save quite early, they still may not accumulate enough to pay for college, and must therefore, find other funds, get more aid, and lower their costs. Due to the limited funds most families accumulate and the late start that most families get, their only solution is to draw on other ways to pay for college.

Paying for college as a management issue

As odd as it might sound, it is necessary to manage and control the college selection and application process in addition to applying for aid. Cost-effective college selection is not a quick process even when done correctly.

What is correct? Picking schools which are a good match for the student and completing the many steps of the process during a fairly compressed time frame. Schools have different requirements and different deadlines, and it is up to the student and parent(s) to stay ahead of these requirements as they may lead to early aid awards and more money. This is also a detail-filled puzzle, so it is critical to keep a good record, tracking, and scheduling system.

The benefits of parent-child teamwork

With good teamwork and motivation, it is often possible to increase the student's merit, reposition family finances, and get much greater aid from selected schools. This means that the student must be willing to do self-analysis and research, prepare conscientiously for college aptitude tests, and prepare thoroughly for campus visits. They should also get **all required paperwork in early**, and not procrastinate and miss early awards. Colleges want to fill their classes and complete admissions as soon as they can, and they reward early effort since it saves them marketing costs.

At the same time, parents need to understand the basics of the **aid system** in order to take advantage of opportunities to change the financial picture that the college sees. This can also lead to more financial aid.

If either "partner" on this team slacks off, chances are that the family will not get aid offers beyond the norm and will have to make up the difference out of pocket somehow.

Taking control of the cost

Most schools have a fixed 'official cost.' So, how can the costs be controlled? By choosing the right schools. One of the worst decisions a family can make is to fixate on an elite school such as an Ivy League or other prestigious, private-'name' college, or a parent's alma mater. This kind of choice often has to do more with parent ego and bragging rights, and may be a terrible fit for the student. Poor school choices can lead to drop outs or add additional time to graduate and, consequently, additional costs. If initially starting at the wrong school leads to a transfer, this will typically result in a loss of credits and, in turn, an increase in costs.

Colleges can be broadly grouped into three major types:

(1) Expensive elites
(2) Public universities
(3) Smaller privates

Larger schools, both publics and elites, tend to be research universities with large classes, impersonal lecture instruction, and little chance to work directly with a professor. Smaller privates, by contrast, usually have smaller classes with skilled teachers who are able to assess and stretch the student. **They are the best bargain in higher education today**. In fact, many of the smaller privates compete very well with the top elites in getting their students into graduate schools. Smaller privates can often take C students and turn them into graduate scholars or professionals. It is kind of like warming the bench in a major sports program vs. playing regularly and growing through playing experience at the smaller school. Who will be more ready for the competition of the real world?

But aren't all private schools expensive? This is one of the most incorrect stereotypes in higher education. Smaller privates compete with the publics and often offer large tuition discounts in order to attract the good students they want.

In many cases, a good student can get a better education at the smaller private at a price competitive with the large public and its less challenging academic program.

The family should also consider the economic benefit to be obtained from the school compared to its cost. Does it really make sense to pay $50,000/year at an elite school to get a major in general liberal arts? Sometimes the parent puts the student totally in charge of choosing the school. This is like telling a student that they will be rewarded with a car after high school graduation to get them around and then letting them dictate whether it will be a high-end Mercedes or a Maserati instead of a used Toyota. The parent needs to remain in charge of the costs or else acknowledge that they are handing over control of their retirement income to their child. The truth is that the child can borrow for school. The parents cannot borrow for retirement, and this consideration should prevail.

Virtually all long-term studies have shown that graduates of Ivy League colleges and other elites are making no more income and have no more job security than graduates of smaller privates or less 'elite' schools. When it comes to graduate school, that is a different matter. Graduates of prestigious schools will typically get better job offers and mentoring, and the value of the degree will be more highly respected. And, admittedly, if a student has a highly focused career goal and can best pursue it at a particular school, then it may make sense to go to that school. For example, if a student is set on a career in government, going to and paying for Harvard might make sense. However, unless there is a specific advantage to attending an elite for a very specific program with a great future economic payoff, the parents should probably save their money; and the student will probably be as well off by going to a different, less expensive school. "The student makes the school," not the other way around.

Know what the individual states offer

There are Federal mandates and agencies, however, education is mostly controlled at the state and local level. Many states and municipalities are creating or incentivizing programs to improve education and reduce college costs. These range from Advanced Placement (AP) courses, honors programs, International Baccalaureate (IB), and dual enrollment programs to lottery sponsored scholarships.

Other ways to lower costs

Good school selection will help the student focus and graduate in four years. It is important for parents to realize that only about 20% of all students graduate in four years. Most students take 5 or 6 years, which drives up parent costs. Some other strategies to help drive down costs will be covered in later sections.

Make sure to know the true costs

College is paid for with after-tax dollars. This means that parents or grandparents have to earn MORE than the listed costs in order to pay for a loved one's education with after-tax dollars. For example, for a parent in a 25% federal bracket and a 9.3% California state income tax bracket, (rounded up to 35%), a school costing $25,000 per year actually will require that the parent earn $38,461 pre-tax. (25,000/(.65)=$38,461).

Multiply this result by 4, (or actually 5, since so few students graduate in 4 years), and a parent is looking at having to earn approximately $192,000 to pay for just the costs of a public university! And that is for one student! Also with education costs rising 6-7% per year, you can see why parents worry.

If parents have their children in private schools, the problem is compounded since they are paying K-12 tuition in addition to what they will pay for college.

It gets worse. Dollars spent for education are dollars no longer available to grow for retirement, medical, or other health or lifestyle costs. If the student finishes school when the parent is 45 and the parent retires at 65, this same $150,000 of after-tax money, which could have otherwise grown at 8% gross per year to over $400,000, is money that will not be available for retirement.

So how does a family pay for college?

There are basically only two sources: the parents' money or other people's money.

A. **Other people's money**, which is the preferable choice, includes:

1. Financial aid
2. Taking cost-reducing actions to lower costs
3. Tax strategies to reclaim money otherwise lost to taxes
4. Work study
5. Student loans
6. Gifts from relatives

B. **The parents' money** includes:

1. Cash flow
2. Savings
3. Investments
4. Parent loans

There are good and bad alternatives to using all of these sources. This module offers an overview of the concepts, processes, and some of the tactics to help differentiate between good and bad options, and will go into detail about the financial aid system.

A. Other People's Money to Pay for College

1. Financial Aid

Broadly speaking, financial aid is money given by the federal and state governments and the colleges themselves to help families and students pay for the costs of a college (or trade school) education.

Types of Aid

There are two basic types of aid:

1. Gift aid, or grants and scholarships, sometimes called 'free money', which does not have to be repaid or earned by working (other than by maintaining required academic standards in some cases).
2. Self-help aid which must be earned or repaid, such as work-study, or interest-subsidized loans, which reduce the repayment costs of a loan.

Federal government aid tends to follow standard criteria for qualification. **States** each have their own aid programs with varying criteria and types of aid, though they mostly follow the government qualification process. **Colleges** themselves have money to offer to the types of students they are seeking. Some of these colleges are in a highly competitive battle with other schools to fill seats with those students.

Many of these colleges will pay to 'buy' good students. Even highly competitive schools with no shortage of applicants seek to 'build' an entering class with the types of students they prefer in order to meet their various missions, so even they will occasionally offer money beyond the need of the student, even if they claim to be a 'need-only' financial aid school. For example, National Merit scholars with no "family need," attending $50,000/year colleges have been known to receive $100,000 four-year grants. These students help increase the school's ranking in the annual US News and World Report rankings, and thus make the college's marketing campaigns easier.

Criteria for financial aid

There are three common reasons for granting aid. The first two are commonly recognized as "the financial aid system." The third area, "enrollment management," is an awkward topic for most colleges; but it is the reality of how they use their own money for their own varied goals. It is important to recognize that colleges are businesses run by educators.

1. **Student financial need**. This is the primary criteria and most aid is based on this criteria.

2. **Student merit**. This can be academic, athletic, performing arts, and, additionally, outstanding service to the community, published author, or other highly distinguishing traits. Elite schools will typically award aid based almost entirely on the merit of the student. Public schools offer much less merit aid, although the type of aid the public school student receives can include relatively more merit aid for high merit students.

3. **Enrollment management**. This is rarely discussed publicly or admitted to by the colleges, insofar as it reflects more on the business and mission of the college itself and less on the needs of the student. Colleges are large businesses, and **they** have many **business** goals, including net revenue, diversity, competitive positioning, rankings in various surveys and publications, alumni relations, endowment planning, four-year completion, student retention, and others, which will ensure the survival and furtherance of their goals. To the extent that the student can fit one of their preferred profiles, the he/she is in a position to get an attractive offer, especially if the student is in the top 25% of the entering class.

a.) **<u>Need-Based Aid</u>**

Needs-Analysis Formula

Most aid is based on financial need. Therefore, it is important to understand the formula for determining the need in order to help implement planning strategies which may increase the ability of a student to qualify for this need assistance.

The basic formula with example values is:

	Cost of attendance (COA)	$18,000
Less:	**Expected Family Contribution (EFC)**	- 11,000
Equals	**Financial Need**	$ 7,000*
Less	**Student Resources**	- 2,000
Equals	**Adjusted Financial Need**	$ 5,000

In this example, *nominal need is $7,000. However, the student has $2,000 in a scholarship, "Student resource," considered a <u>resource</u> earmarked for college. The "need" which the college will typically evaluate subtracts this "resource" to arrive at the actual need which they will evaluate for aid. College practices differ widely in how these moneys are subtracted, and student merit may influence this decision. Some schools reduce 'free money' by subtracting the resource money while others reduce loans or work study or some combination thereof.

It is important to understand each of these elements in more detail, especially how the EFC is derived. This will help your understanding in later sections how various strategies may be employed to increase aid eligibility for more need-based aid. The word eligibility is important here because there is **<u>no guarantee</u>** that lowering the EFC will increase aid. Once a student is above the threshold for federal aid, receiving aid from the school (which is discretionary) typically requires very low family income and a low EFC.

<u>Elements of the Needs-Analysis Formula:</u>

<u>COA</u>-EFC=Need-Resource=Modified Need

Cost of Attendance (COA)

<u>The Cost of Attendance</u> includes tuition, fees, books, supplies, room and board, personal expenses, computer, transportation, lab fees, etc. Each college determines these costs according to a federal formula. However, many schools underestimate certain expenses to make themselves appear more affordable, such as using bus expenses instead of car expenses for the transportation component. Some students

and parents may also wish to maintain a higher lifestyle such as providing a cell phone, a car, and higher personal expenses; so, these must be factored into the COA to arrive at a more realistic budget.

COA-EFC=Need-Resource=Modified Need

Expected Family Contribution (EFC)

This value is the amount that a family is expected to contribute to the total cost of college each year. It is computed by evaluating the family and the student's income and assets, as well as family household information as submitted on financial aid forms.

There are two primary formulas, **(1)** the Federal Methodology and **(2)** the Institutional Methodology. Many private schools use their own institutional formula, or **they** request specific answers (**"**Section Q**"** questions in the CSS (College Scholarship Service) Profile) to supplement these methodologies. They are looking for more sources of money and also at the family lifestyle to get clues that the family has more money than the formulas reveal (money that can finance their student's education).

Federal Methodology Formula (FM) and the FAFSA forms

This formula and these forms (Free Application for Federal Student Aid (FAFSA)) are used by every accredited undergraduate, graduate and trade school in the United States to determine the Federal EFC and how much federal money can be disbursed or loaned by the school toward the student's COA. Most states also use this formula to decide how to disburse their aid money. The FAFSA form may be filled out in paper format but is most commonly completed online.

(ifap.ed.gov/efcformulaguide/attachments/101310EFCFormulaGuide1112.pdf)

Simplified EFC formula example (FM)

1) Parents' Income less (living allowance from table A6) **+**
2) Less State and Other Tax Allowance (table A1)
3) Parents' Assets less (asset protection allowance from Table A5)**+**
4) Student's Income less (Taxes, $4,500 allowance [2010])
5) Student's Assets less (no deductions) X 20%
= Expected Family Contribution (EFC)

The EFC is per student per year. This value will then be used as the basis for determining aid for each student in a family.

The EFC is "Automatically Zero" for independent students that meet special circumstances.

