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Kelly Financial Advisors

Wealth Strategies

Wealth Strategy – College Planning

Part 8 of 12

The cost of higher education has become one of the greatest financial burdens facing parents and students today, not only because of escalating annual tuitions, but also the increasing number of years of undergraduate, graduate and professional school education required for many careers.



As both the cost of education and the importance of obtaining a college degree increase in today's society, planning ahead for this financial goal has never been more vital. However, before putting aside any funds for either your children, grandchildren, or other dependents, it is essential that you ask yourself the following questions:

- How much is it going to cost?
- What are you willing to pay for?
- How many years are you willing to provide financial support?
- How many years are between now and the first year of college?
- And most importantly, can you budget consistent savings without jeopardizing your own personal goals?

Answering these questions may be overwhelming at first, but defining the context within which you are both *willing* and *able* to financially fund future education costs is the key to making better

decisions. The context is defined by the age of the student, the cost of education, your financial needs, aspirations and obligations, your resources and limitations, and unique issues related to your individual circumstances.

The better you can understand these issues, the better you can define an appropriate and successful strategy.

How much is it going to cost?

The first step in the process is to understand the costs involved. Expenses during college years extend well beyond the traditional cost of tuition and books. Expenses can be grouped into five areas:

1. **Tuition:** The cost of education and access to institutional facilities and services. These costs will differ among colleges, most notably between in-state public universities, out of state public universities and private institutions.
2. **Room and Board:** The cost of housing and food. If living on campus, fees are divided between the cost of a residence hall and a meal plan. If living off-campus, traditional housing costs need to be considered such as rent, groceries, utilities, cable and internet, etc.
3. **Books & Supplies:** The cost of books and supplies the student will be required to purchase.
4. **Transportation:** Transportation can be a significant expense whether commuting to campus or returning home occasionally for the holidays. Consideration should be given to air fare, public transportation costs or, if the student will have a car, the cost of gas, maintenance and insurance.
5. **Personal Living Expense:** These costs will be similar among schools and relate more to lifestyle than location. Expenses include cell phone, laundry, grooming, personal care items, entertainment and extracurricular activities.

To obtain an idea of what these costs may currently accumulate to, below are statistics based on national averages. Keep in mind Tuition and Housing can vary dramatically depending on location:

Source: The College Board, *Annual Survey of Colleges*.

