FINANCIAL LITERACY

Tips for College Planning

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If you want your children to benefit from a college education, it's never too early to start saving. A college education is expensive and might be one of the largest outlays you ever make. The good news is that families who want to save for their children's college education now have more options available than ever before.

An investment in a child's college education has the potential to result in a lifetime of increased earnings. According to the College Board's report "Education Pays 2016," full-time workers ages 25 and older with a bachelor's degree earned a median income in 2015 of $61,400, almost 69 percent more than the $36,800 earned by a full-time worker with only a high school diploma. Those with master's degrees earned a median income of $75,200, and those with a professional degree earned a median income of $110,900.

Don't Let College Expenses Derail Your Retirement

Many parents find themselves having to choose between funding their children's college education and saving for their own comfortable retirement.

It's not wise to derail your own retirement to fund a college education. There are no federally-guaranteed loans for retirement. Your children, on the other hand, have access to scholarships, grants and federally guaranteed loans to help pay for their college education. Your children might graduate from college with more debt than you or more than they would like, but that may be one of the trade-offs that has to be made as you balance college and retirement savings.

More parents are starting to realize this.

According to Fidelity Investments' "2018 College Savings Indicator" report, just 7 in 10 parents are saving money for college, down from 72 percent in 2016. Only 29 percent of parents now say they plan to fully pay for their kids to go to college, down from 43 percent in 2016. On average, parents now expect to pay just 62 percent of their kids' total college costs, down from 70 percent two years ago.

As you balance saving for your kids' college education with saving for your own retirement savings, put the two financial needs in perspective. A four-year college education can cost anywhere from $75,000 to $200,000. To maintain your current standard of living in retirement, you might need at least five times those amounts.

Take full advantage of any tax-favored retirement plans available to you, such as 401(k) plans, IRAs and taxsheltered annuities, before funding college savings accounts. In addition to their tax advantages, these plans often offer matching employer contributions. As an added advantage, assets you own in retirement plans, together with life insurance and annuities, will not affect your child's ability to qualify for federal student aid.

Any money you withdraw from tax-favored retirement plans to fund a child's college education may have income tax implications and won't be there when you need it for retirement. You might be able to borrow from a 401(k) plan for college purposes, however, that loan will have to be repaid.

It's a natural inclination to put your children's needs first. But do you want to pay for their college education only to risk becoming dependent on them in your retirement years?

College Savings Plan Options

Let's look at some strategies that can help you save for college expenses.

1. Qualified Tuition Programs (Section 529 Plans)

Section 529 plans allow you to either prepay your child's college tuition or contribute to an account established to pay the qualified higher-education expenses. Although contributions to the account are not tax-deductible for federal income tax purposes, investment growth is tax-deferred. Also, distributions used to pay for qualified higher-education expenses are exempt from federal income tax.

Another nice feature of Section 529 plans is that they are set up by adults who name a child as the beneficiary. If the child completes college and there are funds remaining in the Section 529 plan, a new beneficiary, such as a younger brother or sister, can

be named. Remaining amounts can be distributed to the account owner or another family member. Funds withdrawn for non-educational use (a non-qualified distribution), however, are subject to ordinary income tax on the earnings portion, which is also subject to a 10 percent penalty tax. State income tax might also be assessed.

Section 29 plans are authorized by federal law, but they are operated by the states. The rules, requirements, fees and expenses of these plans vary from state to state, as do state and local taxation of contributions and distributions. For example, some states allow Section 529 plan contributions to be deducted for state income tax purposes.

2. Education Savings Accounts

Taxpayers within specified adjusted gross income levels may contribute up to $2,000 per year per beneficiary to an Education Savings Account. Contributions are not tax-deductible, but the earnings grow tax-deferred and are distributed tax-free, provided they are used to pay the beneficiary's qualified education expenses.

3. U.S. Savings Bonds

Subject to certain limits, interest on series EE and I savings bonds may be excluded from income if you use them to pay qualified education expenses in the year you redeem the bonds.