It is impossible to go over everything in a two-hour educational module. Again, it is recommended that you learn these formulas; but like many "calculations" in the estate planning and financial planning areas, they can be done for you with a calculator.

Institutional Methodology Formula (IM) and the CSS Profile forms

This formula and the CSS (College Scholarship Service) Profile form (also paper or online) are used by about 350 private colleges and scholarship foundations to calculate an institutional EFC, and it is administered by the College Board. This formula includes some items which the federal formula does not include such as family home equity, sibling assets, family farm, and value of a business with fewer than 100 employees. In addition many of the schools add Section Q questions to obtain further information; and they may also require their own institutional forms, business/farm supplement forms, or non-custodial parent forms. The EFC generated under the IM is usually higher, but can be lower.

An advisor should calculate both the FM and IM EFC values in case the student applies to a college using the IM formula to help the family plan properly.

It is recommended that an advisor who wishes to do further work in this area work through both the FAFSA and CSS Profile in detail, including reading all of the detailed help notes. The federal government estimates that over 90% of these forms are submitted with errors.

EFC formula discussion:

The actual formulas used to calculate EFC run about 30 pages of calculations, tables, etc. Here are the key elements:

Parents' Contribution:

1) The **parents' assets** are assessed after an asset protection allowance based on the older parent's age is subtracted at the tabulated rate of the resultant value on assets held as of the signing date of the financial aid forms. **Sometimes assets can be shifted or reduced to lower the assessment of this element**. This does not necessarily increase aid.

2) The **parents' income** is assessed at a graduated rate after deducting the living allowance, which is based on parents' age, and size of family. In most cases, once parents' income reaches about $70,000/year, further income is assessed at a 47% rate. **It then becomes the main determinant of EFC**. This is why a lot of asset shifting may not significantly benefit parents or lower EFC enough to qualify for more aid. Doing so may, in fact, incur substantial transaction and tax costs as well as incur opportunity cost of lost potential earnings. The parents could actually end up spending more than they could possibly gain in increased aid.

Advisors must never claim that lowering EFC will necessarily increase aid. Many advisors who have recommended this have been sued since aid awards are based on many factors; and at the $70,000 and above income level, income typically dominates the EFC value. If the EFC is significantly above the COA, asset shifting will not be beneficial most of the time when the Federal Methodology is the prime determinant of aid. To the extent that it is not financially disruptive, assessable assets could be re-positioned or spent down in order to lower the asset component of the EFC. This will be discussed in more detail later.

Moreover, if the ONLY reason to shift assets is to 'hide' money to lower the EFC, the parents are flirting with fraud, for which the penalties can be quite high. However, most families are far from optimal with their asset structure; and there are many sound financial reasons to shift assets. The advisor must be sure to explain everything carefully to make sure the parents understand how their situation is being improved aside from the financial aid considerations. If there is financial justification, then there is probably little risk of consequence if the changes dramatically lower EFC.

Student's Contribution:

3) The **student's assets** are assessed at a rate almost four times higher than the parents. (20% vs. 5.6%) As a general planning note, it is beneficial to spend down or transfer student assets to the parents or appropriate alternative accounts prior to signing the aid forms. This may not always be possible if assets are held in custodial or trust accounts. Tax costs of account liquidation and limitations imposed by trust documents must be considered.

4) **Student income** is assessed at 50% after the $4,500 exclusion [2010]. To the extent that the student has earned income, some or all of it may be offset with the income tax standard deduction. However, if the income is primarily from unearned and passive sources, such as interest, dividends, or rental income, then the student may be subject to the kiddie tax, and strategies should be considered with the tax advisor to attempt to lower this exposure.

Tax strategies proposed by tax advisors or planners unfamiliar with the financial aid formulas (which are most of them) which shift income and assets to the child in order to save the parents' tax liability may backfire by costing even more in lost financial aid eligibility.

Dates of Assessment

Income values are determined by assessing income for the tax year **prior to the year the student will enter college**. For example, for the academic aid year 2011-2012, the 2010 tax year will be assessed using 2010 tax returns. This is called **the base year**. Thus, taxable events involving income, such as a bonus or tax consequences of selling assets, may be timed for best results before the first financial

aid base year, or after the last base year such as the last half of the junior year, first half of senior year, since there will be no financial aid form the next year.

In most cases, it is difficult to accelerate or defer income for most families, other than for executives and business owners.

Assets are assessed as of the literal date of the signing the FAFSA and Profile forms. Major events which will affect the asset positions could be timed with this in mind. For example, assessable assets could be used to pay down non-assessable debt or bills prior to entering these values on the aid forms and signing them. To the extent large assets are moved into insurance or annuities which will take them off the aid forms, these changes should be completed prior to signing the forms.

Need vs. Aid

The financial need is the amount the student is ELIGIBLE to receive. Some colleges will pay that amount, or less; and for students they wish to "buy," they may pay more than the need to make sure they attend that school.

As a general rule, public universities usually do not meet 100% of need. Many private colleges do meet 100% of need; and for exceptional students for whom they wish to compete, they may meet more than 100% of need in order to outcompete other schools. Wealthy elites will usually meet 100% of need.

Of the need which is met, publics will typically offer a higher percentage of self-help (namely work study and loans) than competitive private schools will. Private schools will typically offer a higher percentage of gift aid than public schools will. Many private schools have empty seats to fill, and they compete with public schools to fill them. This will often take the form of tuition discounts plus whatever else is required to tip the balance against the public. This is one of the hidden bargains which go against popular belief in that private schools cost more than public schools. A good private school education can actually be cheaper than a public school education, especially for students in the top 25% of the entering class. **Selecting the correct college can thus be a more powerful tactic than trying to shift assets**, although asset-shifting opportunities should not be ignored.

Applying for Financial Aid—Forms and Timelines

It is helpful to review the aid process which takes place during the academic senior high school year, when the student applies for admission and financial aid.

Presumably, the student has gone through a college selection process to identify the schools to attend. There should be a couple of safety schools, some desired schools, as well as a couple of "reach" schools. The student's chances for aid are best served by pairing off desired schools with schools with whom their desired schools compete, such as the same athletic conference or similar schools in a 200-mile radius.

In addition, a school in a different geographical area may characterize the student as adding "diversity" to its class, a desirable trait.

Ideally, the student has completed SAT and ACT testing, school visits, and college selection **in their junior year**. A test prep course should be taken in order to attempt to raise test scores, since those scores are the only way the colleges can standardize students around the country.

In the fall of the student's senior year they will fill out applications, obtain letters of reference, write their essays, complete their interviews, do their final school visits, and finish any additional testing

Some students (mostly their parents) become fixated on a specific school and will select "early decision" to obtain preference in admission. This means that the student will contractually commit to that school before any aid or grants are even discussed if the school will admit them early. This should be **discouraged**, as it generally results in a lower financial aid offer since the student is now considered a "sure thing" to the college. Aid appeal is difficult under these circumstances. This is almost like committing to buy a car at full sticker price at one dealer, before talking with competing dealers and negotiating for the best deal. You take what you get.

After admissions applications, the family will complete financial aid applications for the Profile schools, if any, usually in the November-December timeframe, with estimated income tax values. Final returns are requested and sent later to finalize an offer. The FAFSA may be submitted **no earlier than January 1 of the year the student will begin college**. (In fact, it may be submitted as late as June 30 for retroactive awards for the prior school year; but some types of aid, like Perkins loans, get used up early). It is advisable to submit the forms **as early as possible since much aid is offered on a first-come, first-served basis**. Sometimes colleges have special grants available on this basis, so that they can fill their freshmen class sooner and at less cost. Aid forms may be submitted before final tax returns are completed as estimates.

The federal processing center will then issue a Student Aid Report (SAR) with preliminary EFC values. (The College Board does not issue a SAR.) They will advise the family to update the FAFSA with final tax numbers, and correct errors on the SAR. Aid forms are also examined, mostly by computer for anomalies; and about 1/3 are subject to an audit-like process called "verification." Usually, this is simply a request for final tax returns, or for a statement of assets of some kind. If there are indications of fraud, the parents may be asked to provide extensive documentation.

Financial aid forms should be completed with the same accuracy and honesty as one would complete a tax return. Penalties for fraud can be quite heavy, and include substantial fines and even prison time. Federal law can be quite tough in this area.

Sometime in March and April, final award letters are sent by the colleges that have accepted the student, usually by April 15. The student and family then have until May 1 to accept or decline or request an appeal.

The financial aid officer at a college possesses what is called "professional judgment" which basically allows for overriding EFC values, and reducing or increasing an aid award. In this regard, they have more latitude than an IRS agent to change a tax assessment or penalty. This power is typically used to increase aid awards, although they can reduce them.

In the case of a documented change of family circumstance such as death, serious illness, loss of job, divorce, and other extreme circumstances, the appeal can be quite straightforward. In cases where the family would be hard-pressed to pay the EFC without undue hardship or massive debt, they can document their expenses with receipts, and appeal for a reasonable modification. Elite schools can be very hardnosed and have been known to tell students to look elsewhere if their aid offer met the student's need as determined by the EFC. Loss of home equity values, or increase in mortgage costs are usually not considered grounds for appeal.

There is another type of appeal, often called a "competitive" appeal. If the student is under-awarded relative to previous norms for the level of academic standing at the school and can document this, then the college may adjust the award to bring it within norms. Mistakes can be made. The other type is sometimes called a "whine" appeal, whereby the family TACTFULLY pleads hardship, states that the school is the first choice, other schools have made better offers, and they simply want some help figuring out how their child can attend their preferred school. This may or may not raise the award. Generally, pressure will not work. Above all, a family should NEVER tell anyone at the school that they are working with a college financial advisor, as they are likely to lose all credibility and sympathy in an appeal.

Once the aid issues have been resolved, and if there is still need, the parents and student will then move on to exploring other options, including private loans to either the student, parents, or both. Many communities will also hold an alumni/new student meeting, and may offer additional aid. New aid received after school aid is finalized must be reported to the college in order to adjust the overall aid offer.

Unfortunately, most parents wait until the senior year to begin the process of figuring out how to pay for college. Fewer than 5% of parents have more than $5,000 in savings dedicated to higher education costs. Ideally, the family should begin this process in January of the junior year, and no later than summer of the junior year, to avoid overcrowding the calendar with the many things which must take place in the senior year, both the admissions and the financial aid process. Career planning and major field of study planning, college selection, test prep, and visits should be well underway before the end of the junior year. Waiting too long crowds the calendar, forcing some activities to be skipped and reduces choices, which ultimately costs wealth.

EFC in depth

It is important to know how parent and student income and assets are counted in the formulas when examining possible ways to lower the EFC. As with tax preparation, many parents and advisors do not know how to properly classify many income items and where to put them on tax forms. This is also the case with the financial aid forms. The federal government estimated that over 90% of all FAFSA's are submitted with errors. In a way, the tax system is more forgiving than the aid system. A tax return may be revised within three years of filing, and refunds obtained. Once the financial aid year has passed, however, missed aid is gone; and there is no revision.

What goes into the formulas?

The aid formulas draw heavily on the tax returns, as well as summaries of various assets and supplemental items. Refer back to the general formula listed earlier to see where the following general groupings fit in. (Unless otherwise noted, these refer to the **FAFSA** and Federal Methodology.)

The next few pages go into some of the common inclusions and exclusions to the forms. The section is quite detailed, but not exhaustive. Any advisor in the college financial planning area will need to be aware of these items.

I. Non-Assessable Assets

The following items do **NOT have to be reported** on the financial aid forms, and don't affect EFC. They suggest some opportunity for strategizing how to lower EFC:

Life Insurance:

Cash value is not assessed. This can be an excellent way to save part of the total anticipated cost of college, since it can continue to be used to accrue retirement savings. Retirement Life is ideal, and will be discussed in a later section.

Annuities:

Neither qualified nor non-qualified annuities are assessed.

CAUTION: There are a number of schools that currently DO assess life insurance and annuities. The family should ALWAYS ask the college directly but anonymously how they treat these items; and if these are central to the family's finances, they may wish to look at alternative colleges that do not count these products, so that they won't be asked to draw against them.

WARNING: NEVER tell a family that hiding assets to lower EFC <u>will</u> increase financial aid. It may or may not. Advisors have been sued when the family finds out that these tactics have not increased aid, and they have incurred tax liabilities and transaction costs to make such a change on the advice of an advisor. These changes should be justified on their own merits, such as a need for more life insurance, retirement portfolio diversification, the desirability of a way to access retirement funds tax-free, such as with policy loans, the benefits of a multi-purpose cost-effective policy such as Retirement Life, and so forth.