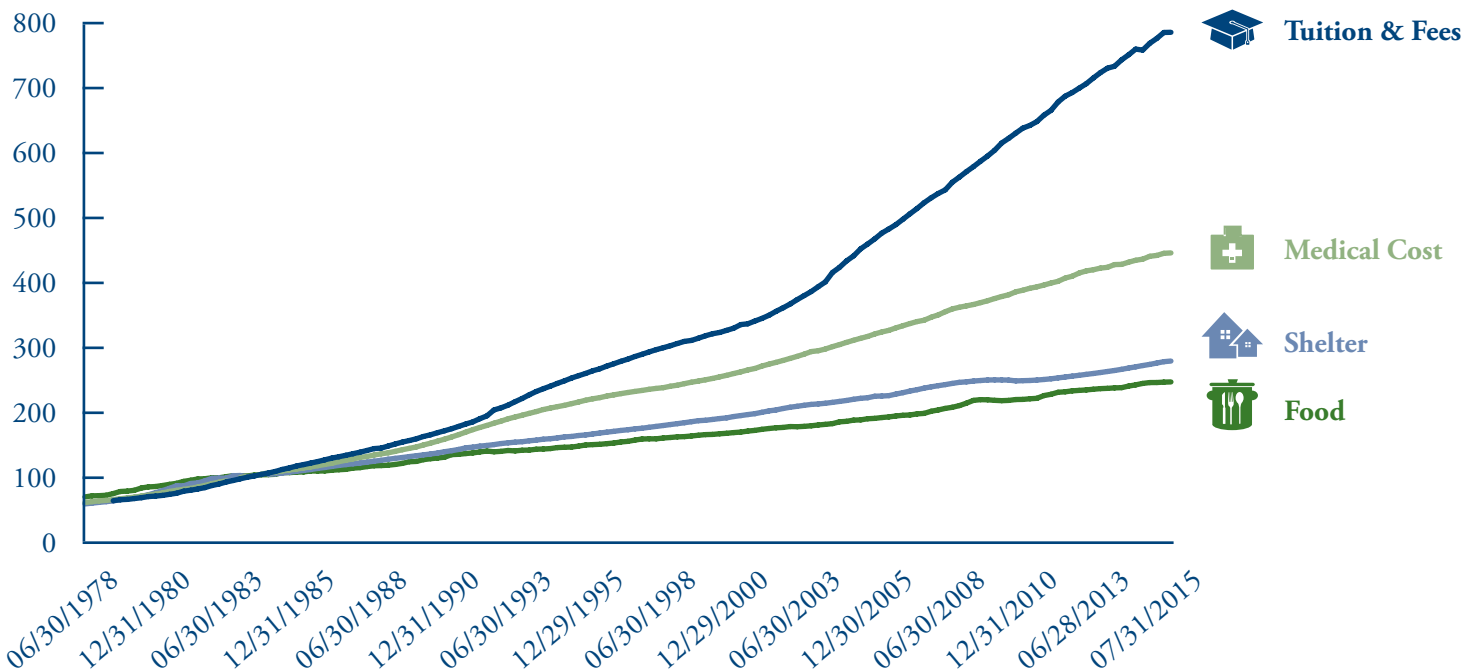
Average Estimated Undergraduate Budgets, 2014-15						
	Tuition and Fees	Room and Board	Books and Supplies	Transportation	Other Expenses	Total Expenses
Public Two-Year						
Commuter	\$3,347	\$7,705	\$1,328	\$1,735	\$2,210	\$16,325
Public Four-Year						
In-State On-Campus	\$9,139	\$9,804	\$1,225	\$1,146	\$2,096	\$23,410
Out-of-State On-Campus	\$22,958	\$9,804	\$1,225	\$1,146	\$2,096	\$37,229
Private Four-Year						
On-Campus	\$31,231	\$11,188	\$1,244	\$1,002	\$1,607	\$46,272

Today, most parents and students are well aware of the fact that college education cost increases have been outpacing average daily cost of living increases for years. The graph below depicts the total increase of tuition and fees in comparison to inflation (the rate at which our daily living costs

increase), medical care, food and shelter over a 30+ year period.

Given these ever increasing costs, there has never been greater incentive to start funding your child's college education early! The earlier you take

US Consumer Price Inflation



CPI Graph Source: Bureau of Labor Statistics, Bloomberg Visual Data • Comparison Charts Source: <http://goo.gl/caOT0e> • Source: www.savingforcollege.com

advantage of college funding vehicles – such as Section 529 Plans, Coverdell ESAs, UTMA's & UGMA's, etc. – the greater value each of your dollars will provide. However, before choosing an investment vehicle for your child's future college needs, it is important to understand the fundamentals of each investment option available to you.



Common Strategies for Establishing College Savings

After obtaining a clear understanding of both the cost of college education and how much you are **willing and able** to pay for this goal, it is imperative to understand which investment best suits your need. Today, there are many investment vehicles available for college savings. As with all investment options, not all strategies are created equal.

Below is a list of the most common strategies for establishing college savings:

- Coverdell Education Savings Accounts
- UTMA's and UGMA's
- Bonds
- 529 College Savings Plans

Coverdell Education Savings Accounts

Coverdell ESAs are a tax-advantaged education savings account (ESA) which you can establish for a child under the age of 18 (this limit does not apply to beneficiaries with special needs). Assuming you meet specified income requirements, the maximum you can contribute **per beneficiary** is **\$2,000 per year**. If your modified adjusted gross income (MAGI) is greater than \$110,000 (single filer) or \$220,000 (married filing jointly), you will be ineligible to contribute to a Coverdell ESA. When the beneficiary reaches 18, no further contributions can be made.

