Financial Intelligence

Peak Asset
MANAGEMENT

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College Planning - Financial Considerations

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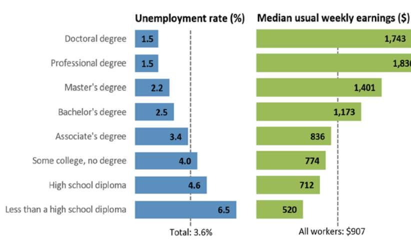
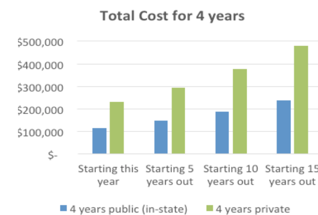
Financial planning for college is becoming much more critical as education costs continue to escalate and loans continue to get bigger and more expensive, prompting what many have called a "student loan crisis". College planning can cross multiple generations as grandparents and other relatives are concerned about the financial future of their loved ones. Even for those well past their college days, continuing education can still be important for future career opportunities or personal development.

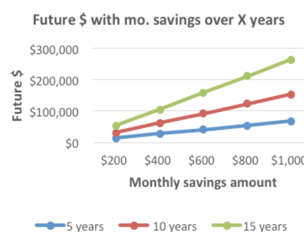
So what is the potential payback for a college education? As reinforced in the following chart, there's no denying the potential benefits of a college education: the ability to compete for and keep a job in today's job market, increased earnings, expanded horizons and higher career satisfaction.



So while the benefits can be obvious, such advantages are coming at a steeper price. According to the College Board, for the 2017/2018 school year, the average undergraduate cost of one year at a four-year public college for in-state students is $25,290, while the average cost for one year at a four-year private college is $50,900. Costs include tuition and fees, on-campus room and board, books, supplies, and transportation, with detailed information available via the College Board (see: https://trends.collegeboard.org). Advanced degrees can come at a substantially higher cost. Though no one can predict exactly what college might cost in 5, 10, or 15 years, annual price increases in the range of 3% to 6% would certainly be in keeping with historical trends. The graph below can give you an idea of what future costs might be for four years of undergraduate college, based on the 2017/2018 costs above and using an average annual inflation rate of 5%.



Many families finance a college education with help from student loans and other types of financial aid such as grants and work-study, private loans, current income, gifts from grandparents, and other creative cost-cutting measures. Although government loans are available, interest rates have been going up, making savings an increasingly important part of any successful college-financing plan. Saving 100% of the total cost isn't realistic for many families, so saving a portion of the projected costs, much like saving for a down payment on a house, will be key. The bottom line is to beware of too much borrowing. Excessive student loan debt — and parent debt — can negatively affect borrowers for years. The more you save now, the less you and your child will need to fund later. The following graph shows how a monthly savings amount can build over 5, 10, or 15 years, if for example, you are able to get a 5% annual return on your investment.



Note: Graph assumes an average annual after-tax return of 5%. This is used for illustrative purposes only, and does not reflect the actual performance of any savings/investment option discussed in this newsletter.

"Saving 100% of the total cost isn't realistic for many families"

Saving for Retirement and a Child's Education at the Same Time

Saving for both goals can be a challenge, but the sooner you take steps to fund estimated costs, the more likely both goals can be met. If funds are tight, retirement should take priority. Remember, your child can always attend college by taking out loans, but there's no such thing as a retirement loan! You also probably don't want to support your children through college only to risk becoming a burden to them in your later years. You might have to consider creative ways to reduce education costs. For example, your child could attend a local college (which may include a lower cost community college to at least complete general electives) and live at home to save on room and board, enroll in an accelerated program to graduate in three years instead for four, take advantage of a cooperative education where paid internships alternate with course work, or defer college for a year or two and work to earn money for college.

Tapping Retirement Accounts for College Expenses

We generally do not recommend using retirement accounts to pay for college, but there may be some exceptions. With IRA's one can withdraw money penalty free for qualified college expenses, even if you're under age 59½. While all distributions from traditional deductible IRA's are taxable, contributions to a Roth IRA can be withdrawn tax-free. With an employer-sponsored retirement plan like a 401(k) or 403(b), you'll generally pay a 10% penalty on any withdrawals made before you reach age 59½ (age 55 or 50 in some cases), even if the money is used for college expenses. Distributions are also taxed as ordinary income. Loans from the employer plan can be another source of funds, but restrictions and payback rules limit the usefulness of this option. If you are considering employer plans as a resource, you should check with your plan administrator to see what withdrawal options are available to you and what restrictions apply.

