

Providing for Your Child's Education: An Educational Funding Review

Do you know the value of a college education?
Have you developed a plan to pay for your child's higher education?

Prepared for:

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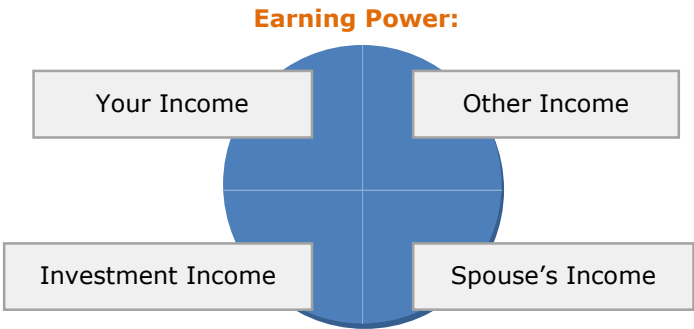
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Your Earning Power

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.



How Much Will You Earn in a Lifetime?

Years to Age 65	Your Future Earning Power If Your Family Income Averages:			
	\$50,000	\$100,000	\$250,000	\$500,000
40	\$2,000,000	\$4,000,000	\$10,000,000	\$20,000,000
35	1,750,000	3,500,000	8,750,000	17,500,000
30	1,500,000	3,000,000	7,500,000	15,000,000
25	1,250,000	2,500,000	6,250,000	12,500,000
20	1,000,000	2,000,000	5,000,000	10,000,000
15	750,000	1,500,000	3,750,000	7,500,000
10	500,000	1,000,000	2,500,000	5,000,000
5	250,000	500,000	1,250,000	2,500,000

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 Charges (2019-2020) for a Full-Time Student to Attend a Four-Year College

	Annual Cost
Public School:	
Resident Student *	\$21,950
Commuter Student **	\$10,440
Private School:	
Resident Student *	\$49,870
Commuter Student **	\$36,800

* Includes tuition, fees, room and board; in-state residency is assumed for public schools.

** Includes tuition and fees only.

Source: The College Board Trends in College Pricing 2019

Note: While these are the average published tuition, fee and room and board charges, many students actually pay less due to grant aid and federal tax benefits.

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

According to the College Board's 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% 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, which rose to \$110,900 for those with a professional degree.

As further proof of the value of an investment in higher education, Education Pays 2016 reports that "in 2015, median earnings were 84% (\$23,200) higher for females age 25 to 34 with a bachelor's degree or higher working full time year-round than for those with only a high school diploma; the premium for males was 75% (\$26,200)."

What Is the Impact of Inflation on College Costs?

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

For the 12 months from January 2019 through December 2019, the inflation rate was 1.8% (source: Consumer Price Index; CPI-U; Percent Change January 2019 through December 2019). For a similar period of time, tuition and fees at four-year colleges increased an average of 2.3% at public colleges and 3.4% at private nonprofit colleges (source: The College Board Trends in College Pricing 2019).

Over the past decade (2009-10 to 2019-20), total in-state tuition and fees at four-year public colleges have increased an average of 2.2% per year **beyond inflation**, while tuition and fees at private nonprofit four-year colleges have increased an average of 1.9% per year **beyond inflation** (source: The College Board Trends in College Pricing 2019).

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

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

	Today's Average Annual Cost	Average Annual Cost in 10 Years Assumed College Inflation Rate:			
		3%	4%	5%	6%
Public College:					
Resident Student *	\$21,950	\$29,499	\$32,491	\$35,754	\$39,309
Commuter Student **	\$10,440	\$14,030	\$15,454	\$17,006	\$18,696
Private Nonprofit College:					
Resident Student *	\$49,870	\$67,021	\$73,820	\$81,233	\$89,310
Commuter Student **	\$36,880	\$49,564	\$54,591	\$60,074	\$66,046

* Includes tuition, fees, room and board; in-state residency is assumed for public schools.

** Includes tuition and fees only.

Source: The College Board Trends in College Pricing 2019

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

Years Until College	4-Year Total Cost		Monthly Savings	
	Public	Private	Public	Private
1	99,338	225,694	8,016	18,212
2	104,305	236,978	4,062	9,228
3	109,520	248,827	2,743	6,232
4	114,996	261,268	2,083	4,732
5	120,747	274,334	1,687	3,832
6	126,784	288,051	1,422	3,231
7	133,123	302,453	1,233	2,801
8	139,779	317,576	1,090	2,477
9	146,767	333,452	979	2,225
10	154,104	350,122	890	2,023
11	161,809	367,627	817	1,857
12	169,899	386,007	756	1,718
13	178,394	405,307	704	1,600
14	187,314	425,574	659	1,498
15	196,680	446,854	621	1,410
16	206,515	469,198	586	1,332
17	216,841	492,658	556	1,263
18	227,682	517,289	529	1,201
19	239,066	543,155	504	1,145
20	251,020	570,312	482	1,095

Based on the College Board's Trends in College Pricing 2019, which estimates that annual costs for a full-time student average \$21,950 at public colleges and \$49,870 at private nonprofit colleges (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 college.

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 to Minors Act (UGMA) or, in some states, under the Uniform Transfers to Minors Act (UTMA), you can realize any available tax savings and still maintain some control of the funds.

Transferring Funds to Children

Each parent and grandparent can gift up to \$15,000 in 2020 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 education purposes and benefit from tax-deductible loan interest.

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 in 2020, including the American Opportunity Tax Credit, the Lifetime Learning Credit, Qualified State Tuition Programs and Education Savings Accounts. In addition, interest paid on qualified education loans is deductible up to specified limits.

