COLLEGE FUNDING

Quick Guide

This quick guide was prepared by Truebridge.

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Don't Agonize—Get Active

You've heard it time and time again: start that college fund before the baby comes home from the hospital. The truth of the matter is, despite the unquestionable wisdom of this advice, very few parents actually follow it. You know the feeling: Young parents face far more pressing financial issues such as buying a house, paying off their own college loans, financing a car, and trying to make ends meet as family responsibilities grow.

So, if you're like most parents, with little or no college savings, don't despair. There are a number of steps you can take to get your children educated and to meet escalating tuition fees without having to give up your Saturday night out on the town or your annual trip to the beach.

Deciding on the best college-funding strategy to use requires a focus on how old your child is and how long it will be before he or she starts college. Your strategy should change and evolve as your child gets older.

How Is Investing for College Different from Other Investing?

It is not. Any investment program, for any purpose, needs to consider rate of return, risk, and when you will need the money. For college investing, when your child is young, you have a long-term investment horizon. You can consider investing in stock When your child is 16 and getting close to going to school (you will need the money soon to pay tuition), you need to reduce your investment risk and move your investments to cash accounts (bank accounts) or short-term bonds.

This is not much different from saving for retirement or saving for a house. The process is the same. What is your goal? How much do you have to work with? When will you need the money? Remember to always focus on when you will need the money; that will help you decide which investment vehicles to consider.

Develop a specific action plan for your college investment program. Remember to:

1. Determine how much you need to invest or how much you can afford to invest on a monthly basis.
2. Think about your willingness to invest in growth investments. This may be one good way to keep your investment rate of return ahead of inflation.

Whatever investment vehicle you select, invest regularly monthly or quarterly. Most funds let you set up an automatic monthly investment program in which a fixed dollar amount is transferred from your bank account into the investment fund.

Qualified Tuition Programs (QTPs) / 529 Plans

Qualified Tuition Programs (QTPs) offer another way to provide for college funding. These programs, also referred to as Section 529 Plans, generally have a tax-favored status. Individuals may participate in either a prepaid tuition plan or utilize a higher education savings account plan.

Prepaid Tuition Plans

These programs are administered by a state or by an eligible educational institution. Under these plans, participants purchase tuition credits or certificates for a designated beneficiary, who would then be entitled to a waiver or partial payment of qualified higher educational expenses. Contract purchasers prepay tuition and fees for a set number of academic years while locking in current tuition rates. In-kind distributions from these plans, such as a waiver of tuition, generally are excludable from gross income for plans maintained by a state. For plans that are maintained by a private institution, in-kind distributions generally will be excludable from gross income. To be excludable, the distributions must be used for qualified higher education expenses.

Higher Education Savings Account Plans

These programs are generally sponsored by a state. Under these plans, participants make contributions to an account that is set up to meet qualified higher educational expenses of a designated beneficiary of the account. There are no income limitations with regard to making contributions to the plan.

Contributions are made to a state's savings account, and are generally managed by private investment or insurance companies. Each state imposes a limit on the amount of contributions that can be made to the plan per beneficiary, and on how large the account balance can grow. Some states allow a state income tax deduction for contributions made. These plans generally allow for the interest earned to be withdrawn tax-free. The withdrawals must be used for qualified higher education expenses. If withdrawals are made for purposes other than qualified education expenses, the amount of earnings that are withdrawn are taxed at the beneficiary's income tax rate and also subject to a 10% penalty.

IMPORTANT NOTE: You can contribute to any state's savings plan. Most plans have no state residency requirements. Therefore, you need not contribute to the plan of the state in which you live or where your child may attend school. By investing in a 529 plan outside of the state in which you pay taxes, you may lose any tax benefits offered by the state's plan. Consider before investing whether you or the designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such states' qualified investment plan.