The major benefit of Coverdell ESAs is their applicability to a broad range of educational expenses. The funds held in a Coverdell may be used for a variety of post-secondary (college) expenses and elementary and secondary education expenses including tuition, fees, books, supplies, equipment, and room and board, as well as other qualifying expenses such as tutoring, computer equipment and software primarily educational in nature. Investments in these accounts grow tax-free and are not taxed at withdrawal. However, it is important to understand the penalties associated with distributions that do not cover qualified educational expenses. Distributions of earnings not used to pay qualified educational expenses are subject to a **10% penalty and must be included in the beneficiary's income**. Balances not used by the age of 30 must be distributed and included in the beneficiary's income and the 10% penalty will be applied.

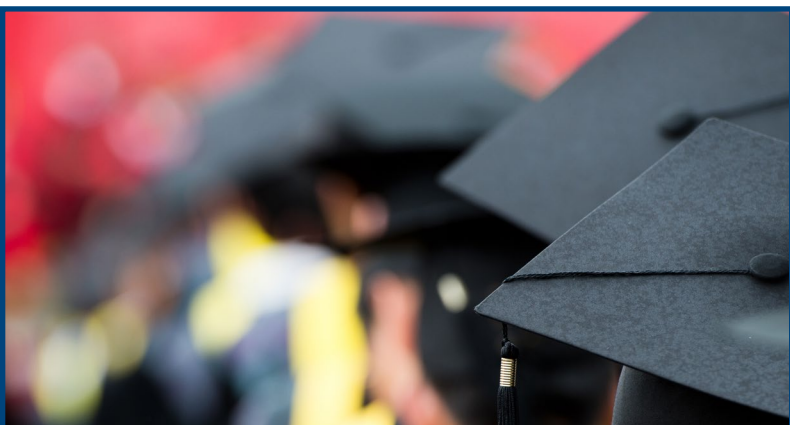
Uniform Transfers to Minors Act (UTMA's and UGMA's)

The Uniform Transfers to Minors Act (UTMA) is a law authorizing parents to manage investments for the benefit of a minor child. The Uniform Gifts to Minors Act (UGMA) is very similar to a UTMA, but does not authorize investments in specific types of property. These vehicles are most beneficial

when utilizing the annual gift exclusion (\$14,000 for 2015) to minimize federal gift and estate tax.

It is important to note that these assets are held in the name of the child, which subjects income to kiddie tax, requiring any unearned income over a specified amount (\$2,100 in 2015) to be subject to the parents' tax rate. The kiddie tax rule applies to those under the age of 18, whose earned income doesn't exceed one-half of their support, and those ages 19-23 who are full-time students and whose earned income doesn't exceed one-half of their support.

UTMAs and UGMAs are often regarded as college funding vehicles; however, in most circumstances are not advisable strategies because of the tax disadvantages as well as the negative impact they can have on eligibility for financial aid.



Bonds as a College Funding Investment Tool

Qualified Education Savings Bonds may be used as a tax-advantaged asset for college funding. Interest from Series I and EE Savings Bonds issued after December 1989 and purchased by an individual at least 24 years of age are tax free if redeemed to pay for higher education expenses. Under normal circumstances, the accumulated interest of these bonds are taxable. The face values of these bonds are as low as \$50 to upwards to \$10,000. Qualified education expenses also include rollovers to either a Section 529 Plan or a Coverdell ESA.

For those whose income falls above the income phaseouts for Qualified Education Savings Bonds (\$115,750 and \$145,750 for joint filers or \$77,200 and \$92,200 for single filers), Municipal Bonds (Munis) may be an attractive strategy for those in search of another source of tax-free income. A financial professional may help you with implementing a municipal bond strategy.