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

Education Tax Incentives Available in 2020

American Opportunity Tax Credit (AOTC)

- May be elected during all four years of a taxpayer's, spouse's or dependent's college education.
- Tax credit of up to 100% of the first \$2,000 and 25% of the next \$2,000 of qualified tuition and related expenses paid in 2020 (maximum of \$2,500). Phased out as adjusted gross income exceeds \$80,000 for single taxpayers and \$160,000 for married couples filing jointly.
- Assuming certain conditions are met, 40% of the credit is refundable to lower income earners who pay little or no income tax.

Lifetime Learning Credit

- Equal to 20% of the first \$10,000 of qualified tuition and related fees paid for all eligible students in 2020 (maximum of \$2,000). Phased out as 2019 adjusted gross income exceeds \$59,000 for single taxpayers and \$118,000 for married couples filing jointly.
- Available for undergraduate, graduate-level and course work that improves job skills.
- Either the AOTC or Lifetime Learning Credit may be taken for the same student in any one year, but not both.

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. Phased out as adjusted gross income exceeds \$95,000 for single taxpayers and \$190,000 for married couples filing jointly.
- While contributions are non-deductible, earnings are not taxed and withdrawals are excluded from income, provided they are used for qualified education expenses. An AOTC or Lifetime Learning credit can also be claimed for the eligible student in the year of withdrawal if the withdrawal and the credit cover different eligible expenses.

Withdrawals from IRAs

- Amounts can be withdrawn penalty-tax-free from an IRA for higher education expenses of the taxpayer and the taxpayer's spouse, child and grandchild. Income tax, however, may be payable on all or a portion of the distribution.

Student Loan Interest Deduction

- Up to \$2,500 can be deducted in 2020 for interest paid on qualified education loans if income limits are met.
- The income phase-out ranges for the deductibility of interest paid on qualified education loans in 2020 are equal to \$70,000 to \$85,000 for single filers and \$140,000 to \$170,000 for joint filers.

Understanding Education Savings Accounts

Eligibility:

Single taxpayers with adjusted gross income of up to \$95,000 or married couples filing jointly with adjusted gross income up to \$190,000 may contribute up to \$2,000 per beneficiary (generally a child under age 18) per year to an Education Savings Account. The age 18 restriction is eliminated in cases where a beneficiary has "special needs." Contributions for the tax year may be made by April 15 of the following year. The contribution amount is gradually reduced to zero for adjusted gross income levels between \$95,000 and \$110,000 for single taxpayers, and between \$190,000 and \$220,000 for married couples.

Deductibility:

Contributions to an Education Savings Account are not deductible. Instead, earnings grow tax-deferred and are distributed tax free, provided they are used to pay the beneficiary's post-secondary education expenses.

Distributions:

Distributions from an Education Savings Account are not included in gross income to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year in which the distribution is made. Qualified education expenses for which non-taxable withdrawals can be used include expenses for qualified elementary and secondary schools (grades K-12; public, private or religious), in addition to the expenses of higher education. Qualified education expenses include tutoring, room and board, uniforms, computers and extended day program costs.

The AOTC or Lifetime Learning credits are coordinated with the tax exclusion for Education Savings Account distributions, meaning both can be used in the same year, so long as the credit and the exclusion cover different expenses.

If total distributions exceed qualified higher education expenses during the tax year, a portion of the Education Savings Account earnings will be included in income and may be subject to a 10% penalty tax.

Understanding Qualified State Tuition (Section 529) Programs

Eligibility:

There are no income or age restrictions on participating in a qualified state tuition program, also known as a 529 plan. In addition, some state plans are available to non-residents of that state.

Contributions:

The maximum amount that can be contributed to a 529 plan varies from state to state, but can be substantial.

Deductibility:

Contributions to a 529 plan are not deductible for federal income tax purposes. Some states, however, allow residents to deduct contributions from state tax returns.

Earnings:

Earnings on 529 plan contributions grow tax free for as long as the money remains in the plan.

Distributions:

Qualified distributions: If used to pay for qualified higher education expenses (e.g., tuition, fees, books, supplies, computers and computer technology), distributions from both state-sponsored and privately-sponsored tuition plans are free from federal income tax. In addition to being used to pay for qualified college education expenses, up to a \$10,000 distribution may be taken each year to pay expenses incurred by the attendance of a designated beneficiary at a public, private or religious elementary or secondary school, as well as to cover the cost of apprenticeship programs.

Non-qualified distributions: The earnings portion of the distribution is subject to federal income tax plus a 10% penalty tax.

Flexibility:

- The donor remains in control and decides when withdrawals are taken and for what purpose.
- Amounts can be rolled over tax free from one 529 plan to another as often as once every 12 months without the need to change beneficiaries. Rollovers may also be made from a 529 plan to an ABLE program, which is a tax-favored savings program for disabled individuals.
- States offering prepaid tuition plans generally will allow the value (as determined by the state) to be transferred for use at a private or out-of-state school.
- The 529 plan owner may withdraw up to \$10,000 tax-free for payments toward qualified education loans. This is a lifetime limit that applies to the 529 plan beneficiary and each of their siblings.
- The qualified beneficiary of the plan can be changed at any time.
- While subject to income tax and possibly a penalty tax (see above), non-qualified withdrawals can be made from the plan for any purpose.

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 already accumulated, determine the amount you must systematically save, based on an assumed interest rate, in order to reach your educational funding goal.

The Plan...

- ☐ Evaluate and select appropriate educational funding vehicles, 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

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, VSA, L.P. is not engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

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