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The final installment in our summer financial planning series is College Planning. This topic is directed primarily to young families trying to determine the best ways to prepare for the future college expenses for their children. As with the previous discussions, please be advised that this discussion is designed to get you thinking about your circumstances and what you must do to plan for the future. It is not intended to answer every question you may have, because the list of possible scenarios would be endless.

College Planning

College Planning is a major concern for most families who either currently have young children or will begin to have children in the next few years. With the cost of college (even state supported schools) rising at alarming rates, it is essential that every young family factor the cost of college expenses into their financial planning. As with any other element comprising your financial plan, i.e. insurance, retirement, purchasing a home, day to day living expenses, etc. savings set aside for college must be placed somewhere on your list of priorities. The order it occupies will depend largely on how much time you have to save for college, how many children you will need to support through college, your current and future income levels, whether you will depend on some type financial aid in addition to the savings you have accumulated, whether you adequately funded your own retirement and adequately insured yourself, and many other factors too numerous to expand on in this limited discussion. The determination of how much you set aside on a regular basis should be arrived at after careful consideration of all the factors in your financial plan. What we will focus on in our discussion will be some of the savings vehicles, state and federal supported programs, and income tax deductions and credits available to you in order to help you prepare for this major expense in the life of your family.

College Savings Plans

While there are many avenues available to save for whatever future expense you might incur, we will focus on the key savings plans that are designed primarily to help you prepare for secondary education for your children. Of the plans that are out there, the plans specifically designed to benefit you in saving for college are:

1. 529 Plans
2. Coverdell Education Savings Accounts
3. Educational Exception to Additional Tax on Early IRA Distributions
4. Educational Savings Bonds

Qualified Tuition Program (better known as 529 plans (for the Internal Revenue Code Section that established them)) comes in two varieties:

a. Prepaid Tuition Plan
b. Savings Plan

Prepaid tuition plans allow you to purchase future tuition credits using today's dollars. A prepaid plan often does not, however, cover the costs for room and board. They are good plans if your child plans to go to school in the state in which the plan is offered (in most cases your home state, because of residency requirements), however, should your child choose to go to a school that is out of state or outside the network of the prepaid plan, then you may have to forfeit some of the credits that you have acquired.

A much better plan is the 529 savings plan. This plan does not lock you into a school and offers more attractive savings options. You can choose any state plan you desire, regardless of where you live and there is virtually no limit on the amount of savings you can contribute to the plan. Distributions are tax free and anyone can set up a 529 plan for the beneficiary of their choice. Beneficiaries can be changed and there is no time limit on when the funds available have to be used. The keys to selecting the best 529 plan are to evaluate the plan sponsors and pay close attention to the plan expenses. Contributions to the plan are not tax deductible however; the earnings grow tax free if you use the distributions to pay qualified tuition expenses. Most plans require very minimal monthly contributions, if a monthly plan is established. You can contribute to a 529 plan in addition to any other education savings plan that is available, such as a Coverdell Education Savings Account.

Coverdell Education Savings Accounts

Coverdell Education Savings Accounts permit you to contribute up to $2000 per year per beneficiary for both college and K-12 qualified education expenses. Contributions must be reduced if the income of the contributor exceeds $95,000 for single or married filing separately and $190,000 for married filing joint returns. If your modified adjusted gross income exceeds $110,000 for a single or married filing separately or $220,000 for married filing jointly you cannot contribute to a Coverdell Education Savings Account. Assets grow and are distributed tax free if used for qualified educational expenses, however, assets must be distributed to the beneficiary by age 30 unless the beneficiary is a special needs person. Beneficiaries can be changed and anyone can contribute to the savings account if they qualify. All contributions must end once the beneficiary reaches age 18.

Educational Exception to the Additional Tax on Early IRA Distributions

The additional 10% penalty is waived if the early IRA distributions (under age 59½) are used to pay qualified education expenses for you, your spouse, or your children or grandchildren. While this is an option that is available to help pay for your child's college expense, CWR does not recommend this option. The primary reason is that while other options are available to help provide your child's education, these options are not available to help fund your own retirement. Withdrawing funds that have been growing tax deferred for years would be difficult if not impossible to replace for your own retirement.

Educational Savings Bonds

Generally, you must pay tax on the interest earned on U.S. Savings Bonds; however, you may be able to exclude interest from income on certain qualified savings bonds if you meet the following conditions:

a. You pay qualified education expenses for yourself, your spouse, or a dependent (for whom you can claim an exemption on your tax return)
b. You modified adjusted gross income is less than $78,100 single ($124,700 joint return)
c. Your filing status is not married filing separately.

A qualified U.S. Savings Bond is a series EE bond issued after 1989 or a series I bond. The bond must be issued in either your name or in the name of both you and your spouse. The owner must be at least 24 years old before the bond's issue date.