There are rules that the federal government has established and which must be adhered to under both types of plans. For example, contributor cannot exercise investment direction, and the interest accumulated within the the account cannot be used as security for a loan. There are other rules to be followed and a state or eligible educational institution may also give direction regarding how its particular program works. The American Opportunity Tax Credit and the Lifetime Learning tax credits can be claimed in the same year as QTP distributions, as long as the QTP distribution is not used to pay for the same costs used to claim the education credit.

Individuals can contribute to both QTPs and Education Savings Accounts on behalf of the same beneficiary. Amounts in a QTP can be rolled over to another state's plan once per year.

SUGGESTION: Assets in a QTP are treated as the parent's assets when applying for financial aid if the parent is the donor. Contributions to QTPs qualify for the annual gift tax exclusion. The person contributing the money to the program may elect to treat the contribution as if made over a five-year period for purposes of the annual gift tax exclusion.

The Coverdell Education Savings Account and Additional Federal Tax Credit Programs

Taxpayers may make nondeductible contributions to a tax-favored account designed specifically for college, elementary, or high school education expenses—a Coverdell Education Savings Account (formerly known as an Education IRA).

Contributions of up to a total of $2,000 per year, per beneficiary, may be made to an account for the benefit of a beneficiary who is under age 18 (students with special needs can be over 18). In 2014 income phase-out for contributions begins for taxpayers with modified adjusted gross income (AGI) above $95,000 ($190,000 for joint filers). No contribution will be allowed once modified AGI reaches $110,000 ($220,000 for joint filers). These limits have been unchanged from 2012.

SUGGESTION: If your modified adjusted gross income exceeds the limits, the child's grandparent or other relative may be able to establish the account and make the annual contribution.

SUGGESTION: Contributions can be made to an Education Savings Account regardless of whether or not the owner has earned income.

Earnings in an Education Savings Account grow tax-deferred, and are never taxed, provided they are used for the beneficiary's qualified education expenses. The American Opportunity Tax Credit or the Lifetime Learning Credit can be claimed for the eligible student in the same year as an Education Savings Account distribution as long as the distribution is not used to pay for the same costs used to claim the education credit. If withdrawals are not used for qualified education expenses, withdrawn earnings are included in the beneficiary's taxable income and are subject to an additional tax of 10%.

IMPORTANT NOTE: If the balance of an Education Savings Account is not distributed before the beneficiary reaches age 30, the account must be emptied upon attainment of that age, unless the individual is a special needs beneficiary. The earnings in the account are taxed at the beneficiary's income tax rate and are also subject to a 10% penalty since they will not have been used to pay qualified education expenses. These taxes can be avoided if the account balance is rolled over to another Education Savings Account benefiting a different beneficiary who is a member of the family of the previous beneficiary.

Here are some other facts regarding the Education Savings Account:

- Contributions qualify for the annual gift tax exclusion.
- An Education Savings Account can be set up for any child under 18; contributions generally cannot be accepted after the child's 18th birthday, unless the beneficiary is a special needs beneficiary.
- There is no limit on the number of Education Savings Account that may be established for a particular child, but the maximum aggregate

contribution for any one child in any calendar year is $2,000.

- Contributions are not deductible.
- Only cash contributions are allowed.
- Subject to the applicable income limits, any individual may contribute to an Education Savings Account; the contributor does not have to be a relative. A child may contribute to his or her own Education Savings Account.
- A child may take tax-free withdrawals to pay qualified higher education expenses even if he or she is enrolled at an eligible educational institution less than full-time; enrollment on a half-time or less than half-time basis will qualify, depending on qualifying expense.
- If the beneficiary dies, the value of the account is includible in his or her taxable estate—not in the account owner's estate.
- The account is considered an asset of the parent when applying for financial aid if the parent is the owner of the account.

If you are eligible to establish an Education Savings Account and make the maximum annual contribution of $2,000 at the beginning of each year for 18 years, assuming a 6% rate of return, the account will have a value of $65,500.

Aid and Other Options

Key Points to Consider When Considering Financial Aid

Never assume you don't qualify for financial aid. Getting help for footing the tab is available for thousands of middle-income parents and many colleges actually sweeten financial aid packages to lure the top students to their school. Most of the financial aid money available is awarded to those people who are diligent about going after it.