Retirement accounts:

401(k), 403 (b), IRA's, SEP, Keogh and other qualified accounts are not assessed. Roth IRA's are not assessed. However, annual contributions are added back into AGI as income for the EFC calculation.

Personal items:

Cars, clothes, household items and other personal items are not assessed.

Family Farm/Business:

A family farm, defined as the principle place of residence with active operation is non-assessable. A family business, where the family operates and has significant ownership and there are fewer than 100 employees is not assessable. An investment farm (non-family farm) is assessable.

Sibling assets:

These are not counted under the FM. Sibling assets, including 529 plans, Coverdell Education Savings, cash, and other assets are assessed in the <u>**IM**</u> formula and are assessed at the parents' 5.6%.

Qualified Tuition Plans (529 Plans):

There are two types–pre-paid tuition plans and 529 Savings Plans. Prepaid tuition plans are offered by states as contracts to "lock in" the cost of future tuition at state public schools at today's costs. These are assessed at the parents' asset rate of 5.6%. Sibling plans are included in the IM and assessed at the parent's rate.

<u>529 Savings Plans owned by the student or parent are assessed at the parents' rate</u>. Earnings and principle withdrawn are not counted as income against the aid formulas. 529 Savings Plans owned by siblings are counted as parent assets under the IM. 529's owned by someone other than the student, such as <u>grandparents</u>, are not counted in the aid formulas.

Trust and Custodial Accounts:

Trust, Uniform Gift to Minors Act (UGMA), and Uniform Transfer to Minors Act (UTMA) assets are reported as student assets at present value even if access is restricted. They are assessed at 20%. However, if trust assets are restricted by court order for a specific purpose, they do not need to be reported. Given the high assessment rate, it may be desirable to move these assets elsewhere. Terms of the trust, taxable impact, and other costs must be evaluated and compared with potential reduction of the EFC.

II. Non-Assessable Income

On the income side, the following types of income do not need to be reported on the financial aid forms, and will not affect EFC:

Employer Education Assistance Benefits:

Although these benefits are not included, they are viewed as 'resources' and will reduce need on a dollar-by-dollar basis.

Loan proceeds:

While these are not assessed as income, if proceeds are held as assets, they will be assessed at the asset rate.

Rollover pension funds:

These are not assessed if rolled into a new qualified account. Pension withdrawals are assessed.

Gifts and Support:

Cash gifts other than parental support are assessed as financial aid income. Non-cash gifts and support, such as autos and stocks, are not assessed.

Veterans Educational Benefits:

VA educational benefits, including VA work study, are not assessed, but are considered 'resources' and will reduce need on a dollar-by-dollar basis.

Flex Spending Plan contributions and payments:

These are not assessed in the FM formula, but are assessed in the IM formula. This includes typical cafeteria plans, Medical and Health Savings accounts. Contributions lower taxable income and, therefore, lower the EFC.

Combat Pay (reported but excluded):

Addressed in use of “Professional Judgment”.

Employment Severance Packages (reported but excluded):

Addressed in use of “Professional Judgment”.

III. Financial Aid Income and Benefits:

Although the financial aid system parallels the federal tax system, it also diverges significantly in parts. Here are some of the more common inclusions and exclusions which may differ from how these items are treated in the tax system.

A. Untaxed Income and Benefits (Addbacks):

Current year retirement contributions:

Contributions to tax deferred savings plans and to pension plans are assessed and must be added back to income on the financial aid forms.

Untaxed principle from retirement withdrawals:

Untaxed portions of retirement, pension, annuity, or life insurance **withdrawals** (not loans) are assessed. This includes distributions from Roth accounts, taxable or non-taxable. In addition, IRA to Roth conversions will typically result in taxable income, which will drive up the EFC.

Living allowances:

Members of the clergy, military, and others often receive housing, food, and other allowances, except rent subsidies for low income housing, are assessed, whether cash payments or cash value benefits. This includes non taxable fringe benefits as compensation for a job.

Child support payments:

Child support payments received are assessed. **This should be taken into consideration when structuring a divorce settlement**. For example, the custodial spouse, who would be responsible for reporting income and assets for financial aid, might be given a larger portion of assets instead of income, since assets are assessed at a maximum of 5.6% and income might be assessed as high as 47% on the federal forms.

Income exclusions:

Some items, such as the exclusion of gain on the sale of a home, are assessed even though they may be excluded from taxation insofar as they represent a source of funds to pay for college as do the other items in this section.

B. Financial Aid Income Deductions:

Some amounts are deducted from financial aid income. These include:

Child Support paid:

This is a deduction in calculating EFC.

Need-based work programs:

Federal and campus-based work study can be excluded if it has already been included in the student's income taxes, to avoid double counting.

Taxable grants and scholarships:

One of the bigger surprises for students and parents is to discover that scholarships can be taxable. When scholarship money is used for room and board, and under certain other circumstances, it is taxable income to the student under federal income tax law. To avoid double counting, therefore, taxable grants and scholarships are a deduction against the student's income in the aid formula.

Taxes:

Federal, state, and social security taxes paid are all deductions from the aid formulas. There are some exceptions. Social security tax on tips, 10% early withdrawal penalty on retirement accounts, the advanced earned income credit, and household employment taxes are not deductible from the aid formula. State tax deduction is calculated as an allowance based in state of residence and earned income. Social security tax is also calculated in the formula based on earned income.

Income protection allowance:

This is calculated in the aid formula as a deduction based on the number of family members in college and the number of household members. For the student, the income allowance is a fixed value of $3,080 in 2010 in the Federal Methodology only. There is no student income allowance in the institutional methodology.

Employment expense allowance:

This allowance is calculated in the formulas as 35% of the lesser of the earned income when both parents work. The maximum allowance for 2010 is $3,500. Business owners can consider employing a spouse without earned income in order to obtain this additional allowance to lower EFC.

COA-EFC=Need-**Resource**=Modified Need

Resource

Resources are funds set aside for education costs which the college views as dedicated college savings beyond the family's income and assets. Typically these funds are the **most heavily penalized** insofar as they reduce need on a dollar-for-dollar basis. Some examples include:

- Scholarships or grants
- VA, veteran educational, and other federal benefits
- Cash gifts paid directly to the college for educational costs from outside the family such as from grandparents.
- Employer education funds
- Other sources of funds which the college feels can be used to pay for education costs, such as ROTC allotments, subsistence pay, reserve benefits, etc.

In general, tactics which can sensibly avoid money being classified as a resource, such as receiving grandparent gifts as a loan, instead of as a tuition reduction or in cash, can increase adjusted financial need.

1.) Merit Based Aid

Merit-based aid includes grants, scholarships, and tuition discounts. Private scholarships not granted by the colleges are not necessarily considered college aid, but they are included here because they are usually granted on the basis of merit. Some private scholarships may also be based on ethnic or nationality considerations, or other factors specified by the organization granting the scholarship, even including geographical location, parental employment, customer status, or membership in an organization. Locating and qualifying for these scholarships can be major research efforts and very time consuming and competitive, often to no avail.

Most merit aid is based on academic, sports, performing, or other talent. Good but less qualified students may get larger merit awards due to higher need, than less needy students with more merit.

There are need criteria for receiving federal and some state grants, typically very low income. They are not based on merit. These would include Pell grants and SEOG grants. The states also offer merit awards to good students, typically qualified by grade point and course of study.

Colleges themselves offer most grants, whether they come in the form of cash or tuition discounts. Colleges can avoid spending endowment money by offering tuition discounts. As explained in the discussion above on enrollment management, they will use these to fill otherwise empty seats in order to get some revenue. This is akin to airlines offering deep discounted seats in order to avoid losing the time-dependent revenue of an otherwise empty seat. Again, it all depends on what they want in order to shape the composition of their entering class.

Will a very good student get merit aid? That depends on where the student goes to school. Elite schools, which have a high number of well-qualified applicants, do not grant merit aid, or so they claim. They have been known to offer scholarships while competing for a highly desirable student against their top rivals such as Princeton competing with Harvard or Yale. This is uncommon, however. In addition, public universities typically do not give large grants, since their endowments are usually smaller; and they have a large applicant student pool. Instead, they may sweeten an offer with additional amounts of subsidized loans within the federal limits, and more work study. Moreover, alumni groups may help with especially needy students.

Will a very wealthy student get merit aid? College funding is one of the great marvels of the modern world. Therefore, it is one of the greatest opportunities for a good advisor to be rewarded. Colleges want wealthy and connected students and alumni. They are willing to pay for such students.

Where do schools get the money? Fees subsidies, grants, and tuition of course, but the full sticker price most schools charge each student is below the actual cost of that student attending the institution. Private schools are subsidized by alumni, friends, boosters, foundations, to a very large extent corporations, and to a lesser extent governments. Public schools have support from the same sources and much larger access to government resources. The majority of these funds come with stipulations attached. The criteria range from student diversity, academic offerings, community service, military commitments, the ratio of alumni and parent participation. Example: A college with a predominant ethnic group will offer scholarship money to encourage the attendance of other ethnicities. Example: A corporate sponsor will match dollar for dollar parent contributions to the annual fund. The parents raise $500,000, sponsor matches with $500,000. Even better, match ratio for dollar, if the parents/alumni participate at a ratio above fifty percent, the sponsor will complete the campaign. Example: fifty five percent of parents participate in gifting to a capital campaign with an average gift of $150 that raises fifteen percent of the goal, the sponsor will complete the campaign by contributing the remaining eighty five percent. This is why college campi have buildings with hard to pronounce names. It is also, why college is remotely affordable.

The best bargains are at smaller private schools for which the applicant is in the top 25% of the entering class for THAT college. Many of these schools are excellent, even though under enrolled, and they often out-compete the other schools in getting their students into grad schools. Due to their smaller size, they can offer more personal and tailored attention, stretch the student far beyond what large, impersonal research universities do, and turn C students into A scholars. They are probably the best bargain in higher education. Long-term studies show that elite school bachelor's degree recipients, on average, are neither making more money nor are they enjoying any more job security than graduates of these private schools.

How should the student prepare?

It should come as no surprise that the most important criteria for merit aid are:

1. **Good grades in hard courses**, such as IB (International Baccalaureate), AP (advanced placement or honors classes) when offered. Caution the family to be careful about doing poorly in these advanced curricula. It is better to get good grades in core classes, than fail rigorous classes.

   Good SAT and ACT test scores. These are about the only way that a college can geographically standardize students, since grades can vary greatly. The student should take a test prep in order to be familiar with the format and to identify weak areas in time to grow further in those areas. The ACT and SAT tests are often called the "money tests." A good review can raise scores on the SAT 100-200 points, if for no other reason that they get the student focused and used to the test format and timing.

2. **A good resume of achievement.** The student should have participated in an area of genuine interest for a significant period of time during high school. Colleges want more than bookworms; **they** want young adults who have developed beyond pure academics and will bring maturity and diversity to share with fellow students.

How can the student compete for 'tuition discounts'?

1. The student should **apply early** since many school scholarships are awarded early and are intended to motivate applications sooner in the senior year.

2. The student should identify probable careers, the majors required for those careers, then research schools which offer those majors. As mentioned earlier, the student should apply to at least six and preferably ten schools.

3. The student should select schools which compete against each other. They should be from the same athletic conference, or be located in close proximity geographically, or compete academically. A couple of competing schools should be considered far away geographically, so the student seems to be more

"unique," not from their typical local market. This helps the college create diversity among the student body, which is desirable.

4. The student should also apply to a good in-state public university, since many of the private schools compete with these schools for students and may offer tuition discounts to equalize costs.

5. The student should apply to schools with declining enrollments or with low yields. Colleges with declining enrollments often give discounts to fill otherwise empty seats. Low yield is a low number of attendees compared with the number of accepted applicants. This also encourages tuition discounts.

6. The student should select schools in which the student will be in the top 25% of the entering class, based on prior statistics. The best practical way to determine this is to compare the student's SAT score with prior class statistics. During visits, the student should create and then nurture relationships with faculty, coaches, and so forth, in order to develop advocates with the financial aid and admissions offices.