College Savings Options

The insert to this newsletter provides information on the most common savings options used for college. Investment choices within these options will need to be made based on timeframes, possible returns, and associated risks. In summary, the most popular options include the following:

529 Plans

Think of college savings, and most investors think automatically of a 529 plan. They can have excellent tax advantages as contributions and earnings accumulate tax deferred and withdrawals are tax free if the money is used for qualified education expenses. Over 30 states offer their own additional tax advantages, and Colorado is one of the most generous in allowing deductions on contributions up to a taxpayer's taxable income. Participation in a 529 plan isn't restricted by income level and lifetime contribution limits are high, typically $300,000 and up (limits vary by state). You can also change the beneficiary to other family members if the listed beneficiary does not have enough qualifying expenses and/or receives a scholarship. For some states, you can now withdraw up to $10,000/year for K-12 expenses and still keep the state tax deduction; however, many states including Colorado have not yet approved this change. Possible disadvantages for 529 plans include the fact that when withdrawals are not used for qualified education expenses, earnings are subject to income tax and a 10% federal penalty, and any state tax deduction taken would likely need to be recaptured. If a student gets a scholarship, then the 10% penalty on un-qualified withdrawals would be adjusted down; however the earnings are still subject to taxes. Other possible disadvantages include limitation on investment choices with only two changes allowed per year, and possible high costs/commissions, especially if sold through brokers. (Note: Colorado's CollegeInvest Direct plan is a highly rated, low cost plan that we would generally recommend for those able to make their own investment selections).

Coverdell ESA

A Coverdell education savings account (ESA) is a tax-advantaged education savings vehicle that lets you contribute up to $2,000 per year for a beneficiary's K-12 or college expenses. Your contributions grow tax deferred and earnings are tax free at the federal level if the money is used for qualified education expenses. You have complete control over the investments you hold in the account, but there are income restrictions on who can participate, and there is a low $2,000 annual contribution limit.

Custodial Account (UTMA/UGMA)

A custodial account allows a minor to hold investment assets in his or her own name with an adult as custodian. All contributions to the account are irrevocable gifts to your child, and assets in the account can be used to pay for college. When your child turns 18 or 21 (depending on state law, with Colorado being 21), he or she will gain control of the account. Earnings and capital gains generated by the account are taxed to your child each year under the "kiddie tax" rules, and may require parents to prepare tax filings.

Savings Bonds

Series EE and I bonds are types of savings bonds issued and backed by the federal government that may offer a tax benefit for parents that have modest adjusted gross incomes. They are only available to be purchased on-line and purchases are limited to $10,000 per person, per year. If savers are content with modest returns and want very little risk to their savings, this may be an option.

Taxable Brokerage/Savings Account

Due to the limitations and complexity of other savings options, saving and investing in a taxable account might be the preferred choice of many investors for at least some college costs. Money held here gives a family maximum flexibility and control on how such funds will be invested and used. If the student receives a scholarship and/or relatives chip in, money in this account could be used instead for future car purchases and/or to help cover future retirement expenses. For those in higher tax brackets, investment choices can be made that generate minimal or no taxes. Tax strategies also might exist to eliminate or reduce taxes if investments with built in gains are sold or transferred and then sold.

In many cases, paying for some college costs through such accounts qualifies a family for one of the tax credit/deduction options explained later in this newsletter. After taking advantage

Savings Options Comparison: Table 1 (all information is subject to change and is not intended to provide specific advice for any individual)