The U.S. government is the largest source of financial aid. Other sources include:

- The school itself
- State governments
- Private sources, such as corporations and philanthropic organizations
- The armed forces

There are two types of financial aid:

1. Need-based aid is calculated based on your financial circumstances.
2. Merit-based aid is awarded by the school for special talents or achievements, regardless of financial circumstances.

A key concept in this area is expected family contribution. This is a calculated amount that estimates how much you can afford to contribute to the cost of college. This contribution amount is the same no matter what school you apply to. The financial aid process attempts to put all colleges within your financial reach, regardless of the total cost of the school. You are eligible to receive more aid at a higher cost school.

Being eligible does not mean you're going to get the financial aid. Total aid packages typically range between 65% and 100% of the amount you are eligible for, depending upon the college.

Example: You Are Eligible to Receive More Aid at a Higher-Cost School		
	Private School	**Public School**
College Cost	$40,000	$30,000
Expected Family Contribution	$4,000	$4,000
You Are Eligible for This Much Aid	$36,000	$26,000

IMPORTANT NOTE: The Expected Family Contribution is different for everyone. We used $4,000 in this example to illustrate how this amount stays fixed and the amount of financial aid for which you are eligible increases as the cost of the school goes up.

SUGGESTION: Don't rule out an expensive school until you get all the facts.

You will need to understand the financial aid application process—and to budget some time for it, because it is lengthy. It will be helpful to minimize your income during the base year—the year on which the award of aid is based. And you should understand the effect of assets on financial aid**.** Take a moment as well to look at some suggestions we offer to help you get aid.

Scholarships

There are many sources of scholarships. Work closely with your high school guidance counselor. Fill out and submit the Free Application for Federal Student Aid (FAFSA); your child may be eligible for federal grants and loans. Colleges or universities that accept your child will consult the FAFSA and may offer a scholarship as part of the admissions package.
Contact business, civic, or religious groups in your community to see what's available. Apply for as many as possible. These can really add up, and remember, you'll never get anything if you don't apply.

There are sources that students should look into when trying to locate additional scholarship or grant money. One is *The Scholarship Book: The Complete Guide to Private-Sector Scholarships, Grants, and Loans for Undergraduates* (Daniel J. Cassidy). This book lists thousands of private-sector scholarships, grants, loans, fellowships, internships, and contest prizes. Students should also contact the colleges and universities that they are interested in to see what types of assistance programs they offer to students. In addition, there are many Internet sites related to scholarship searches.

Federal Loans and Grants

Call the Federal Student Aid Information Center at 1-800-433-3243 to request a free copy of *Funding Education Beyond High School: The Guide to Federal Student Aid,* which provides information on government loans and grants. You can also obtain a copy online at www.studentaid.ed.gov. Also call your state higher education agency which can give you additional information about obtaining loans and grants in your state.

Grants

Name of Grant	Grant Amount
Federal Pell Grants: This is the largest need-based program. Millions of undergraduates receive Federal Pell Grants each year. Graduate students are not eligible.	The maximum grant for 2019-2020 award year is $6,195. The amount you receive depends on need, the cost of the college, whether you attend for a full academic year, and if enrollment is full or part time.
Federal Supplemental Educational Opportunity Grant Program (FSEOG): This is a need-based program. However, it is school-based, which means that while the money comes from the federal government, individual colleges and universities distribute money to students who demonstrate need. Graduate students are not eligible.	Undergraduates can receive grants of up to $4,000 a year.