4. Savings/Investment Accounts

Depending on your risk tolerance, your income tax bracket and the time frame in which you will need the funds, you can place education savings in a savings account, a certificate of deposit, U.S. Treasury securities or a money market account. Or you can invest the funds in some combination of stocks and bonds, either directly or through mutual funds.

5. Grandparents

Many grandparents want to help finance their grandchildren's college education. Grandparents can fund Section 529 plans, either as the account owner or, if the plan allows, by making contributions directly to a Section 529 plan already established by the parents. Grandparents can also fund Education Savings Accounts, purchase U.S. savings bonds for qualified higher-education expenses, or simply set

up a college savings account for the future benefit of their grandchildren. Another option might be for grandparents to consider making annual gifts to college-age grandchildren.

Understand the Tax Implications of Your Options

Before you decide how to fund your children's college education, make sure you understand the tax implications of each option. You don't want any surprises. We recommend meeting with a competent, trusted financial advisor before making any decisions.

If you maintain separate education accounts for each of your children, you must decide if those accounts will be held in the name of the child, a parent or another adult. In making this decision, consider the impact on your family's income taxes and who you want to have control of the assets.

The good news is that you could reap tax savings if the account is held in the child's name and income earned by the account is taxed to the child, who will probably be in a lower tax bracket than the parents.

There is a catch, however. If the child is under age 19 (under age 24 if a dependent full-time student), the socalled "kiddie tax" applies. In 2019, unearned income is taxed at 0 percent up to $2,600, 24 percent from $2,600 to $9,300, 35 percent from $9,300 to $12,750, and 37 percent on unearned income above $12,750. Any additional unearned income over $12,750 is taxed at the parents' top rate. Once the child reaches age 19 (age 24 if a dependent full-time student), all unearned income is taxed at the child's rate, which currently could be as low as 10 percent.

How to Maintain Control of the Funds for Your Child

If you are nervous about your child having control of the funds, there are alternatives that can produce tax savings while maintaining some control.

1. Minor's Trust

You can establish either a Section 2503(b) or Section 2503(c) trust to maintain control of principal and income while your child is a minor. Both types of trusts qualify for the annual gift tax exclusion per donor ($15,000 in 2019). Trust income is taxable to the trust or, if distributed, to the minor.

A minor's trust can, however, be expensive and time-consuming to establish. Unless you anticipate substantial gifts over a number of years, the next alternative might be more attractive.

2. Custodial Account

Depending on the state you live in, you can establish a custodial account under either the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA). With a UGMA or UTMA account, the income is taxed to the child as described above in the section titled “Understand the Tax Implications of Your Options” Only the custodian has control of the funds until the child reaches age 18 or 21 (depending on the state).

The custodian can be a parent or any other adult. Gifts made to a custodial account qualify for the annual gift tax exclusion per donor ($15,000 in 2019).

It’s also important to consider the potential impact that a college savings plan might have on your child’s ability to qualify for student loans and grants. The way the financial aid formula works, children are expected to contribute a much higher percentage of their assets toward paying college costs than their parents are. So if receiving student financial aid is an objective, you might want to avoid saving money in your child’s name.

First Things First – Apply for Scholarships

Rather than planning to save for this whole expense, you can choose to prepare for only a portion of the projected costs. There are a number of programs, such as scholarships and grants, that can help offset these expenses.

The difference between a scholarship and a grant is generally not that big. All scholarships are grants, but not all grants are scholarships. The key feature to both is that they do not have to be paid back, which makes them very attractive and generates high competition to receive them. Scholarships are solely focused on education, whereas grants can also be, but are not restricted to it. So, scholarships are where most college-bound students should, and do, look first.

Where to find scholarships? Many are sponsored through your local civic or religious affiliations and, of course, through both the state and federal government. Students also can receive awards by winning contests or participating in community service. Some are based on merit for extraordinary academic performance, and athletic scholarships are awarded to those who excel in all types of sports.

Some Fun and Surprising Scholarship Opportunities

Now, the good news is that you do not have to be a super athlete, or even a Sheldon Cooper, to qualify for a scholarship. Scholarships are available to an unbelievably large field, such as those who participate in duck calling, are fluent in Klingon, possess a passion for writing greeting cards or are duct-tape couture designers.