YEAR 2018 RULES	FEDERAL/STATE TAX	FEDERAL GIFT TAX TREATMENT	FEDERAL ESTATE TAX TREATMENT	MAXIMUM INVESTMENT	QUALIFIED EXPENSES
529 Plan	Non-deductible contributions; withdrawn earnings excluded from income to extent of qualified higher education expenses. Over 30 states provide deduction incentives	Contributions treated as completed gifts; apply $15,000 annual exclusion, or up to $75,000 with 5-year election	Value removed from donor's gross estate; partial inclusion for death during a 5-year election period	Established by the program; many in excess of $300,000 per beneficiary	Tuition, fees, books, computers and related equipment, supplies, special needs; room and board for minimum half-time students. K-12 up to $10,000 in some states
Coverdell Education Savings Accounts	Non-deductible contributions; withdrawn earnings excluded from income to extent of qualified higher education expenses and qualified K-12 expenses also excluded	Contributions treated as completed gifts; apply $15,000 annual exclusion	Value removed from donor's gross estate	$2,000 per beneficiary per year combined from all sources	Tuition, fees, books, supplies, equipment, special needs; room & board for min. half-time students; add'l categories of K-12 expenses
Qualifying U.S. Savings Bonds	Tax-deferred for federal; tax-free for state; certain post-1989 EE and I bonds may be redeemed federal tax-free for qualified higher education expenses	No gift as qualifying bonds must be owned by the parent	Value included in bond owner's gross estate	$10,000 face value per year, per owner, per type of bond	Tuition and fees
Roth IRA	Non-deductible contributions; withdrawn earnings excluded from income after age 59 1/2 – and five years; 10% penalty on early withdrawals waived if used for qualified higher education expenses	No gift involved	Value included in the owner's gross estate	$5,500($6,500 for taxpayers age 50 and over)	Same as 529 plan
Traditional IRA	Deductible or non-deductible contributions; withdrawals in excess of basis subject to tax; 10% penalty on early withdrawals waived if used for qualified higher education expenses	No gift involved	Value included in the owner's gross estate	$5,500($6,500 for taxpayers age 50 and over)	Same as 529 plan
UGMA/ UTMA	Subject to new "Kiddie" tax rules. Earnings and gains taxed to minor; first $1050 of unearned income is tax exempt; unearned income over $2,100 for certain children under age 24 is taxed at tax rates for trusts	Transfers treated as completed gift; apply $15,000 annual gift exclusion	Value removed from donor's gross estate unless donor remains as custodian	No limit	No restrictions
Taxable Account	Earnings and gains taxed in year realized; special lower tax rates for certain dividends and capital gains; option for tax free bonds	No gift involved; direct payments of tuition not considered gifts	Value included in the owner's gross estate	No limit	No restrictions

Savings Options Comparison: Table 2 (all information is subject to change and is not intended to provide specific advice for any individual)

YEAR 2018 RULES	ABLE TO CHANGE BENEFICIARY	TIME/AGE RESTRICTIONS	INCOME RESTRICTIONS	FEDERAL FINANCIAL AID	INVESTMENTS	USE FOR NON-QUALIFYING EXPENSES
529 Plan	Yes, to another member of the beneficiary's family	None unless imposed by the program	None	Counted as asset of parent if owner is parent or dependent student	Menu of investment strategies as developed by the program; 2 changes/year	Withdrawn earnings subject to federal tax and 10% penalty
Coverdell Education Savings Accounts	Yes, to another member of the beneficiary's family	Contributions before beneficiary reaches age 18; use of account by age 30	Contributions phase out for incomes between $190,000 and $220,000 (joint filers) or $95,000 and $110,000 (single)	Counted as asset of parent if owner is parent or dependent student	Broad range of securities and certain other investments	Withdrawn earnings subject to federal tax and 10% penalty
Qualifying U.S. Savings Bonds	Not applicable	Bond purchaser must be at least 24 years old at time of bond issuance	Interest exclusion phases out for incomes between $119,550 and $149,550 (joint filers) or $79,700 and $94,700 (single)	Counted as asset of bond owner	Interest earning bond backed by full faith and credit of U.S. government	No penalty; interest on redeemed bonds in federal income
Roth IRA	Not applicable	Withdraw earnings tax-free only after five years and age 59 1/2	Must have taxable compensation; contribution limit phases out for incomes between $189,000 and $199,000 (joint filers) or $120,000 and $135,000 (single)	Not counted as asset; withdrawals of principal and interest counted as financial aid income	Broad range of securities and certain other investments	Taxable portion of withdrawal prior to age 59 1/2 also subject to 10% early withdrawal penalty
Traditional IRA	Not applicable	Withdraw without penalty only after age 59 1/2	Must have taxable compensation; amount deductible reduced or eliminated for taxpayers who participate in an employer retirement plan and have income above certain limits	Not counted as asset; withdrawals of principal and interest counted as financial aid income	Broad range of securities and certain other investments	Taxable portion of withdrawal prior to age 59 1/2 also subject to 10% early withdrawal penalty
UGMA/ UTMA	No; represents an irrevocable gift to the child	Custodianship terminates when minor reaches age established under state law (generally 18 or 21). CO is 21.	None	Counted as student's asset; interest/dividends as income	As permitted under state laws	Funds must be used for benefit of the minor
Taxable Account	Not applicable	None	None	Counted as asset of the owner	Broadest range of investments, including tax free	No restrictions