7. The family should explore supporting the school as volunteers on the Parent Council or Capital Campaigns.

Private scholarships:

This is an area that requires caution. First, only about 1% of all college aid comes from private scholarships. There are many "scam" companies that claim to be able to find unclaimed scholarships (which is untrue), and they require a fee which is supposedly refundable with a guarantee. In most cases, it is usually impossible to meet the conditions of the guarantee, so the parents' money is lost. The best source of scholarships is from local organizations, and the high school counselors are in the best position to work with the student to apply for these.

There are national scholarships which are very highly competitive. The student and parents could spend too much time chasing a low probability payoff, time which would be better spent on school selection, test prep, visits and finding a good match for the student's goals.

There are free scholarship search sites which can be put to work; and the student might want to investigate scholarships having to do with ethnic background, national origin, and other factors specific to the student.

2. Student Loans

Student loans fall into two basic categories, need based and non-need based.

1. Need based loans:

There are two types of need-based loans. Federal subsidized Stafford loans are fixed rate and offer about $20,000 in loans over four years, with the amounts planned to go up modestly and the rates going down under current legislation. The federal government pays the interest on these loans until the student has been out of college for six months.

Federal Perkins loans are about $4,000/year, 5% rate, and are also interest subsidized until six months out of college. The school controls loan offers. There are a limited amount of funds available annually, which is another reason why students should apply for aid early, in January. Sometimes these loans are used by a college as a sweetener to help convince student to attend the school.

2. Non-Need based loans:

These loans may not require financial aid need of the student.

The first is the unsubsidized Stafford loan. The terms are the same as the subsidized Stafford loan, but the government does not pay interest. The interest accrues and is added to principle. Repayment does not start until six months after leaving school.

States have loan programs as well, and these can vary widely.

Private loans should be one of the last sources for the student to fund an education. The credit crunch has tightened standards and pricing, and there are many unforgiving fees and penalties when the student is late with payments. Terms should be compared carefully, as some companies will lower the rate after 24-36 months of on-time payments.

Students can also explore family loans with parents and relatives. The student may be able to obtain lower rates this way, and the relatives may be able to gain a higher return than they currently receive. Interest will likely not be deductible.

3. Tax incentives (federal)

This section and the next explore how taxes may be saved to free up funds to help pay for college. This chapter covers federal credits and deductions. The next covers income shifting techniques to exploit tax savings which may be realized by

shifting taxable income from a higher bracket taxpayer to a lower one, typically the student's.

There are requirements to be able to attain these savings. The same expenses cannot be used to qualify for more than one credit or deduction. Once the qualified expenses are allocated, that's it; they cannot be double counted. So the trick is to determine where the biggest benefit will come from, when there is a choice between two tax techniques.

In addition, many of these apply only to tuition and fees. To the extent that the student gets additional aid disbursed by the school which can be used for other expenses, it should be directed in such a way as to pay for qualified expenses but not eliminate the usage of one of these credits or deductions. For example, if aid can be used for room and board, it should not be directed to tuition or fees, so that a credit can also be used for that instead.

It is helpful and usually necessary to enlist a CPA or competent tax adviser to help optimize the savings. However, this is one reason for going into a lot of detail in the sections above. A College Financial Planner can also determine if a tax strategy will hurt the financial aid eligibility. It is a team effort to locate the greatest total savings.

Most of these incentives also have income limits, after which they are phased out. For details on phase-outs, qualified expenses, and details of these incentives, consult IRS publication 970. It is about 86 pages, and goes into these items in great detail. www.irs.gov/pub/irs-pdf/p970.pdf

The specific credits and basic features are:

Hope Credit is no longer available. It is replaced by the:

American Opportunity Credit:

This is a $2,500 credit that is allowed per "academic period" for four years of postsecondary study per student. It is calculated as 100% of the first $2,000 eligible expenses, then 25% of the next $2,000. It cannot be used by the same student in the same year with a Lifetime Learning Credit. It phases out for parents' modified adjusted gross income (MAGI) from $90,000 to $180,000. See chapter 2 of IRS 970.

Lifetime Learning Credit:

This credit is calculated as 20% of qualified tuition and related expenses up to $10,000, and may be used once per year per family. The maximum is a $2,000 credit in one year. With high tuition expenses, it may be wiser to use this credit, since the American Opportunity can only be used four years. There is a phase out with MAGI. Again, any qualified expense claimed elsewhere may not be used for this credit. See chapter 3 of IRS 970.

Student loan interest deduction:

Up to $2,500 per year loan interest deduction above the line is allowed for ANY loan that is used to pay college costs. This INCLUDES loans from life insurance. Eligible expenses are somewhat broader and include tuition, fees, books, supplies, room, board, transportation, and related personal expenses. Income phase-outs for married couples filing jointly beyond $150,000. When parents have phased out, they may want the student to take out a loan on which the interest accrues, like a non-subsidized Stafford loan. When the student begins repayment, the student will likely be under phase-out limits and can then deduct the interest.

Or, the parents may consider a HELOC (home equity line of credit) loan instead, since they will not be subject to the $2,500 limit in this case, and will only be phased out at the much higher phase-out for itemized deductions. An added benefit is that this interest expense drops income, and it also reduces assessable home equity, and therefore, drops EFC to possibly qualify for more aid. The limit on writing off the interest on HELOC debt is interest on $100,000 of new HELOC debt.

Deduction for qualified higher education expenses:

In the last few years, this deduction has expired and then has been added back in December. Tuition, fees, books, supplies, and equipment count as qualified expenses, and up to a $4,000 deduction above the line may be taken. Phase-outs for married filing jointly are beyond $160,000 in 2010. If this deduction is claimed, then the American Opportunity and Lifetime Learning Credit may not be claimed, even if there is no overlap for expenses. This deduction may be beneficial if you cannot take the American Opportunity Credit.

Penalty free IRA withdrawals:

If a withdrawal is made for qualified education expenses, the 10% early withdrawal penalty is waived; but the proceeds are still taxed as income and will also increase income in the EFC calculations. This option is not desirable, and should be avoided if possible. In addition, it removes retirement funds from long-term growth and may damage retirement plans.

4. Tax strategies

In addition to using the federal education tax credits and deductions, families can also use strategies which save taxes, which then can be allocated towards educational costs. These strategies involve shifting income to a child to utilize the child's lower tax bracket or to take advantage of deductions not available to parents and grandparents. This is sometimes referred to as utilizing the child's "tax capacity."

In cases where the child is **not** eligible for aid, the primary consideration is the tax savings. When the child is eligible for aid, care must be taken to evaluate how tax

savings might actually cost more in lost aid, since the child's income and assets are assessed at a higher rate than those of the parents.

Use of these tactics must be balanced against the possibility of incurring the 'kiddie tax,' which would cause the income to be taxed at the parents' highest marginal bracket. CPA's are well versed in these tactics. Again, the caveat is that they may not know how to evaluate the impact on financial aid.

The common ways to shift income are:

1. Gifting appreciated assets during college years
2. Compensating the child
3. Gifting assets that will earn and grow
4. Gifting business interests

Tax capacity and the kiddie tax.

The kiddie tax applies to any student under age 24. Earned income, such as wages, is not subject to the kiddie tax. Any investment income of the child, such as interest, dividends, or rental income ('unearned' income) over $1,800 is taxed at the parents' top rate instead of the child's lower rate (10% ordinary income, 5% capital gains).

The kiddie tax does not apply to the first $900 of investment income; and the child is allowed a standard deduction of $900, so these earnings are tax-free. The next $900 of investment earnings are not subject to the parents' higher rate. The actual rate would depend on how much other earnings the child may have. So at least the first $900 in earnings can be tax-free. The next $900 would usually be taxed at a far lower rate than the parents' normal rate.

To the extent that the student provides over half of the funds for self-support including funds from almost all sources, the kiddie tax does not apply; and the child will also be able to claim the personal exemption. Scholarships and grants do not count in computing support. Hence, students who are able to draw on funds from other sources including loans may carry a larger amount of unearned income without triggering the kiddie tax. And to the extent that higher income parents have personal exemptions, education tax credits, and deductions phased out, this will also allow the student to claim them and save income otherwise lost to taxes.

A student over 24 is no longer subject to kiddie tax. The ability to carry larger amounts of unearned income may provide the ability to shift larger amounts of income to the recipient later to take advantage of lower relative tax rates.

Income shifting strategies:

As mentioned above, these strategies shift income from the higher tax bracket parent or grandparent to the lower bracket child in order to lessen the tax liability. The tax savings generated in this way are sometimes referred to 'tax scholarships.'

Gifting appreciated assets during college years.

A gift of appreciated stock, for example, can be gifted by high-income parents and then sold by the student. Assuming the sale proceeds exceed 50% of the student's support, a standard deduction up to $5,700 and personal exemption up to $3,500 can be deducted. Then education tax credits and deductions like the American Opportunity credit may be claimed by the student to offset some or all of the remaining tax liability.

Compensating the student.

Parents with a business or rentals can hire the student to perform necessary work at a reasonable rate of pay. The wages are deductible from the business or rental income, which will lower EFC as well as income and social security taxes. The student can take a standard deduction of the wages plus $300 up to the maximum $5,700 standard deduction limit. Because this is earned income, a child could contribute to Roth or regular IRA's for longer-term tax deferred growth, and these assets would typically not be counted on the aid formulas.

Shifting assets that earn and grow in pre-college years.

For parents who cannot employ a child in a business or gift appreciated assets, there may be the ability to gift assets to grow and be taxed at the child's lower rates. This is typically done in a custodial account. The potential impact on financial aid must be considered as the child approaches college age, since custodial assets are assessed to the child at a much higher rate in the aid formulas. It may make sense to sell these assets and convert them into a custodial 529 plan to lower their assessment rate to that of the parent. Tax costs of this liquidation must be considered as well, but taxed earnings over the years may raise the tax basis and offset a huge tax increase. Or, the asset may be liquidated over several years to keep the tax rate low.

Gifting business interests.

Typically, this would involve gifting shares of S corp. stock, interests in a limited liability corporation, or interests in a family limited partnership.

5. Funds from extended family

Grandparents often love to help their grandchildren get through college. As a side benefit, they can sometimes reduce their estate tax liability as well. The exact tactics that will be beneficial depend on whether or not the student will be eligible for financial aid.

Tuition gifts.

If a gift is made directly to a student, the gift is counted as financial aid income, and is assessed at a 50% rate to the student. If the gift is over $13,000 per grandparent to one student, it becomes subject to gift tax and uses up some of the unified tax credit for gift and estate tax. However, if a gift is made directly to the educational institution for tuition (this can include private elementary and high school), there is no reduction to the $13,000 per grandparent gift tax exclusion. The gift must be cash. However, this money is viewed as student 'resource,' so it will reduce eligibility for financial aid dollar for dollar. If the student is not eligible for aid, the point is moot. As an alternative, the grandparent could delay the gift until the student has finished college, to help pay off student loans, and pay off loans to the extent of the annual gift exclusion with no tax or aid impact.

Using a qualified tuition plan. (QTP or 529)

In cases where the grandparent wants to lower the estate and help the grandchild, but wants to retain control of the money in case retirement needs exceed expectation or does not wish to cede control over the money until the child proves to be responsible and is in college, a QTP may be a good choice. This avoids losing control of a custodial account, for example, when the child turns 18, as is law in most states.

With this strategy, each grandparent can contribute up to $65,000 to a QTP for each grandchild (5 times the annual gift exclusion), or $260,000 total, for example, for two grandchildren.

If the primary goal is simply to reduce the estate, they may be better served by gifting directly to the college's annual fund or capital campaigns. Tuition most likely will not be deductible. However, the school is very likely to discount to donor families and the gifts are tax deductible.

Using retirement accounts of pay for college:

When grandparents have more than adequate retirement resources, including an IRA, they may wish to fund their loved one's education by withdrawing some IRA funds. When used for educational expenses, these funds will not be subject to an early withdrawal penalty. In addition, reducing IRA funds from the estate also reduces "income in respect of a decedent" in their estate and thus reduces an adverse tax impact on it.

Charitable giving:

If the donor has a charitable desire, wants to also address estate tax issues, and accepts that they will not receive more tax or college benefit than the actual amount of a gift, they may want to consider a charitable trust, such as a charitable remainder trust. The advantages include a current tax deduction, removal of the asset from the estate, and removal of future income and appreciation from the estate. This is offset by the loss of future financial benefits from the donated assets and reducing the amount of inheritance from heirs. Donating a highly appreciated asset with a low yield this way, then selling the asset and reinvesting the proceeds into a higher yielding instrument, can increase cash flow without depleting the principle.