Section 529 Plans

Section 529 Plans are one of the most common, if not the most utilized, tool for college savings. They are a federal tax-advantaged college savings vehicle which allows tax-free growth of earnings as well as tax-free withdrawals, among many other benefits. There are two types of 529 plans: college savings plans and prepaid tuition plans. Though college savings plans and prepaid tuition plans share the same federal tax advantages, there are important differences to understand about each.

529 Plans: College savings plans

College savings plans allow you to save money for college in an individual investment account (either through a financial professional or directly). They are widely popular due to their high contribution limit and wide range of fund options. Their favorable gift tax treatment allows the owner to utilize a rare loop hole allowing investors to contribute up to five times the annual gift tax exclusion of \$14,000 (2015) or \$70,000 per spouse tax-free. In addition to the aforementioned benefits, you may find certain state tax advantages such as deductions for contributions depending on your state residency and the state's plan you purchase.

With a broad range of investment options and beneficial gifting strategies, comes flexibility. Under federal rules, you can change the beneficiary of your account to a qualified family member at any time without penalty. You are eligible for a rollover such as this once per year without income tax or penalty implications.

As with any investment vehicle, there are also some things to be wary of when funding a 529 College Saving Plan. Regardless of the rate at which tuition and fees has been increasing over the last 30+ years, there is risk of overfunding a 529 Plan. Alternative from funding most other financial goals, **there is a tax penalty associated with overfunding a 529 Plan.** If your child has excess funds in his or her plan after college, there will be a 10% tax penalty applied to the earnings portion of each unqualified distribution. Tracking the funding level of this goal is essential to avoid any penalties.

529 Plans: Prepaid tuition plans

Prepaid tuition plans are close cousins to college savings plans. Although their federal tax treatment is the same, the dollars you contribute are used to purchase an amount of tuition credits or units subject to your specific plan's rules and limitations. The rate of return achieved in the prepaid tuition plan is equal to the rate of inflation of tuition, recently about 6%. By contributing savings to a prepaid tuition plan, you are essentially purchasing tuition expenses and fees at today's prices for use in the future. Prepaid tuition plans can be run either by states or colleges depending on the type of university. For state-run plans, you prepay tuition at one or more state colleges; for college-run plans, you prepay tuition at the participating college(s). Typically, the tuition credits or units are guaranteed to be worth a certain amount of tuition in the future, despite how much college costs may increase between now and then.

Prepaid tuition plans do provide some measure of security over rising college prices, but there is also a level of risk attributed to each plan's limitations. One major drawback is that your child is generally limited to your own state's prepaid tuition plan and to certain colleges in which your plan participates in. If your child attends a different college, prepaid plans may differ on how much money you'll get

back. Additionally, some prepaid plans have been forced to reduce benefits after enrollment due to investment returns that have not kept pace with the plan's offered benefits. Even with these limitations, some college investors appreciate the peace of mind of locking in tuition expenses today.



Choosing a College Savings Plan

Although 529 plans are a creature of federal law, their implementation is left to the states. Currently, there are over 50 different college savings plans available, with many states offering more than one plan. Fortunately, the state in which you reside in does not hinder you from purchasing another state's 529 plan. Additionally, 529 plans vary in the investment options they offer. Ideally, you'll want to find a plan with a wide variety of investment options to suit your specific needs.

Before selecting a plan, it is essential to review the fees and expenses of the plan, as these tend to vary widely from plan to plan. Watch for underlying fund expenses, as well as annual maintenance fees (administration and management fees). Given the myriad of plans available, it may be helpful to consult an experienced financial professional who can help you select a plan and determine which investments are most appropriate for you.