Per the FAFSA rules, a family is expected to contribute toward annual college costs based on percentages of assets and income. The percentages are:

50% of student's income, after certain allowances (e.g. $6,570 in 2018). Income includes grandparent contributions.
20% of student's assets
22%-47% of parent's income, based on sliding income scale and after certain allowances
2.6%-5.6% of parent's assets, based on sliding income scale and after certain allowances

Excluded assets: Retirement accounts, life insurance, equity in home, family owned business

of any such program, you could then cover remaining expenses that year by withdrawing from a 529 account. In Colorado and potentially other states that offer deductions upon contributions, you could open and fund a non-commissioned 529 plan (e.g., the Direct plan in CO) during the year of college (or when paying for continuing education at a college), contribute into a low risk money market option, and then during the same year withdraw cash for the qualified education expenses. For Colorado taxpayers, this could equate to an immediate 4.63% return on your money for any contributions into a 529 plan.

Financial Aid Considerations

Many families rely on some form of financial aid and/or government loans to help pay for college. Financial aid can be based on financial need or on merit, and you should almost always go through the application process via a FAFSA (Free Application for Federal Student Aid) form. To determine financial need for a college year, the federal government and colleges look primarily at your family's income two years prior to the year of college, but other factors come into play, including your assets and how many children you'll have in college at the same time. Financial Aid Calculators (both generic and for specific colleges) can show how much a family is expected to pay for a year of college. If after running through some calculators, it looks like you could qualify for sizable amounts of financial aid based on need, then one should consider the impact that savings options have on financial aid. The insert on savings options summarizes the possible impact on financial need.

Considerations for Grandparents and Relatives

As the cost of a college education continues to climb, many grandparents and other relatives are stepping in to help. When assisting in college costs, one should always involve parents in the decision-making process, where goals, strategy, and implementation are understood and agreed to. Some ways to accomplish this goal include the following:

Outright Cash Gifts

A common way to help with college costs is to make an outright gift of cash or securities to the student; however, one should consult with tax/estate planning professionals if considering more than the annual federal gift tax exclusion amount, which in 2018 is $15,000 for individual gifts and $30,000 for gifts made by a married couple. Also, if there is a chance for financial aid based on need, a cash gift to the student carries an assessed rate of 50% on the FAFSA application, which can impact financial aid eligibility. If financial aid is a possibility, then one workaround is for the grandparent to give the cash gift to the parent instead of the grandchild, because gifts to parents do not need to be reported as income on the FAFSA. Another solution is to wait until your grandchild who is planning to graduate in 4 years is past January 1 of his or her sophomore year when FAFSA forms no longer have to be filled out for the remaining two years of college. Yet another possibility is to wait until the student graduates from college and then give a cash gift that can be used to pay off school loans.

Pay Tuition Directly to the College

Tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment, so any such payment can be in addition to the annual exclusion maximums mentioned before. But payments can only be made for tuition — room and board, books, fees, equipment, and other similar expenses don't qualify. As another possible negative, colleges may reduce a student's institutional financial aid for the following year by the amount of the grandparent's payment. So before sending a check, find out if such payment will affect your grandchild's eligibility for any scholarships and/or grants.

529 Plans

As explained earlier, 529 plans provide a number of benefits, and extended family can also contribute to such plans to pay for college costs. In Colorado you can contribute to a Colorado based 529 plan owned by yourself or by the parent and still claim a CO state tax deduction.

Regarding financial aid, grandparent-owned 529 accounts do not need to be listed as an asset on the FAFSA form. However, like gifts, withdrawals from a grandparent-owned 529 plan are reported as untaxed income to the beneficiary (grandchild), and this income is assessed at 50% by the FAFSA. By contrast, parent-owned 529 accounts are reported as a parent asset on the FAFSA (and assessed at 5.6%) and withdrawals from parent-owned plans aren't counted as student income. If a student is likely to qualify for financial aid, then one option is for the grandparent to delay taking a withdrawal from the 529 plan until within two years of graduating. Another option is for the grandparent to change the owner of the 529 account to the parent.

Keep in mind that some colleges may treat 529 plans differently than the norm for purposes of distributing their own financial aid. In some cases parent-owned and grandparent-owned 529 accounts are treated equally because colleges simply require a student to list all 529 plans for which he or she is the named beneficiary.