Feeling a little better now? Well, here are a few more scholarship categories: water skiers, gardeners, bass fishermen, bowlers, taxidermists, pool players, marble shooters and even nudists. The blind, asthma patients and others also have outlets for scholarships. Without getting too personal, do you have natural red hair? If so, a redhead scholarship such as the one provided by Scholarship Red could easily win you some free money for college.

The bottom line is, don't limit your thinking of scholarships only to the next Heisman Trophy Winner, or Bill Nye, the science guy type; the reality of the matter is that scholarships can be given out to people with many different types of characteristics, heritages or ethnic backgrounds, as well as those with a connection to the military and even those of a specific gender or height. Speaking of height, Tall Clubs International offers tall students a $1,000 scholarship. To qualify, girls must be at least 5-foot-10, and guys must measure at least 6-foot-2.

OK, just one more before we move on. Jif, the peanut butter company, holds the "Jif Most Creative Sandwich Contest," which can be a fun way to award money to students preparing to attend college. The award includes a scholarship worth $25,000, but just as important, a Jif Peanut Butter Basket worth $50!

Not all scholarships will provide you a free ride in college, covering all of your tuition and expenses. Some will give you $200, $500, $1,000 or whatever amount, but every bit helps, right? And you never know when and where a big check might come from.

Where to Find Scholarships to Apply For

Now, where to begin your search? Start with website searches, such as FastWeb or FinancialAidFinder. Be sure to look at College Board's Scholarship Search, as well as Scholarships.com, Unigo.com and Peterson's Award Database. These are only the tip of the list. There are many lists, and they can be fun and fascinating to review.

Other Ways to Reduce College Costs

Unless your child has his or her heart set on earning a degree from a prestigious out-of-state university, there are ways to reduce college costs. Here are a few strategies to consider.

1. Consider Public vs. Private Schools

Your child does not have to attend an Ivy League college to receive an excellent education. Check out the public colleges in your state, which typically charge considerably less tuition than private colleges. In addition, there are well-regarded private colleges that do not charge "Ivy League tuition."

2. Look into Local Community Colleges

Community colleges are typically less expensive than four-year universities, and they offer students the financial advantage of being able to live at or near home. Students often fulfill basic course requirements at a community college and then, after the second year, transfer those credits to the four-year college of their choice. Before you do this, make sure the community college credits will be accepted at the university your child plans to attend.

3. Have Your Student Live at Home

Encourage your child to attend a nearby college and live at home, at least for a year or two. Eliminating room-and-board expenses can substantially reduce college costs.

4. Look into Tuition-Reduction/Reimbursement Plans

Find out what types of tuition-reduction plans are offered at the colleges you are considering. Some colleges offer reduced tuition to the children of alumni or to children of college employees. Find out if your employer has any educational benefits available to the children of employees.

5. Accelerate Graduation

Some students take as many course credits as they can each semester to earn a degree in a shorter period of time. This is easier to do if the student is not working while taking classes. Also check out Advanced Placement programs.

6. Have Your Child Apply for Work–Study Jobs

Work–study programs provide part-time jobs for undergraduate and graduate students who have financial need. In addition, many colleges offer employment opportunities in housing units and dorms and in on campus offices.