Loans

Name of Loan or Grant	Amount That Can Be Borrowed	Interest Rate	Repayment
Federal Perkins Loan Program: This federal loan program is a school-based program administered by colleges & universities. Individuals receive this loan based on need. The Federal Perkins Loan Program Extension Act of 2015 extended the Perkins Loan Program for two years, until September 2017. After September 30, 2017, the Federal government will no longer issue new Perkins loans for new or existing borrowers.	Full time dependent undergraduates can borrow up to $5,500 annually ($27,500 total). $8,000 annually for graduate students ($60,000 total including any Federal Perkins Loans you borrowed as an undergraduate).	This is a low interest loan. The interest rate is 5%.	Repayment begins 9 months after a student graduates or leaves school. Repayment may run up to a maximum of 10 years.
Stafford Loan Program: The subsidized program allows students who are in financial need to borrow money for educational expenses. The unsubsidized program is for students who do not qualify for the maximum subsidized student loan. Eligibility for the unsubsidized Stafford Loan is not based on financial need. Beginning July 1, 2012 subsidized loans for graduate and professional students are no longer available.	Full-Time dependent undergraduates can borrow up to: 1st year $5,500 (no more than $3,500 of this amount may be in subsidized loans), 2nd year $6,500 (no more than $4,500 of this amount may be in subsidized loans), 3rd and 4th years (each) $7,500 (no more than $5,500 of this amount may be in subsidized loans). Full-time independent undergraduates (or dependent undergraduates whose parents are unable to get a PLUS loan) can borrow up to: 1st year $9,500 (no more than $3,500 of this amount may be in subsidized loans), 2nd year $10,500 (no more than $4,500 of this amount may be in subsidized loans), 3rd and 4th years (each) $12,500 (no more than $5,500 of this amount may be in subsidized loans). Graduate students can borrow a total of $138,500 (maximum subsidized is $65,500). Annual loan limit is $20,500 (unsubsidized only).	For loans first disbursed between July 1, 2018 and June 30, 2019, the interest rate on subsidized and unsubsidized loans to undergraduate students is fixed at 505%. The interest rate for unsubsidized loans to graduate students is fixed at 6.06%. Interest is not required to be paid on the loan while the student is in school. In addition to the interest, there is also an origination fee of 1.066% for loans between October 1, 2018 and September 30,2019.	Repayment is deferred until 6 months after a student graduates or leaves school. An interest will be charged for unsubsidized loans during this time. Repayment can run up to 10 years, or more if an extended plan is elected. An income-based repayment may be available based on eligibility.
Federal PLUS Loans: These loans enable parents with good credit histories to borrow money for their child's undergraduate education. Eligibility is not based on financial need.	The annual loan limit is the difference between the cost of attendance minus any other financial aid you receive.	For direct PLUS loans first disbursed on or after July 1, 2018 and before July 1, 2019, the interest rate is fixed at 7.60%. In addition to the interest, there is also a fee of up to 4.248% of the loan deducted from each loan disbursement between October 1, 2018 and September 30, 2019.	Repayment begins immediately after loan disbursement, but can be deferred while enrolled at least half-time as a student. It can be deferred another 6 months after the student ceases to be enrolled at least half-time. Repayment is made over 10 years, or more if an extended plan is elected.

Home Equity Line of Credit

You can establish a home equity line of credit, based on your home's appraised market value minus any unpaid mortgage and then borrow a percentage of the home's equity. You may wish to set up this line of credit in advance and then borrow as needed for each year of college.

IMPORTANT NOTE: Remember that the cash you have on hand or in a bank account is counted as an asset when schools determine your child's eligibility for federal need-based financial aid; however, the equity in your home is not. Therefore, establish the credit line, but don't withdraw the funds until after you receive a financial aid determination.

Borrowing from Your Qualified Retirement Plans

You may be able to take a hardship withdrawal from a qualified retirement plan to pay for tuition and related fees for post-secondary education.

Avoid taking a hardship withdrawal until all other options have been exhausted.

Withdrawals from IRAs

The 10% penalty tax that applies to most withdrawals from a qualified retirement plan before the account owner reaches age 59½ will not apply to withdrawals from an IRA, either Traditional or Roth, for qualified higher education expenses of the taxpayer, spouse, children, or grandchildren.