Education Tax Credits and Deductions

For parents and students trying to manage college bills and student loan payments, the federal government offers education-related tax benefits. The requirements for each are different and you cannot use multiple offerings for the same expense, nor can the expense reported be withdrawn from a 529 as a qualified education expense. Here is some general information on available programs, which is subject to change from year to year. For more information regarding which program(s) might apply for you, consult with your tax professional and/or see IRS Publication 970 for more detail.

American Opportunity Credit (the best of all programs if qualified)

The American Opportunity credit is a tax credit available for the first four years of a student's undergraduate education, provided the student is attending school at least half-time in a program leading to a degree or certificate. The credit is worth up to $2,500 in 2018. The credit must be taken for the tax year that the expenses are paid, and parents must claim their child as a

dependent on their tax return to take the credit. Credits can apply to multiple students.

In 2018, a full credit is available to single filers with a modified adjusted gross income (MAGI) below $80,000 and joint filers with a MAGI below $160,000. A partial credit is available to single filers with a MAGI between $80,000 and $90,000 and joint filers with a MAGI between $160,000 and $180,000.

The mechanics of claiming the credit are relatively easy. If you paid tuition and related expenses to an eligible educational institution during the year, the college generally must send you a Form 1098-T by February 1 of the following year. You then file Form 8863 with your federal tax return to claim the credit.

Lifetime Learning Credit

The Lifetime Learning credit is another education tax credit, but it has a broader reach than the American Opportunity credit. As the name implies, the Lifetime Learning credit is available for college or graduate courses taken throughout your lifetime (the student can be you, your spouse, or your dependents), even if those courses are taken on a less than half-time basis and don't lead to a formal degree. For example, this might apply for those taking courses to acquire or improve job skills, especially since work related education can no longer be deducted as a miscellaneous expense on a Schedule A. (note: If self-employed, one can still deduct qualifying education costs on a Schedule C).

The Lifetime Learning credit is worth up to $2,000 in 2018 (it's calculated as 20% of the first $10,000 of qualified expenses). The Lifetime Learning credit must be taken for the same year that expenses are paid, and you must file Form 8863 with your federal tax return to claim the credit. In 2018, a full credit is available to single filers with a MAGI below $57,000 and joint filers with a MAGI below $114,000. A partial credit is available to single filers with a MAGI between $57,000 and $67,000 and joint filers with a MAGI between $114,000 and $134,000. The Lifetime Learning credit is limited to $2,000 per tax return per year, even if more than one person in your household qualifies independently in a given year.

Tuition and Fees Deduction (not available unless extended)

This program may be extended, and if so, could provide a maximum $4,000 deduction per return on qualified expenses. The AGI level was higher than the levels in the Lifetime Learning Credit (i.e. phased out at $80,000 single and $160,000 joint).

Student Loan Interest Deduction

The student loan interest deduction allows borrowers with incomes below a certain level to deduct up to $2,500 worth of interest paid on qualified student loans. Generally, federal student loans, private bank loans, college loans, and state loans are eligible. However, the debt must have been incurred while the student was attending school on at least a half-time basis in a program leading to a degree, certificate, or other recognized educational credential.

For 2018, to take the full $2,500 deduction single filers must have a MAGI of $65,000 or less and joint filers $135,000 or less. A partial deduction is available for single filers with a MAGI between $65,000 and $80,000 and joint filers with a MAGI between $135,000 and $165,000. Also, an individual must have the primary obligation to pay the loan and must pay the interest during the tax year. The deduction may not be claimed by someone who can be claimed as a dependent on another taxpayer's return. Borrowers can take the student loan interest deduction in the same year as the American Opportunity credit or Lifetime Learning credit, provided they qualify for each independently.

In Summary

Although the benefits of college education can rarely be discounted, the true challenge for today and in the future is how to pay for the high costs of such education. College planning is becoming more important and more complex than ever before, and we look forward to working with you and perhaps your extended family to help you reach your college funding and retirement goals. We also encourage you to tap all resources available, which can include your tax professional, high school college counselors, financial aid and college savings websites, college websites and enrollment personnel, 529 plan representatives, estate planning attorneys, and family and relatives that have paved the way and/or are willing to help you through the journey. For those involved with the college planning process, the decisions you make today can have a significant impact on the financial wellbeing of yourself and your loved ones!

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