The following page shows a comparison of each of the college savings vehicles described above:

YEAR 2015 RULES	529 Plan	Coverdell Education Savings Accounts	Qualifying U.S. Savings Bonds	UGMA/UTMA
Federal Income Tax	Non-deductible contributions; withdrawn earnings excluded from income to extent of qualified higher education expenses	Non-deductible contributions; withdrawn earnings excluded from income to extent of qualified higher education expenses and qualified K-12 expenses also excluded	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	Earnings and gains taxed to minor; first \$1050 of unearned income is tax exempt; unearned income over \$2,100 for certain children through age 23 is taxed at parents rate
Federal Gift Tax Treatment	Contributions treated as completed gifts; apply \$14,000 annual exclusion, or up to \$70,000 with 5-year election	Contributions treated as completed gifts; apply \$14,000 annual exclusion	No gift as qualifying bonds must be owned by the parent	Transfers treated as completed gift; apply \$14,000 annual gift exclusion
Federal Estate Tax Treatment	Value removed from donor's gross estate; partial inclusion for death during a 5-year election period	Value removed from donor's gross estate	Value included in bond owner's gross estate	Value removed from donor's gross estate unless donor remains as custodian
Maximum Investment	Established by the program; many in excess of \$300,000 per beneficiary	\$2,000 per beneficiary per year combined from all sources	\$10,000 face value per year, per owner, per type of bond	No limit
Qualified Expenses	Tuition, fees, books, supplies, equipment, special needs; room and board for minimum half-time students	Tuition, fees, books, supplies, equipment, special needs; room and board for minimum half-time students; additional categories of K-12 expenses	Tuition and fees	No restrictions
Able to Change Beneficiary	Yes, to another member of the beneficiary's family	Yes, to another member of the beneficiary's family	Not applicable	No; represents an irrevocable gift to the child
Time/Age Restrictions	None unless imposed by the program	Contributions before beneficiary reaches age 18; use of account by age 30	Bond purchaser must be at least 24 years old at time of bond issuance	Custodianship terminates when minor reaches age established under state law (generally 18 or 21)
Income Restrictions	None	Ability to contribute phases out for incomes between \$190,000 and \$220,000 (joint filers) or \$95,000 and \$110,000 (single)	Interest exclusion phases out for incomes between \$115,750 and \$145,750 (joint filers) or \$77,200 and \$92,200 (single)	None
Federal Financial Aid	Counted as asset of parent if owner is parent or dependent student	Counted as asset of parent if owner is parent or dependent student	Counted as asset of bond owner	Counted as student's asset
Investments	Menu of investment strategies as developed by the program	Broad range of securities and certain other investments	Interest-earning bond backed by full faith and credit of U.S. government	As permitted under state laws
Use for Non-qualifying Expenses	Withdrawn earnings subject to federal tax and 10% penalty	Withdrawn earnings subject to federal tax and 10% penalty	No penalty; interest on redeemed bonds included in federal income	Funds must be used for benefit of the minor

How a professional can help

A professional can help a client evaluate the benefits and drawbacks of several products designed specifically for College Savings. By saving in advance for college, you can take advantage of tax benefits and provide tax-deferred growth for your investments to increase the efficiency of long term savings in addition to the value of long term compounding over time.



About RFA

Reilly Financial Advisors is a fee-only Registered Investment Advisor, aimed at helping our clients both define and achieve their individual financial goals through four unique service offerings:

1. **Wealth Building – for those still accumulating their investment portfolios**
2. **Wealth Management – for those who have amassed their savings and have specific needs associated with their wealth**
3. **Wealth Legacy – for those who have accumulated a significant amount of wealth and face unique wealth transition needs**
4. **Corporate Retirement Services – tailored solutions for plan sponsors and participants**

RFA, founded in 1999, services clients around the United States and in more than a dozen countries worldwide. As an independent advisor, we are able to provide our clients with the highest level of Fiduciary services which allows us to make investment decisions based solely in the best interest of our clients. Our goal is to be our client's first point of contact for all of their financial needs, serving as a trusted financial partner for the long term.