Testamentary Trust:

Essentially, a will with a testamentary trust can be devised to make payout conditional on completion of college. Alternative conditions can be imposed to the extent the child does not attend college or conditional beneficiaries may be named. This can be an excellent accountability incentive for the student, possibly including greater payouts for better grades.

6. Controlling the Cost of College

There are numerous ways to lower the ultimate costs, and, thereby, directly reduce the risk to wealth posed by large education costs. Sensibly choosing an adequate vs. a 'status' college, as discussed above, is a start. Some of the more common ways to do this include the following academic and cost-cutting strategies.

Finishing in four years:

Less than 20% of all students complete a four-year degree in four years. This is due to a number of factors including lack of focus, need to work, and poor choice of college fit for the student. Early career planning in high school can help focus a student and lessen the risk of change of major and loss of time. Thoroughly matching the personality of the student with the 'personality' of the college will help avoid change of college and the need to make up for lost time and lack of full transfer credit. For students who must work to pay for college, it may be preferable to take out loans that have favorable enough terms instead, and then pay them back after graduation, when the degree will have enabled the student to earn at a higher rate of pay.

Cutting the time in college:

Taking AP (Advanced Placement) courses in high school and passing with high enough grades can count toward graduation and shorten the time in college as well as increasing the student's competitiveness for merit awards. However, AP classes are typically only practical for the better students and may be impractical for 'late bloomers.' An alternative is to pass "CLEP" or college level exam program tests, which are typically

easier and still satisfy many college requirements. There are companies which will offer preparatory classes and test preparation with guarantees. If the student begins this preparation early in high school, it is entirely practical to have completed a half year of college prior to beginning the first year. CLEP exam credit is typically not allowed after the student has begun college.

The student may also consider distance learning courses, either online or correspondence, during school break time in order to further accelerate graduation.

In addition, the student could consider acceleration programs offered by the college, such as a three-year degree or combined bachelor/master degree programs.

A number of states offer “dual enrollment” opportunities for high school students to attend community colleges and will directly pay tuition to the college instead of the high school. Some states have advanced high school programs that will allow the student to graduate twelfth grade with an Associate’s Degree. Several colleges are extending this through the Bachelor’s Degree. This could save years and several thousands of dollars.

Some programs also offer five-year degree co-operative work study plans, in which the student works at a paid job for three six-month periods, or some variation, and gets both valuable work experience as well as a way to try a variety of work situations. The earnings tend to be significantly more than campus work study jobs, and are more relevant to the student’s career, probably increasing a starting salary after graduation over what would be offered to a grad without experience.

Many students wish to attend an elite or private college. This is typically at a higher cost and students are required to live on campus, at least through the freshman year. A cheaper way could be to complete two years of community college or a low-cost public university and then transfer to the more expensive private college to complete the degree. The final degree is the same. Be careful to make sure credits will transfer.

Students who attend out-of-state public college usually pay non-resident tuition which is much higher. They could become in-state residents to lower this tuition. The parents, however, must be willing to give up listing the student as a dependent on the tax return. This is not an automatic process, and colleges will expect proof of residence, a duration requirement, a ‘non-academic purpose,’ such as employment in the state prior to attending college and so forth. The student must be willing to meet as many of the residency requirements as possible. It may take a year or two. One especially persuasive piece of evidence is to obtain a professional license such as a real estate or insurance license, and obtain employment in this field during this time. This strategy will not categorize the student as independent for financial aid purposes. Therefore, the family may lose the tax deduction. A tax professional should evaluate the benefits.

7. Using Parents' Money to Pay for College

The previous section provided an overview of how to use other people's money, including the student's, to pay for college. This section gives an overview of the three main ways to obtain money to save and pay for college which will come directly from the parents' own funds:

1. Increasing cash flow
2. Parent loans
3. Selecting investments to save for school.

1. Increasing cash flow for retirement, lifestyle and college funding

Generally, budgets do not work. The main reason is that most budgets are artificial constructs imposed over how people actually enjoy living. Consequently, you should not change your lifestyle substantially if you expect a budget to work. Incremental changes over time may eventually redirect a family, but they may not be willing to make much change anyway, until they can equate their lifestyle choices now to some things they want more in the future. This can be a tough mental challenge. Moreover, no one likes to do cash flow planning, even though all wealth building and lifestyle enjoyment is the result of how cash flow is managed.

Fortunately, financial advisors have many tactics at their disposal. Here are a few common ones.

Cash flow strategies:

1. Reduce discretionary expenditures. Consider what each consumption choice actually contributes to your life purposes and those of your children. Do you consume for status? Is it for self-image? Perhaps you need to come to terms with who you are, and if you wish to continue to be hostage to your current way of looking at the value of your expenditures

2. You may wish to take a part-time or temporary job to meet a savings goal. If you choose self-employment, the tax code allows numerous ways to shelter or minimize this income from taxes or shift otherwise taxable income to children for tax savings.

3. By delaying retirement, you may be able to restore your desired lifestyle goals which may be impacted by helping children with college.

4. Build an emergency fund. This helps avoid having to cash in longer term, higher yielding investments at times when the market is performing poorly, and avoid negative tax consequences.

5. Fund a smaller portion of college expenses. Loans are available to students for education, but they are not available to parents for funding retirement.

6. Minimize incurring new debt, or select debt with lower after-tax rates, such as home equity loans, instead of using non-deductible credit cards and other consumer debt. Better yet, if you own a cash value life policy, this may be your cheapest form of borrowed funds.

7. A reverse mortgage should be approached with caution, as you may wish to reserve it to supplement retirement living; but to the extent that it can be used to eliminate higher cost debt or emergency needs, it might be considered if the age of the youngest borrower exceeds 62 years.

8. Consider allocating a portion of your long-term savings into a tax-deferred arrangement that will also allow you to withdraw funds in the form of loans easily and cheaply, such as permanent insurance. This can help diversify equity-only retirement plans as well.

9. The Home Equity Acceleration Plan (H.E.A.P.™) (http://www.heaplan.com). Many clients simply can't budget themselves. While not a college savings plan per se, by using H.E.A.P.™, clients can automatically start building wealth by reducing the debt on a personal residence. Because H.E.A.P.™ is a plan that happens automatically, a client does not have to think or plan. They simply live their lives as they normally would, and it will work to reduce the debt on their home and create more wealth (wealth which could be accessed later on to pay for a loved one's college education).

Debt Consolidation

Until the recent mortgage credit crunch, this was an easy way to roll more expensive credit and bills into a new mortgage in order to decrease required monthly debt service and, thereby, free up cash. In addition, the cheaper rates offer cheaper cost of debt. And refinancing for 'equity-stripping' certainly can make sense for borrowers who can put the equity to work for returns greater than the mortgage costs.

Nowadays, refinancing terms are more rigorous, but families with excellent credit may still find the process easy. Other borrowers will have to evaluate their existing situation to see if this still makes sense. This tactic can allow access to more cash without requiring a change in lifestyle.

2. Parent loans for college

To the extent that parents must choose to borrow for college, there are several types of loans, some good, some not.

Federal PLUS Loans (Parents' Loan for Undergraduate Students):

Virtually every financial aid award letter that comes back with a shortfall recommends that parents consider taking out a PLUS loan to make up the difference. They are not need based. These loans have a ten-year maturity, are based on credit score, and carry a rate of about 8.5%, although the rate is set annually. The loan rate can be reset down a percent or so if the parents complete 24-36 months of on-time payments. They can carry up-front loan costs and are often compared with HELOCS. They are limited to an amount based on Cost of Attendance less other aid received.

The disadvantage of a PLUS loan is that education interest deduction is limited to $2,500 annually, whereas, in most cases, a home equity loan allows for deduction of all interest costs for the first $100,000 borrowed. Moreover, PLUS loans can become a debt service nightmare for a parent relying on them to finance the education of more than one child. Each year the parent borrows for that year's expenses, and the effect is like ratcheting up the debt payment each year. It becomes a staircase of ever-increasing loan payments. Many parents at some point must resort to a mortgage refinance to get out from under the huge accumulated monthly PLUS loan payments. The problem is at this point the large amount of PLUS loan debt may drive down the parents' credit score, resulting in higher refinancing costs. It may have been much cheaper to start out with the home refinance.

Personal residence loans:

Two types will be discussed: a HELOC and a refinance, whether that be a refinanced into a first or a fixed second mortgage.

When a first is refinanced, or a fixed second is added, with cash out in order to have a fund for college, a large chunk of cash must be stored safely. There will be new interest expense on the money that was formerly equity in the home. Unless the money is stored in an annuity or cash value life insurance, it will now be assessed as a financial aid asset and assessed at a 5.6% rate. On the other hand, any home equity which would have been assessed on the Profile formula will now be reduced. There will be no change to the FAFSA and the Federal EFC.

If the family needs to use more than the 10% usually allowed to be withdrawn annually without surrender charges or penalty, it makes little sense to put it into an annuity. In addition, these withdrawals will have to be reported as financial aid income, hurting the eligibility for future aid; and the client may have a 10% penalty issue if withdrawing money from an annuity prior to age 59 ½.

If all of the borrowed funds from a home equity line are immediately poured into a life insurance policy, preferably some kind of UL, it will be classified as a MEC (modified endowment policy) unless the initial death benefit is increased to the point where the policy will not be economically viable. Typically, a cash value life policy will have very little cash in the early years (unless a "high cash value" policy is used).

The hope is that, by transferring money to a cash value life insurance policy which may be treated as a non-countable asset, the child will receive increased aid which will offset the costs inside the life insurance policy.

The upside to using the “right’ cash value life insurance policy to grow wealth is that the money in the policy will not go backwards due to stock market declines (which is one of the major drawbacks of how people invest in 529 Plans).

However, the interest on the loan will not be deductible since it is being put directly into life insurance with the intention of later withdrawing it.

A better solution, depending on the amount needed, may be to take out a HELOC. Interest will accrue only as incurred, and the borrower may pay as they go. The client could also use a H.E.A.P.™-type plan (http://www.heaplan.com) to optimize payoff and minimize outstanding balances. If home equity is assessed, as with the IM, as the loan balance grows, this will tend to lower EFC over time to qualify the family later for increased aid. A HELOC also qualifies the family for interest deduction greater than the $2,500 allowed for parent educational loans, like PLUS loans.

To the extent that the family wishes to invest in a cash value policy like the Retirement Life policy which will address many typical needs which could threaten retirement, they could begin to fund this policy through regular earnings and payroll deductions. To the extent that they need additional funds for college and living expenses, they could draw against the HELOC. Once the policy has sufficient cash value to support loans, the family could then choose to borrow against whichever loan had more favorable terms, typically the LI. This might be a bit of a balancing act for many families; but as long as the life policy is maintained and eventually overfunded, the family would have protection against many events which could threaten the ability to pay for college and be on a path to accumulate additional retirement funds.

Margin account loans:

If the family has stock available against which to borrow, a margin loan can also satisfy short-term cash needs. The debt reduces the net equity to be reported, which would lower the families EFC, since the net asset is reduced. Interest rates on these loans will typically be equivalent to HELOCs. The disadvantage is that, if margined stocks take a plunge in value, as happens periodically, the stock is subject to a margin call and is a very dangerous way to fund for college expenses and is NOT recommended by the Wealth Preservation Institute.

Retirement account loans:

Loans taken against retirement accounts that are used for educational purposes are free of the 10% penalty if withdrawn prior to age 59 ½. There is no advantage to the EFC. Terms are usually favorable. However, these loans must usually be paid back in five years. If the borrower loses his/her job, the loan may be due immediately. Furthermore, the loan reduces the money available for long-term growth and may risk missing large market upswings.

Life Insurance loans:

Life insurance, if not a MEC, can be an ideal way to save for college and retirement due to the tax deferred buildup and the tax-free loans available. Retirement Life (equity indexed life universal life insurance) is the policy that makes the most sense in today's marketplace. It also removes the threat that disability, long-term care, death, or severe illness crises can destroy a college funding plan while still allowing long-term cash buildup as both a savings vehicle for the parent and a vehicle to pay out cash flow needed to pay for college as tax-free loans.