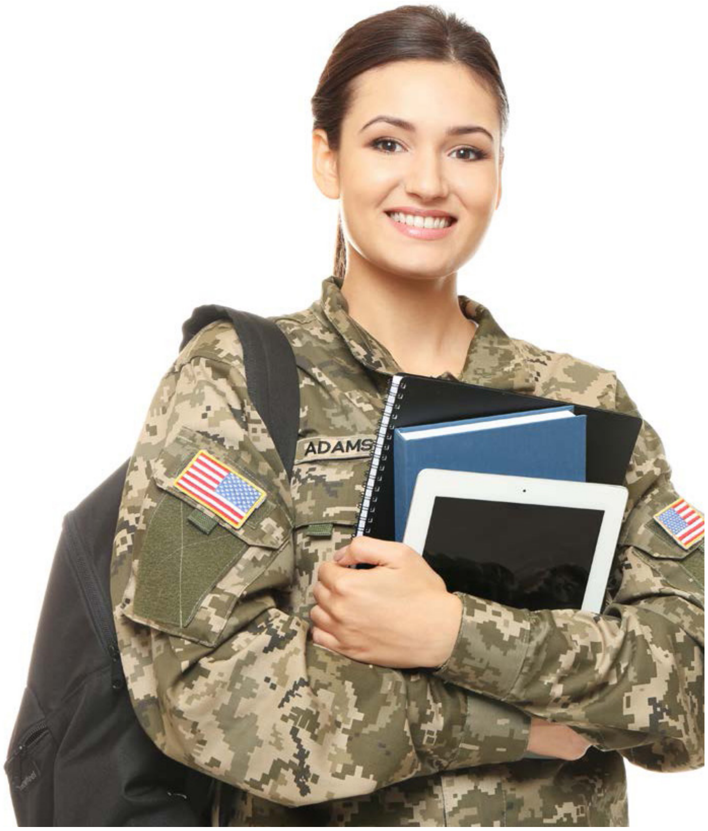
7. Have Your Child Join the ROTC

If your child is interested in pursuing a military career after college, consider having him or her apply to one of the service academies or enrolling in ROTC (Reserve Officers' Training Corps). This college program is offered at more than 1,700 colleges and universities across the United States and prepares young adults to become officers in the U.S. military.

In exchange for a paid college education and a guaranteed post-college career, participants, called "cadets," commit to serve in any branch of the military after graduation.

An Overview of Financial Aid

As you review your options for funding your child's college education, contact the financial aid offices at the colleges you're considering. They are an excellent resource for reviewing the types of financial aid available at their respective colleges.



Financial aid can be in the form of grants and scholarships, which do not have to be repaid, in the form of loans, which do have to be repaid, or in the form of a work–study program, which requires the student to work for a specified number of hours each week in return for money to pay college expenses. Financial aid is either merit-based or need-based.

The kinds and amounts of available financial aid that are available often vary from year to year, making it difficult to plan in advance. The federal student aid website offers a wealth of information on this topic.

To apply for financial aid, you need to fill out the Free Application for Federal Student Aid, or FAFSA®. The FAFSA uses a formula known as the "federal methodology" to determine your child's financial aid eligibility. Be sure to complete this form as early as possible in the year in which your child will be attending college.

An Overview of Grants

The beauty of student grants is that they do not have to be repaid. To be eligible for federal student aid grants, you must complete the FAFSA. The following are the primary student aid grant programs currently available from the federal government:

1. Federal Pell Grant

Pell Grants are considered a foundation of federal financial aid, and aid from other federal and nonfederal sources might be added to these grants.

2. Federal Supplemental Opportunity Grant (FSEOG)

FSEOGs are for undergraduates with exceptional financial need. Pell Grant recipients with the lowest expected family contributions will be considered first for a FSEOG. A student can receive between $100 and $4,000 per year.

3. TEACH Grant Program

The Teacher Education Assistance for College and Higher Education (TEACH) Grant Program provides grants of up to $4,000 per year to students who intend to teach in a public or private elementary or secondary school that serves students from lowincome families.

4. Iraq and Afghanistan Service Grant

These grants provide up to $5,717.11 per year for the 2018–19 award year to students whose parent or guardian was a member of the U.S. armed forces and died as a result of performing military service in Iraq or Afghanistan after the events of 9/11. Students who are awarded these grants must be ineligible for a Pell Grant due only to having less financial need than required to receive a Pell Grant and must have been under age 24 or enrolled at least part-time in an institution of higher education at the time of the parent's or guardian's death.

Doing some homework at least one year before your child is ready to attend college can reduce your personal outlay for his or her education. Combine as many of these strategies you can to reduce the total cost.

Contact HPN to Learn More College Planning

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