Qualified higher education expenses include tuition at a post-secondary educational institution, books, fees, supplies, and equipment. The amount of the IRA distribution cannot exceed the qualified higher education expenses for the taxable year.

Borrowing from Your Retirement Plan

Many companies allow employees to borrow from their 401(k) or other qualified retirement plan. But remember: ***This is a retirement fund first and foremost*!** We usually recommend that you save for your retirement first—it is the single largest commitment you have to fund. So if you are going to borrow from your or your spouse's 401(k) plan, do it knowing it will get in the way of your retirement plans.

Since your loan is secured by the 401(k) plan, Department of Labor rules won't let you borrow more than 50% of your ***vested account balance***.* There are also certain tax rules that limit the amount you may take as a loan without it being considered a distribution. Under current tax law, a 401(k) plan can permit you to borrow as much as $50,000 or half of your vested benefits in the 401(k) account, whichever is less. If your vested account balance is at least $10,000, you can borrow up to $10,000 even if 50% of your vested account balance is less than $10,000. If your vested 401(k) plan account is less than $10,000, you can borrow up to your vested account balance. The following chart summarizes these borrowing options:

Your vested account balance	The maximum you could borrow is …
$0–$10,000	Your vested balance
$10,000–$20,000	$10,000
$20,000 and higher	50% of your vested account balance, not to exceed $50,000

Loan terms are usually no more than five years for general purpose loans. Loans must be paid back on a regular basis—quarterly, monthly, or biweekly, but at least once each quarter.

IMPORTANT NOTE: When you borrow from your 401(k) plan, you no longer earn investment returns on the amount you borrow from the account. In effect, that money is no longer in the 401(k) plan earning money—you have borrowed it and it is out doing something else. So, although the interest you pay on the loan goes back into your 401(k) account, the true cost of the loan is the amount you would have earned on that money had you not borrowed it from the account. It is what we call opportunity cost and it is a tricky concept. It is true that "you're paying yourself back," but that's not all that's happening—you are also missing out on the investment earnings on those funds that were borrowed!

*Your vested account balance is the amount of your contributions, plus some percentage of any employer-matched contributions, depending on the length of your service with the company.

On the flipside, borrowing from your 401(k) loan can work to your advantage if the market is losing money. By pulling the money out as a loan, you're not participating in a losing market.

Life Insurance Loans

Certain types of life insurance policies include a savings component, or cash value. You may borrow against the accumulated cash value at relatively low interest rates. Essentially, you are borrowing from your own savings. Interest rates may be fixed or variable depending on the policy. Be sure to ask your insurance agent if the dividend rate will be reduced when you take out a loan. Also ask them to send you information regarding the loan provisions so you will fully understand all the implications of your loan. Provisions will vary with different policies and insurance companies.

Life insurance loans can be a convenient way to borrow money, especially if the interest rate is low. These loans can be, but do not have to be, repaid. However, interest on the loan is due on each policy anniversary. If the interest is not paid when due, it will be added to the loan, and any outstanding loan balance will be deducted from the death benefit your beneficiary will receive when you die. It is important that you at least pay the interest as it comes due, since interest will continue to accrue on the interest owed on the loan, resulting in a compounding effect. If the policy loan is still outstanding when the policy is surrendered or lapses, there may be income tax consequences.

IMPORTANT NOTE: If you use the cash value in your insurance policy to pay the interest on a life insurance loan, you may use up all of your cash value, which can cause your policy to lapse.

Is the Interest Tax-Deductible?

Interest on life insurance loans is treated as non-deductible personal interest, with one exception: If you use the funds to purchase investments, the interest may be deducted as investment interest.

To qualify for this exception, you must meet the following criteria:

- The investment must be purchased with the actual money that was borrowed.
- The interest on the debt must actually be paid by you and not added to the debt.
- The investments cannot be tax-exempt securities.
- You may be required to show that the check received from the insurance company was deposited directly into a brokerage account to buy the investments.

The bottom line is that you must make sure you keep all supporting documentation, in order to prove to the IRS that the money was used specifically to purchase investments. ♦