The risk is that too much will be borrowed from the policy, and the benefits will be reduced. The other risk is an opportunity cost. Retirement Life removes the risk of negative equity returns unlike equity based retirement funds. It does not, however, capture all of the upside due to caps on returns or partial participation rates. For portfolios which are highly weighted towards equities or mixed equities and bonds, an EIUL policy may be a good middle ground to increase diversification; and it may be superior to the fixed returns of a bond or fixed annuity.

3. College and Retirement Investments

College savings and retirement savings are two aspects of one long-term financial challenge. The money for both needs comes from one stream of cash flows during the income years. Best returns are obtained from long-term investments. By focusing only on short-term college funding needs, you may be restricted to conservative short-term savings with a lower return on investment.

There are many long-term investment choices to save for college, and the main ones will be overviewed in this chapter. Because there are many loan alternatives to pay for college, they can be used to avoid the need for lower earning, short-term investments or forced liquidation of sensible long-term investments.

Any investments anticipated for use in saving for college and retirement should be screened through several criteria:

1. **Rate of return vs. risk:** Higher returning investments usually carry higher risk, but longer term investments have more time to recover from downturns in an investment, such as in the equity markets.

2. **Flexibility:** Ideally, the investment can be used for either retirement funding or college; and is better if it can be changed from an assessable asset to a non-assessable asset on the aid forms.

3. **Control:** It is important to control where to move or keep funds in order to keep up with college inflation costs and manage the risk/return tradeoff.

4. **Tax benefits and efficiency:** Tax-deferred growth and tax-free withdrawals are desirable. If taxable, long-term capital gains instead of ordinary income are preferred. The 'kiddie' tax should be avoided. The investment should coordinate well with education tax incentives, and the tax benefits should match well with the rate of return.

5. **Affect on financial aid:** If financial aid is a possibility, then investments which do not affect aid would be preferable.

6. **Self-completions of the college and retirement funding plans:** The investment plan must provide for completion in the event of death, disability, or other critical illness such as long-term care, chronic, or serious illness.

Investment Options:

There are many different ways to "invest" for college savings. The following list is not exhaustive but will cover most of the typical options.

EE bonds:

Interest on these bonds for qualified education expenses (tuition and fees) are tax-free when used by any family member. There are income phase outs for parents with income of roughly $100-130K. Bond redemptions may be rolled over to a QTP or CESA. To qualify for the tax-free treatment, the purchaser must be 24 or older.

I-Bonds:

Families may purchase up to $10,000/year of these bonds where returns rise and fall with the level of inflation. Tax on interest may be excluded to the extent that interest is used to pay for qualified educational expenses, modified adjusted gross income is under the phase-out limits, and the purchaser of the bond is at least 24.

Traditional IRA's:

For parents who can employ the student in their business prior to college, an IRA is a good way to set aside funds to grow wealth in a tax-deferred vehicle. These assets are not counted in the aid formulas. To the extent that the student withdraws the funds for qualified education expenses, there is no penalty for early withdrawal. The tax liability can be offset by claiming an American Opportunity or Lifetime Learning credit, if

eligible. This effectively removes income from the parents' rate during accumulation, then permits withdrawal at the lower student's rate.

It is **strongly discouraged** that parents withdraw funds from their IRA unless they are certain that they have excess funds from their retirement funding sources.

Roth IRA's:

Roths have many of the same advantages. They are non-assessable assets in the aid formulas. In addition, they provide the flexibility to withdraw non-taxable funds for non-college purposes to the extent of principle contributions. If the funds are not used for college, they become non-taxable for retirement purposes after age 59½ and a five-year holding period. Also, they may be useful to diversify from too much QTP savings. If the Roth has more funds than needed, the Roth IRA funds may be kept since they do not have to be consumed for college.

Tax efficient mutual funds:

There are a number of ways to construct these types of funds (or ETFs). They may be indexed funds; they may hold low turnover stocks; they may utilize tax-wise techniques, such as selling highest cost basis shares when needed or matching securities with losses against gains, and so forth. The advantage is that these funds may be kept in the event the student does not go to college and used for retirement or other purposes. This overcomes one of the major tax risks of QTPs. However, like any equities, they carry market risk and may have lost value when funds are needed.

Annuities:

The benefit of holding money in annuities is that they are not counted in the aid formulas at most of the colleges. They can be held as a retirement vehicle as 'safe' money to create a predictable income stream during retirement. For annuities with shorter surrender penalties, money subject to aid assessment may be 'parked' for a modest return, better than cash, and be used to repay student loans or other college debt after the student has finished.

The disadvantages of annuities is that earnings are taxable at ordinary income rates, there are withdrawal and surrender penalties, there are fees for mortality and risk to the original investment, and there is a 10% penalty for withdrawal under age 59 ½.

Single premium immediate annuities can be utilized to reallocate money from countable assets to a sheltered vehicle. The income impact will be minimized because of the exclusion ratio.

Variable annuities, which invest excess funds in side funds, can offer a greater return than fixed annuities but, like equities, carry a greater risk of loss or downturn during a time when funds may be needed.

QTPs or 529s:

These come in two flavors. There are 529 pre-paid tuition plans, and the far more preferred 529 Savings plans. The pre-paid tuition plans, as the name suggests, 'lock' in the tuition rate to protect the family from the rise in the costs of tuition and fees. They are usually most beneficial in one state, although most of the time the funds are portable at a lower rate. Although these fees have averaged a 6-7% increase annually, there have been periods of time when they do not rise at all. So the risk is that the ultimate costs of tuition may not be greatly higher than when parents started the plan, so the investment will have earned a low return. The other disadvantage is that some states have dropped their programs and returned the funds, especially when tuition has taken a very large jump.

529 Savings plans are much more popular, maybe excessively so, to the extent that they are perceived as the 'silver bullet' of college funding. This is a dangerous perception, insofar as they carry substantial risks, including taxes and possibly poor returns.

The advantage of 529s is that they allow tax deferred growth and tax free withdrawals for qualified education expenses, which are defined broadly. In some states, contributions are tax deductible. In addition, they offer flexibility in change of beneficiary and allow lump-sum contributions equivalent to five years annual gift exclusions. That creates an opportunity to quickly lower estate tax liability.

529s are typically mutual funds, most are sold at a commission, and carry annual management expenses like most mutual funds. These costs can drain returns. The most popular ones are age-based funds, which begin in the early years with aggressive investments, perhaps all equities. Periodically, mechanically, typically every few years, the asset allocation is changed to a more conservative mix, which lowers the expected return. The allocation is very conservative as the child enters college in order to provide maximum principle protection at that point.

A family that counts on receiving an average annual return based on long-term returns on equities finds that this ratcheting down of the expected return underperforms their expectation. In addition, if returns are low in the early years, this strategy sells when equities are low, then reinvests in a more conservative allocation, which will not recover as much as the original allocation. So this creates market risk. This is exactly what has happened since 2000.

Another major risk is that the student may not attend college, and there may be no other beneficiary to substitute. In that case, the money withdrawn is taxed at ordinary income rates along with a 10% tax penalty. This same taxation applies to 529 funds applied to expenses which have been paid by another tax-favored education source.

Putting all of one's college savings into a 529 can be viewed as an undiversified portfolio insofar as this component carries both risk to principle as well as potential tax risk.

A better alternative is to take a portfolio approach and add, perhaps, a tax-efficient fund, which will be a good long-term retirement vehicle, although non-qualified, along with cash value life insurance, which will remove downside risk and allow for tax-free borrowing from the cash value.

Expenses of 529 Plans

529 plans are not inexpensive.

Typical, annual asset fees on the money invested in mutual funds inside a 529 plan range from up to 1% with direct-sold plans (no broker) and from .75% to in excess of 3% a year with advisor-sold plans.

Coverdell Education Savings Accounts: (CESA)

The rules for this investment option are detailed. The main features only will be covered.

Up to $2,000 per student can be saved with after-tax contributions up to age 18 for a maximum of 18 times $2,000 or $36,000. There are income phase-outs; but money can be gifted, say to the student, for the student to make the contributions. Withdrawals for qualified educational expenses are tax-free. Excess withdrawals are subject to a 10% penalty, and qualified expenses may not be paid with other education funds.

One unique advantage of CESA's is that they may be used for pre-college tuition and fees. Students with a drug conviction are still eligible for a CESA. The balance of a CESA must be distributed before the beneficiary reaches age 30; otherwise the balance will be taxable with a 10% penalty. However, the balance may be rolled over to another eligible beneficiary to avoid taxation or to a QTP for the same beneficiary. CESAs are considered gifts, and, therefore, reduce the annual gift exclusion.

CESA balances are assessed as parent assets, but withdrawals are not assessed as student income.

Coverdell Education Savings Accounts

General Information

1. ***Who is Eligible for a Coverdell Education Savings Account?***

Anyone may contribute to a Coverdell Education Savings Account regardless of his or her relationship to the beneficiary. The beneficiary of a CESA must be under age 18 at the time a contribution is made on his or her behalf, unless the beneficiary is a “Special Needs” beneficiary as discussed later. A CESA may also be established to receive rollover contributions or transfers from another CESA.

Coverdell Education Savings Accounts are subject to limitations based on the status of the contributor as well as the status of the beneficiary. For purposes of this discussion, except as noted, the term “beneficiary” is used to refer to an individual whose education is to be financed, in part or in whole, through a CESA.

2. When Can I Make Contributions to a Coverdell Education Savings Account?

You may make contributions for the calendar year until April 15 of the following year. You may make contributions to a Coverdell Education Savings Account for the calendar year regardless of your age; however, you may not make a contribution to a CESA after the beneficiary attains age 18, unless the beneficiary is a “Special Needs” beneficiary. A “Special Needs” beneficiary is one who needs additional time to complete his/her education due to physical, mental or emotional limitations. In addition, as discussed below, a beneficiary may roll over contributions to another CESA until he or she attains age 30. A beneficiary may also roll over his or her CESA to a new beneficiary who is a member of his or her family so long as the recipient has not attained age 30.

The term “Member of the Family” shall have the meaning prescribed by Code Section 529(e)(2) and shall mean any individual who bears one of the following relationships to the beneficiary:

(a) the father or mother of the beneficiary or an ancestor of either;
(b) a son or daughter of the beneficiary or a descendent of either;
(c) a brother, sister, stepbrother, or stepsister of the beneficiary;
(d) a stepfather or stepmother of the beneficiary;
(e) a stepson or stepdaughter of the beneficiary;
(f) a son or daughter of the brother or sister of the beneficiary;
(g) a brother or sister of the father or mother of the beneficiary;
(h) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the beneficiary; or
(i) the spouse of any of the individuals described in sections (a) through (h) above; or of the beneficiary; or
(j) the first cousin of the beneficiary.

3. How much can be contributed to a Coverdell Education Savings Account?

The maximum contribution that can be made to all Coverdell Education Savings Accounts that cover a particular beneficiary may not exceed $500. It is the joint responsibility of the contributor and the beneficiary to verify that excess contributions are not made on behalf of a particular beneficiary. Qualifying rollover contributions and transfers are not subject to these limitations. Note: special rules apply to contributions to CESAs for purposes of gift and estate taxes.

In addition, if your adjusted gross income (or combined income if you file a joint tax return) as modified below exceeds certain limits, you are not eligible to make a contribution to a Coverdell Education Savings Account. For this purpose, your adjusted gross income is increased by amounts excluded under Section 911 (certain exclusions applicable to U.S. citizens or residents living abroad), Section 931 (certain exclusions applicable to U.S. citizens or residents living in Guam, American Samoa, or the Northern Mariana Islands), and Section 933 (certain exclusions applicable to U.S. citizens and residents living in Puerto Rico) of the Code.

The amount you may contribute to a Coverdell Education Savings Account for a particular beneficiary is reduced proportionately for adjusted gross income (as modified above) which exceeds the applicable dollar amount. The applicable dollar limit is $95,000 for an individual, a married individual filing a separate tax return or a head of household; and for a married individual filing a joint tax return this limit is increased to $190,000. If your adjusted gross income as modified above exceeds the applicable dollar amount by $15,000 or less ($30,000 or less in the case of a married individual filing jointly), you may make a contribution to a CESA. The amount you may contribute, however, will be less than $2,000.

To determine the amount you may contribute to a Coverdell Education Savings Account, use the following calculations:

Step 1. Subtract the applicable dollar amount from your adjusted gross income as modified above. If the result is $15,000 or more ($30,000 or more in the case of a married individual filing jointly), you may not make a contribution to a CESA.

