

# Providing for Your Child's Education... An Educational Funding Review

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## Think About It...

**Your earning power – your ability to earn an income – is your most valuable asset.**

Few people realize that a 30-year-old couple will earn 3.5 million dollars by age 65 if their total family income averages \$100,000 for their entire careers, without any raises.

**The question is how much of this money will be available to help pay for your child's education?**

# How Much Will a College Education Cost?

## Approximate Undergraduate Costs (2009-2010) to Attend a Four-Year College

	Annual Cost
<b>Public School:</b>	
<b>Resident Student *</b>	<b>\$15,213</b>
<b>Commuter Student **</b>	<b>\$ 7,020</b>
<b>Private School:</b>	
<b>Resident Student *</b>	<b>\$35,636</b>
<b>Commuter Student **</b>	<b>\$26,273</b>
* Includes tuition, fees, room and board; in-state residency is assumed for public schools.	
** Includes tuition and fees only.	
<b>Source:</b> The College Board Trends in College Pricing 2009	

## Do You Know...the value of an investment in higher education?

**According to the College Board's Education Pays 2007, full-time workers ages 25 and older with a bachelor's degree earned a median income in 2005 of \$50,900, almost 62% more than the \$31,500 earned by a full-time worker with only a high school diploma. Those with master's degrees earned a median income of \$61,300, which rose to \$100,000 for those with a professional degree.**

## What Is the Impact of Inflation on College Costs?

Unfortunately, college costs have been rising at a faster rate than the general inflation rate.

Through December 2009, **the inflation rate was -0.3%** (source: Consumer Price Index; CPI-U; January 2009 – December 2009).

For a similar period of time, **tuition and fees at four-year colleges increased an average of 4.4% to 6.5%** (source: The College Board Trends in College Pricing 2009).

Failing to consider the impact of inflation on college costs could undermine your ability to provide for your child's education.

# The Impact of Inflation on College Costs

Consider the funds that may be needed when an 8-year-old child is ready to attend college in 10 years:

	Today's Average Annual Cost	Average Annual Cost in 10 Years Assumed College Inflation Rate:		
		4%	6%	8%
<b>Public School:</b>				
Resident Student *	\$15,213	\$22,519	\$27,244	\$32,844
Commuter Student **	\$7,020	\$10,391	\$12,572	\$15,156
<b>Private School:</b>				
Resident Student *	\$35,636	\$52,750	\$63,819	\$92,431
Commuter Student **	\$26,273	\$38,890	\$47,051	\$68,145
<p>* Includes tuition, fees, room and board; in-state residency is assumed for public schools.</p> <p>** Includes tuition and fees only.</p> <p><b>Source:</b> The College Board Trends in College Pricing 2009</p>				

## How Much Should You Save for Your Child's Education?

Years Until College	4-Year Total Cost		Monthly Savings	
	Public	Private	Public	Private
1	\$ 68,849	\$ 161,287	\$ 5,556	\$ 13,015
5	83,686	193,043	1,169	2,738
10	106,807	250,206	617	1,446
15	136,316	319,332	430	1,007
20	173,980	407,560	334	782

Based on the College Board Trends in College Pricing 2009, which estimates annual costs at \$15,213 public and \$35,636 private (includes tuition, fees, room and board). In-state residency is assumed for public schools. Table assumes 5% annual increase in college costs and a 7% after-tax annual return on investment, based on monthly compounding. No additional investments are assumed once the child starts school.

## Some Educational Funding Options

### **Custodial Accounts**

There may be certain tax advantages to maintaining a separate educational fund in the child's name. By setting up a custodial account under the Uniform Gifts of Minors Act (UGMA) or, in some states, under the Uniform Transfers to Minors Act (UTMA), you can realize any tax savings and still maintain some control of the funds.

### **Transferring Funds to Children**

Each parent and grandparent can gift up to \$13,000 in 2010 to each child without any gift tax consequences.

### **Borrowing**

The primary problem with borrowing is that it adds to the cost of education and may possibly divert funds that are needed to accomplish other important financial objectives, such as saving for retirement. If borrowing becomes a necessity, your child may qualify for a student loan, although that source of college funding may become less available or attractive in the future. In most states, you can take a home equity loan for educational purposes and benefit from tax-deductible loan interest.