State and Federal Supported Programs

In addition to savings for college, several scholarships and financial aid programs supported by state and federal offices are available to assist in covering the expenses of a college education. Grants and scholarships are the best because the money is usually tax free and never has to be paid back. In addition, student loans are available to help bridge the gap between savings, scholarships and grants available. The most notable of the state and federal supported programs include:

a. Hope Scholarship
b. Pell Grant
c. Supplemental Educational Opportunity Grant
d. Perkins Student Loan
e. Stafford Loans

Hope Scholarship

Georgia and several other states have earmarked monies from the state lottery program to fund students desiring to go to college. Each participating state has its own minimum application requirements and minimum requirements to continue to receive funding while the student is in school, including minimum maintained grade point averages. Please consult your local state to determine if it offers a program like this.

Pell Grant

The Pell Grant is a federally sponsored program designed primarily for low-income families, which offer a maximum of $4,050 per student for the 2006-2007 academic year, based on need.

Supplemental Educational Opportunity Grant

The federally sponsored Supplemental Educational Opportunity Grant offers need based awards up to $4000 per student per year.

Perkins Student Loan

The Perkins loan is made directly to the students; parents need not co-sign this loan. Students don't need to begin repaying the loan until nine months after they graduate, leave college, or fall below half-time status. They have 10 years to repay the loan. Perkins carries a low interest rate and interest doesn't begin to accrue until repayment begins. A school's financial aid office determines how much a student gets, but the cap on borrowing for undergrads is $4000 per year and grad students can borrow up to $6000 per year.

Stafford Loans

Stafford Loans come in two packages:

a. Subsidized Stafford Loan (Need Based)
b. Unsubsidized Stafford Loan (Non Need Based)

Interest rates for Stafford loans are variable, but the cap is 8.25%.

With a subsidized Stafford Loan, interest does not accrue until six months after a student graduates, leaves school, or falls below half-time status. Students can borrow up to maximums that rise the longer the student remains in school, between $2,625 freshman year and $5,500 senior year.

Unsubsidized Stafford Loan is a non-need based loan for which most students who apply for aid are eligible. Interest accrues immediately, but payment may be postponed until after graduation. Borrowing amounts are the same as the subsidized Stafford Loan, which rises the longer the student remains in school.

Available Income Tax Deductions and Credits

Student Loan Interest Deduction

The student loan interest deduction is an above the line tax deduction available to filers with the exception of married filing separately. Up to $2,500 per year in interest paid on a student loan can be deducted per year if the taxpayer meets the income limitations offered under the program. For single, head of household filers the maximum income is $50,000 to qualify for the maximum student loan interest deduction, which is gradually reduced for incomes from $50,000-$65,000. For married filing jointly the maximum income is $100,000 to qualify for the maximum student loan interest deduction, which is gradually reduced for incomes from $105,000-$135,000.

Tuition and Fees Deduction

The tuition and fees deduction is an above the line tax deduction available to filers for qualified tuition and fees paid to a secondary educational institution for both undergraduate and graduate students. Up to a maximum of $4000 per year can be deducted based on the tuition and fees you paid. To qualify for the full deduction, your modified adjusted gross income cannot exceed $65,000 ($130,000 for married filing jointly). If your modified adjusted gross income is from $65,000-$80,000 ($130,000-$160,000 for married filing jointly) you can qualify for up to $2000 in tax deductions based on the tuition and fees you paid.

Hope Credit (not to be confused with the Hope Scholarship)

The Hope Credit is a tax credit available to taxpayers for expenses incurred for qualified educational expenses at the undergraduate and graduate level of college. A tax credit differs from a tax deduction in that a tax credit is a dollar for dollar reduction in your tax liability whereas; a tax deduction reduces your taxable income by the amount of the deduction. The Hope Credit is only available for two years per student. The maximum credit per year is $1,650. This amount is available for those taxpayers whose modified adjusted income does not exceed $45,000 ($90,000 for married filing jointly). The amount of credit available is gradually reduced between the modified adjusted gross income amounts from $45,000-$55,000 ($90,000-$110,000 for married filing jointly). It is not available if modified adjusted income exceeds these amounts. The Hope Credit cannot be used in the same year that the Lifetime Learning Credit is used for a student.

Lifetime Learning Credit

The Lifetime Learning Credit is a tax credit available to taxpayers for expenses incurred for qualified educational expenses at both the undergraduate and graduate level of college. In addition, it can be used for expenses incurred for courses to acquire or improve job skills. Up to $2,000 per year of tax credit can be claimed for qualified educational expenses incurred. Where the Hope Credit allows up to $1,650 per year per student for a maximum of two years per student, the Lifetime Learning Credit only allows up to $2,000 per year per <u>family</u>, however, there is no limit on the number of years each student can take the Lifetime Learning Credit. The modified adjusted gross income levels are the same for the Lifetime Learning Credit as the Hope Credit.

While this month's newsletter highlights some of the more important resources available in preparing for college expenses, the list of options available are certainly not exhausted in this discussion. My hope is that it will stimulate you to begin to evaluate your needs and options in preparing for your child's college expenses.

Till next time,

Charlie