Step 2. Divide the above figure by $15,000 ($30,000 in the case of a married individual filing jointly), and multiply that percentage by $2,000.

Step 3. Subtract the dollar amount (result from (2) above) from $2,000 to determine the amount that you may contribute to a CESA. In addition to the limitations described above, the $2,000 may be reduced by other amounts contributed to an individual retirement plan for the benefit of a particular beneficiary but is not affected by the adjusted gross income of the beneficiary. The maximum contribution amount is subject to reduction or other provisions after 2010. If the beneficiary of the CESA also maintains a Traditional or Roth IRA, his or her overall contributions to other individual retirement plans may be limited. Please contact your tax advisor for more information.

4. Can I roll over or transfer amounts from another Coverdell Education Savings Account?

Amounts may be “rolled over” from one Coverdell Education Savings Account to another Coverdell Education Savings Account benefiting the same beneficiary. In addition, amounts may be rolled over without any tax liability to benefit a member of the family as defined in paragraph 2 of the beneficiary provided that they have not attained age 30 at the time of the rollover. Rollovers between CESAs may be made once per year and must be accomplished within 60 days after the distribution.

5. What if I make an excess contribution?

Contributions that exceed the allowable maximum for federal income tax purposes are treated as excess contributions. A nondeductible penalty tax of 6% of the excess amount contributed must be paid for each year in which the excess contribution remains in the beneficiary’s account.

6. How do I correct an excess contribution?

If a contribution in excess of the allowable maximum is made, it may be corrected to avoid the 6% penalty tax for that year by withdrawing the excess contribution and its earnings on or before the date, including extensions, for filing the tax return for the beneficiary’s tax year for which the contribution was made. An excess contribution may be corrected by June 1 of the taxable year following the taxable year in which the excess contribution was made. Any earnings on the withdrawn excess contribution will be taxable in the year the excess contribution was made and will be subject to a 10% tax penalty.

7. What forms of distribution are available from a Coverdell Education Savings Account?

Distributions may be made as a lump sum of the entire account or distributions of a portion of the account may be made as requested.

8. When must distributions from a Coverdell Education Savings Account begin?

Distributions must be made (or otherwise will be deemed made) no later than 30 days from the earlier of the beneficiary's death or attainment of age 30. A distribution from a Coverdell Education Savings Account may be rolled over to another beneficiary’s CESA according to the requirements of Section (4). Note that the Economic Growth and Tax Relief Reconciliation Act of 2001 waives the distribution age limitation if the beneficiary of the CESA is a “Special Needs” student.

9. Are there distribution rules that apply after death?

Special rules apply in the case of the divorce or death of a beneficiary of a Coverdell Education Savings Account. In particular, any balances to the credit of a beneficiary must within 30 days of death be either: (i) rolled over to another beneficiary's Coverdell Education Savings Account according to the requirements of Section (4) (in which case the distribution will not be subject to tax) or (ii) distributed to a death beneficiary or the beneficiary's estate (in which case the distribution will be subject to tax).

10. How are distributions from a Coverdell Education Savings Account taxed tor federal income Tax Purposes?

Amounts distributed are generally excludable from gross income if they do not exceed the beneficiary's "qualified higher education expenses" for the year or are rolled over to another Coverdell Education Savings Account according to the requirements of Section (4). "Qualified higher education expenses" generally include the cost of tuition, fees, books, supplies, and equipment for enrollment at (i) accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree or another recognized post-secondary credential and (ii) certain vocational schools.

In addition, room and board may be covered if the beneficiary is at least a "half-time" student. This amount may be reduced or eliminated by certain scholarships, qualified state tuition programs, AMERICAN OPPORTUNITY, Lifetime Learning tax credits, proceeds of certain savings bonds, and other amounts paid on the beneficiary's behalf as well as by any other deductions or credits taken for the same expenses. The definition of "qualified education expenses" includes expenses more frequently and directly related to elementary and secondary school education including the purchase of computer technology or equipment or Internet access and related services.

To the extent payments during the year exceed such amounts, they are partially taxable and partially non-taxable similar to payments received from an annuity. Any taxable portion of a distribution is generally subject to a 10% penalty tax in addition to income tax unless the distribution is (i) due to the death or disability of the beneficiary, (ii) made on account of a scholarship received by the beneficiary, or (iii) is made in a year in which the beneficiary elects the AMERICAN OPPORTUNITY or Lifetime Learning credit and waives the exclusion from income of the CESA distribution. You may be allowed to take both the AMERICAN OPPORTUNITY or Lifetime Learning credits while simultaneously taking distributions from CESAs. However, you cannot claim a credit for the same educational expenses paid for through CESA distributions.

To the extent a distribution is taxable, capital gains treatment does not apply to amounts distributed from the account. Similarly, the special five- and ten-year averaging rules for lump-sum distributions do not apply to distributions from a CESA. The taxable portion of any distribution is taxed as ordinary income. The IRS does not require withholding on distributions from CESAs.

11. What if a prohibited transaction occurs?

If a “prohibited transaction” as defined in Section 4975 of the Internal Revenue Code occurs, the Coverdell Education Savings Account could be disqualified. Rules similar to those that apply to Traditional IRAs will apply.

12. What if the Coverdell Education Savings Account is pledged?

If all or part of the Coverdell Education Savings Account is pledged as security for a loan, rules similar to those that apply to Traditional IRAs will apply. In general, those rules provide that the amount pledged is treated as distributed.

13. How are contributions to a Coverdell Education Savings Account reported for federal tax purposes?

Contributions to a Coverdell Education Savings Account are reported on IRS Form 5498.

14. How are earnings on a Coverdell Education Savings Account calculated and allocated?

The method of investing annual earnings is set forth in the Coverdell Education Savings Custodial Account Agreement. The growth in value of the IRA is neither guaranteed nor projected.

15. Can you roll money from a 529 Plan to a Coverdell Education Saving Account?

No. Unfortunately, this cannot be done.

3. College Planning Using Cash Value Life Insurance

In order to accomplish diversification and hedge the risk of either poor performance or taxability of a college savings vehicle, cash value insurance (especially some form of universal life) should be considered. First, cash value life insurance can complete a college funding program if the death benefit is purchased on a parent. Second, excess funds can grow tax-deferred and come out tax-free both for college funding for the child or grandchild and for supplemental retirement income for the parent.

Moreover, the market returns can never pull down the policy cash value below a 0 return, unlike a 529 or tax- efficient funds. If market returns are very modest, there is a crediting option which will multiply the returns. (At present, the 140% participation rate in the S&P 500 index (minus dividends)) As with any equity indexed product, the

ultimate return may trail the actual market; however, the amount of risk reduction is superior. Given recent market returns since 2000, this type of savings and risk reduction vehicle would have greatly out performed 529s which have not done well.

CAUTION:

The advisor is urged to be extremely cautious of another college funding vehicle which provides a guaranteed return of premium immediately if funded in a lump sum. This type of policy is a modified endowment policy and carries a 3-5% return which takes several years to begin accumulation due to payment of commission in the early years. Some advisors recommend selling assets to take them off the aid formulas and put them in this type of MEC policy. It is a big error to assume that this will cause the EFC to drop enough so that a college will then give more aid. In fact, by liquidating assets, the client may incur tax liabilities; they may incur an opportunity cost by liquidating high return investments and putting them into a very low returning investment; they may create new costs such as mortgage interest due to a refinance, and so forth. In the end, the college may grant little or no additional aid due to ‘hiding’ assets.

Many advisors have been sued for creating new costs and lost opportunity for clients in the hopes of getting more aid which never was realized. There should always be good economic rational when moving money around such as to better diversify a family’s total financial life plan. To the extent that the EFC can be lowered and results are beneficial, then the advisor should not be concerned when choosing between two sound strategies.

Remember, the merit of the student and the choice of school are the most important factors in receiving more aid.

Industry speak

If you listen to many of the insurance companies and independent marketing organizations (IMOs), you’ll be of the opinion that funding a cash value life insurance policy (Equity Indexed Universal Life (EIUL) Insurance), is a no-lose proposition.

When you fully understand the numbers, you’ll know that such statements are inaccurate and misleading which is why an education module covering this subject matter is important to read (so you can give “client-first” advice).

A quick review

College Funding using 529 Plans

Paying for a child or a grandchild's college education has become increasingly difficult as the costs of college continue to increase. It really is unbelievable how much college costs today (and it increases every year).

Today, 529 plans seem to be the tool of choice to pre-fund and build a tax-favorable pool of money for college education. See the following Pros and Cons to 529 Plans:

Pros—

1) Once funded (after-tax), the money can **grow tax-free** and be **removed tax-free** for qualifying college education expenses.

2) If owned by the parent or grandparent, once funded correctly, the assets (including growth) are out of their estate for estate tax purposes.

3) If owned by the parent or grandparent, if the child or grandchild does not go to college, the money can be used by the person funding the 529 Plan and would act like an IRA (with similar income taxes and penalties).

Cons—

1) If the child does not go to college, the growth on the money is taxable and subject to potential penalties when withdrawn/used by the parent/grandparent.

2) The money in a 529 Plan is **subject to loss due to market risk**.

3) 529 Plans are not "self-completing" should a parent or grandparent die prior to complete funding.

4) 529 Plans have funding limits. Funding is limited by the $13,000 annual gift tax exclusion (although they can be super-funded in year one by pouring in all of the first five year's worth of gifts all at once, $65,000).

Using Cash Value Life Insurance as an alternative funding vehicle for college expenses

Why would anyone use cash value life insurance as a funding vehicle to pay for college education? Good question, and here are the simple and easy to understand

reasons. (Initially, it will be assumed that the life insurance policy will be purchased on a child's parent.)

1) **Life insurance is a "self-completing" plan**. Let's assume Dad is the breadwinner in the family; and if he happens to die when a child is young without fully funding a 529 plan, there will be a significant shortfall when the child goes to college. With life insurance, if Dad dies, a sizable income tax-free death benefit will pay to the heirs who can choose to use that money for college education.

2) Money in a cash value policy will not only **grow tax-free** but it can be **removed tax-free** when used to pay for college expenses (policy loans).

3) If the child does NOT go to college, the policy will be a **terrific tax-favorable, wealth- building/retirement tool for the parent**. If you've read the education module on cash value life insurance, you'll know why cash value life insurance can be such a powerful wealth building tool.

4) After borrowing from the policy, it will still have cash in it and should grow for years to come. That means that money can be removed tax-free later on when the **parent is in retirement** (this is not possible with a 529 Plan).

5) Money in a cash value life insurance policy is **not a countable asset** when a child goes to apply for financial aid for college (this is the case with most colleges but not all).

Based on the above positives of using cash value life insurance policies, you'd think it is an easy decision to counsel a client to use a policy to fund for college education.

Unfortunately, that is not the case. As you will see with the following numbers, cash value life insurance as a college-funding vehicle only works when a client not only funds the policy for future college expenses but also "overfunds" the policy with cash to be used as a supplemental retirement vehicle for the parents.

The following examples will clearly illustrate the problems with using cash value life insurance as a college funding vehicle when it is not properly "overfunded," and some examples will illustrate how cash value life insurance works very well as a funding vehicle.

Example 1

Assume your client is a 30-year-old (male) parent who has a 6-year old child. Assume the child will go to college at the age of 19 and will be there for five years. Assume Dad has $3,500 each year to pay towards a college funding vehicle and that he

choose to fund that money each year into an EIUL policy every year from the child's age 6-18. Assume the policy runs at the MEC minimum death benefit and that the annual rate of return is 7.5%.

Initially assume that, when Dad takes out tax-free policy loans from the policy, he does so with "wash" loans.

How much could Dad remove from his life insurance policy from the child's age 19-23? **$12,330**.

How much could be removed each year from a 529 Plan where we assume a 1.2% mutual fund expense on the money in the 529 plan? **$16,125**.

Which one worked better? Hands down; it's the 529 plan.

What about using "variable loans" in the life policy?

If you read the life insurance education module, you'll know that a client can usually take significantly more cash out of the policy when you assume a variable loan rate (the life illustration is usually setup to have a lending rate of 1-3% lower than the crediting rate).

In the previous example, what if the policy had a **1%** positive loan spread? How much could be removed from the life policy each year for college? **$12,696**.