# Additional Educational Funding Options

## Education Savings Plan

You can begin a systematic savings plan today to help finance your child's future education costs. If life insurance is one of your education funding choices and you die prematurely, the death benefit could be used to help fund your child's education. In addition, certain types of life insurance provide a tax-deferred accumulation of cash values. These cash values could serve as a source of education funds, in addition to being available for emergencies or other opportunities (withdrawals and loans will reduce the policy's death benefit and cash value available for use).

## Education Tax Incentives

A variety of education tax incentives are available, including the HOPE Scholarship Credit, the Lifetime Learning Credit, Qualified Tuition Programs and Education Savings Accounts. In addition, interest paid on qualified education loans may be deductible.

## Note:

The potential impact on the availability of student loans and grants should also be evaluated in selecting education funding options.

## An Overview of Education Tax Incentives: HOPE Scholarship Credit and Lifetime Learning Credit

<b>HOPE Scholarship Credit</b> (American Opportunity Tax Credit)	<ul style="list-style-type: none"><li>■ May be elected during all four years of a taxpayer's, spouse's or dependent's post-secondary education.</li><li>■ Tax credit of up to 100% of the first \$2,000 and 25% of the second \$2,000 of qualified tuition and related expenses paid in 2010 (maximum of \$2,500).</li></ul>
<b>Lifetime Learning Credit</b>	<ul style="list-style-type: none"><li>■ Tax credit equal to 20% of up to \$10,000 of qualified tuition and related fees paid in 2010 (maximum of \$2,000).</li><li>■ Available for undergraduate, graduate-level and course work that improves job skills.</li></ul>
<b>Note:</b>	<ul style="list-style-type: none"><li>■ Either the HOPE Scholarship or the Lifetime Learning Credit may be taken for the same student in any one year, but not both.</li><li>■ Both credits are phased out as modified adjusted gross income exceeds specified levels.</li></ul>

# An Overview of Education Tax Incentives: Student Loan Interest Deduction and IRA Withdrawals

## Student Loan Interest Deduction

- A deduction of up to \$2,500 in 2010 for interest due and paid on qualified education loans.
- Phased out as modified adjusted gross income exceeds specified levels.

## Withdrawals from IRAs

Amounts can be withdrawn penalty-free from an IRA for the higher education expenses of the taxpayer and the taxpayer's spouse, child and grandchild.

# An Overview of Education Tax Incentives: Education Savings Accounts

## Education Savings Accounts

- Allow for contributions of up to \$2,000 per year per student for the benefit of a beneficiary who has not reached age 18.
- Contributions are not deductible, but earnings are not taxed and withdrawals are excluded from income, provided they are used for qualified education expenses for elementary, secondary or post-secondary schools.
- Contribution amounts are phased out as modified adjusted gross income exceeds specified levels.
- A HOPE or Lifetime Learning Credit can be claimed for the eligible student in the year of withdrawal if the withdrawal and the credit cover different eligible expenses.

# An Overview of Education Tax Incentives: Qualified State Tuition Programs

## Qualified State Tuition Programs

- Also known as Section 529 plans, the maximum amount that can be contributed varies from state to state, but can be substantial.
- There are no income or age restrictions on participating in a qualified state tuition program.
- Contributions are not deductible for federal income tax purposes, but earnings grow tax free for as long as the money remains in the plan. Some states allow residents to deduct Section 529 contributions from state tax returns.
- If used to pay for qualified higher education expenses, distributions are free of federal income tax.

# Educational Funding Action Checklist

## The Analysis...

- Decide how much of your child's education you wish to fund (all or part?).
- Based on the type of school your child will be attending, select a target annual educational cost that you will aim to fund.
- Determine to what degree you want to take inflation into account.
- Estimate the total educational fund that will need to be available when your child enters college.
- After subtracting any amounts you have accumulated, determine the amount you must systematically save, based on an assumed interest rate, in order to reach your educational funding goal.

# Educational Funding Action Checklist

## The Plan...

- Evaluate and select educational funding options, available education tax incentives and savings vehicles.
- Commit to a systematic educational savings plan.

## You Can Manage Your Finances...

*It's by managing your finances that you write the story of your life. You are both the author and the story's principal character. Resolve to perform what you ought.*

**Benjamin Franklin**