What if the policy has a **2%** positive loan spread? **$12, 974**.

To many who are used to illustrating variable loans in EIUL policies, the previous numbers won't make much sense. When you run a life insurance illustration at the MEC minimum death benefit, you almost always are able to take out sizable amounts of cash and significantly more when you illustrate a 1-3% loan spread. Why in the previous example did the borrowing figures not significantly increase with a variable loan?

The answer is quite simple; while the illustration was run with the MEC minimum death benefit, it was not really "overfunded." Paying a $3,500 premium may sound like decent amount of money when funding a 529 plan for college funding, but that amount is not considered "overfunding" when trying to design a life insurance policy to work as a significant cash accumulator.

There are some very positive things when funding a life policy for college funding. Using the current assumptions, the life insurance policy would slowly grow cash back in the policy after the amount assumed had been borrowed over the five-year college period and would have $64,000 of cash in it when Dad turns 70 with wash loans, $142,000 with a 1% loan spread and $209,000 if there is a 2% loan spread like the insurance companies believe will happen.

Additionally, the death benefit at age 70 would be $280,000. A client would neither have the ability to accumulate more cash to be used tax-free in retirement nor would he/she have an additional death benefit for the heirs should a 529 Plan be funded instead.

While the above positive sounds great, when you tell a client that they can fund $3,500 into a 529 Plan and remove **$16,125** vs. less than **$13,000** with a life insurance policy if both had a gross return of 7.5%, the client is going to usually opt for a 529 Plan.

Other mitigating factors

A many clients who had money in 529 Plans in 2007-2009 really regretted the decision due to the fact that most 529 Plan account balances fell 40% or more over that 12-month period. This is a significant downside to funding 529 plans and one huge benefit to funding a non-variable cash value life insurance policy (principal protection).

Example 2

For example 2, assume that, instead of insuring the life of the parent, the 6-year old's life is insured instead.

The same amount could be taken out of the 529 plan from the child's age 19-23 as funded at $3,500 a year: **$16,125**.

How much could be removed from the life insurance policy tax-free from ages 19-23 on the policy insuring the 6-year old child's life? **$15,339**.

As expected, the numbers are more than what could be removed from a life insurance policy on the Dad, but the numbers still fall a little short of what could be removed after-tax from a 529 Plan.

It is also important to understand that the examples are all run to maximize cash value which also minimizes commissions. The target premium on Example 2 is less than $1,000 (mainly because an increasing death benefit was used).

It is also important to understand that the illustration in this example and the others in this module are run using the "maximum" withdrawal amount from the life insurance policy when illustrating how much can be borrowed. In this example, there is only $1,097 in cash left in the policy at the end of the fifth borrowing year. This is NOT a conservative example. If the policy does not perform as illustrated or better in the next year and subsequent years, there will be a call for premium; or the policy will lapse. Keep in mind that this policy must stay in force for the rest of the child's life in order for the loans to not be taxable. That's a long time and one of the pitfalls of using cash value life insurance as a funding vehicle on the life of the child.

If you want to use "conservative" illustrations, you should run them where there is a target amount of cash left in the policies at the end of the borrowing phase. It is recommended that you leave 23% of the premiums paid as a cash value at the end of the borrowing phase.

If you requested from the life insurance software that the policy have $14,000 in cash surrender value when the child turns 23 in this example, the child would be able to borrow out:

$12,532 at age 19
$12,908 at age 20
$13,296 at age 21
$13,694 at age 22
$14,105 at age 23

Total: $53,239 (using wash loans)

How much could be removed from the life insurance policy using max level income? $15,339 x 5 = $76,695.

How much could be removed from the 529 Plan (which also assumes a level income and that the stock market doesn't go in the tank shortly before or shortly after the child goes to college)? $16,125 x 5 = $80,625.

The point with the previous exercise as well as with all of these illustrations is to point out to advisors that funding life insurance for college planning sounds easy. Just fund a life policy for X amount of years and show max borrowing. If you have the right variables manipulated the right way, you can make life insurance look like a very attractive option for college funding; however, the truth of the matter is that choosing to use life insurance as a college-funding vehicle is a very complex matter with many variables that must be discussed with and disclosed to clients so they can make an informed decision about how to best fund for their child's college expenses.

FYI, if the illustration reflected a 2% variable loan spread the number would increase to **$16,781** a year as the maximum level income borrowing each year for five years (which would be slightly higher than what could be taken out of the 529 Plan).

Example 3 (one that gets closer to making life insurance work better)

Now assume that instead of funding $3,500 every year from the child's age 6-18, fund $9,100 each year for five years (the same total funding amount as the earlier examples and assuming it's on the Dad's life). Assume the same 7.5% rate of return.

Note: This illustration was run on the parent, not the 6-year old child. When short funding on the child, the amount borrowed did not reach the level of what could be removed via borrowing from the 30-year old parent's policy (it was close but not quite as much).

How much could be removed from a 529 plan from ages 19-23? **$20,163**.

How much could be removed tax-free from the cash value life policy? **$17,269**.

What if there is a 1% loan spread with the policy loans? **$19,175**.

What if there is a 2% loan spread with the policy loans? **$19,562** (getting closer).

Is there a minimum funding example using a reasonable rate of return where cash value life works better than a 529 plan? Yes, make the child younger or the parent younger.

Example 4

Now assume the child is just being born (zero for calculation purposes). How does that help the numbers? Quite a bit because the life insurance policy has more time to accumulate cash and overcome initial up-front loads.

Note: This illustration was run on the parent, not the 1-year old child. This time the amount that could be borrowed from the child's policy was significantly lower than from the parent's policy.

How much could be removed tax-free from a 529 Plan using the same assumptions from Example 3)? **$29,051** each year from the child's ages 19-23.

How much could be removed tax-free from the life policy?

$32,075 from the life policy if there is a 2% spread on the loan.

$31,438 from the life policy if there is a 1% spread on the loan.

$30,784 from the life policy with wash loans of 7.5%.

With the "right" fact pattern, minimum funding of a life insurance policy can work as a better wealth accumulation tool for college funding. However, as you can see, the fact pattern is very narrow though.

Additionally, what happens if over time the stock market and the S&P 500 only average say 3.5%?

How much could be removed from a 529 plan? **$13,030**.

How much could be removed from the life insurance policy? **ZERO**.

This is a little misleading since there is still a cash surrender value in the policy of approximately $49,000 and the guaranteed cash value amount equals approximately $32,000. The illustration software simply does not allow borrowing from the policy due to insufficient cash.

The account value in the 529 plan is $60,000.

If you are going to pitch using cash value life insurance to your clients as a college-funding vehicle, you better be giving them "full disclosure" which would include information about what happens when returns over time are low (not what were reasonably illustrated at inception).

"Overfunding" a cash value life insurance policy for college planning (it works!)

The definition for this education module of "overfunding" is NOT just funding a policy at the MEC minimum death benefit but instead is defined as paying a sizable premium into the policy over a short period of time (10 or less years).

What's sizable? In the college funding scenario, it's funding the policy with not only the amount of money a client can budget for college planning but also for supplemental retirement planning/income for the parent(s).

Where can a parent find this other/extra money to fund into the life policy to overfund it?

Two main places for non-affluent clients (affluent clients simply have the money and need to choose to allocate it to the policy whereas non-affluent clients have to "find' the money)

1) Reallocate money from a 401(k) plan

Many clients fund tax-deferred 401(k) plans for retirement savings. While this sounds like a good idea for most clients under the age of 50, funding cash value life insurance after-tax will be a better, more tax favorable, and conservative way to grow wealth (see the education model on qualified retirement plans for the numbers to back up this assertion).

Therefore, instead of funding $5,000-$15,000 into a tax-deferred qualified plan, the client can allocate that money to funding a cash value life insurance policy. This "additional" funding will make the life insurance policy work as a much better cash accumulating tool and should allow for plenty of money to be used for college funding and as a supplemental retirement plan.

2) Borrow money from a home

Many clients have as their only major asset the equity in their personal residence. Many times clients strip equity from their home at the time their children go to college because they neglected to properly plan. This can also be done when children are young and when using that money to "overfund" a cash value life insurance policy, it will significantly increase the financial viability of using the policy both as a college-funding vehicle and a tax-favorable retirement vehicle.

Example 5

For this example, assume that the client is 40-years old instead of 30. Assume he has two children ages 13 and 10. Assume the client has not funded for his children's education and has sufficient income from all sources to "overfund" $50,000 a year into an EIUL policy every year (6) until the first child goes to college. The client is funding the policy not only to fund for college education but also to fund for his own retirement.

How did cash value work to help build wealth for college and to provide a tax-free retirement income stream for the parent? It worked really well.

Using a conservative 7% rate of return, the parent can remove $20,000 a year tax-free from the life policy when his first child starts college at age 19 and can remove $20,000 a year for that first child's first three years of school.

Then the parent could remove $40,000 tax-free for two years while his second child starts school and while the first child finishes up years 4-5 and then $20,000 a year each year for three years while the second child finishes up years 3-5.

$20,000 Years 1-3
$40,000 Years 4-5
$20,000 Years 6-7

It certainly makes sense that the client can pull out $200,000 to be used for his children's education since he paid premiums of $250,000.

The question is: How much can the client borrow from the policy **in retirement** from ages 66-85?
$66,108 tax-free every year for 20 years with wash loans
$91,127 tax-free every year for 20 years with a 1% variable loan spread
$180,715 tax-free every year for 20 years with a 2% variable loan spread

This is the POWER of using cash value life insurance to fund for college planning AND retirement.

Summary on using life insurance for college funding.

Using cash value life insurance from a pure financial standpoint is very difficult to justify for most average clients looking to minimum fund the policy when their goal is to only fund for college planning (unless you weigh the additional advantages cash value life has over using 529 plans). Advantages such as:

-the life policy self completes a plan for a parent who dies.

-locking in investment gains every year.

-allowing the client to use the funds tax-free for any other purpose.

-allowing the client to keep the policy in-force until he/she retires and potentially borrows more money out of the policy tax-free.

-the fact that cash value life insurance is not a countable asset for financial aid calculations.

-also, Retirement Life™ also comes with a free long-term care rider to protect the client when in retirement.

However, when a client properly "overfunds" a cash value life insurance policy not only for college funding, but also for supplemental retirement planning, it is very powerful and has a high probability of financial success in addition to the other advantages listed above.

Caution and full disclosure are the keys to giving your client proper advice when it comes to using cash value life insurance to fund for college planning. This is a very powerful and useful topic and advisors who choose to use it to help their clients will significantly grow their business while helping clients and their children in the process.

Special attention needs to be made when running illustrations. Depending on the age of the client, age of his/her children, health of the client, and the amount and time frame for funding a policy, it will make more sense to fund a policy on either the child or the parent. Advisors must understand all the nuances to properly illustrating conservative "real-world" scenarios for clients so informed decisions can be made.

College Planning Summary

This course has covered a lot of ground because college funding is a very large topic with many aspects. The focus has been on explaining how the system works and then to point the way to how to preserve as much of the parents' wealth as possible.

There was shown to be two separate problems covering two different time periods.

First, the mechanics of the aid formulas were explained to understand how money is distributed. This is necessary background to understand the tactics to use when saving and when paying for college.

The first stage, saving for college, showed various ways to save in advance, by investments, increasing cash flow to generate additional savings, and saving taxes to generate even further savings.

The second stage, paying for college, focused on tactics which might be used for those families who did not save in advance. This included student academic improvement to get more aid money, freeing up cash flow, repositioning family finances to qualify for more aid as determined by the aid formulas, and the proper way to manage gifts, loans, and other sources of funds or discounts, as well as lowering the actual costs. The course also broke down the problem into two approaches, first using other people's money, including the student's, in order to preserve family wealth. This focused on financial aid, gifts, tax savings, and college loans. Secondly, it turned to how the parents might most efficiently use their own money to make up any shortfall, including cash flow strategies, parent loans, and investments and to do so in ways to avoid harming their lifestyle and retirement.

Additionally, this course material covered how to fund for college expenses with the "proper" use of cash value life insurance.

With the basic background information provided in this module along with some of the more advanced material on the use of cash value life insurance, you are now armed with information/knowledge that will put you in a very elite class of advisors who can properly advise clients to properly position themselves to pay for their loved one's education and help posture students if possible to receive financial assistance.