

Start a College Fund: 8 Strategies

Section 529 Plans[#]

Section 529 plans are named after the tax code that governs them. Almost all 50 states offer the plans, and rules vary by state. In many cases, you don't have to be a state resident to take advantage of them; in fact you can invest in multiple 529 plans in multiple states, if desired. There are two types of 529 plans.

#Offered by properly licensed registered representatives.

College Savings Plans

Generally, college savings plans offer tax-deferred earnings, since 2002, distributions from qualified state tuition plans are tax free if used to pay for qualified higher education expenses (some states offer tax exemptions and deductions, so check around). Depending on the state, maximum contribution amounts range from a low of \$100,000 to over \$250,000^{##}. The account owner keeps control of the assets; for gift tax purposes, he or she can contribute up to \$11,000 per year without any gift tax consequences. Under a special gift tax rule, he or she can make a single contribution of up to \$55,000 (\$110,000 jointly) and treat the contribution as if it was made over a five year period*. You give up the right to manage the money, through; a portfolio manager invests in several mutual funds. Please keep in mind that the underlying investment options are subject to market risk and will fluctuate in value. Other unusual 529 plan details include: You can name yourself the account owner and beneficiary in planning for your own educational expenses. (You can also withdraw funds for non-educational expenses, but the earnings are subject to income tax, and a 10% tax penalty applies.) You can also rename beneficiaries. Also, some states let the account owner be a friend as well as a relative. Some states offer tax deductions to residents who contribute to their 529 plans. Keep in mind that there are fees and expenses and tax ramifications associated with 529 plans that you should take into account before choosing a 529 plan. (The tax bill exempting earnings on qualified withdrawals from federal income tax expires on 12/31/2010, requiring the government to take some further action to secure these provisions prior to this date in order for them to remain in effect following 12/31/2010. State tax treatment varies.)

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*Note that if death occurs within five years of making an accelerated gift, the estate receives only a pro-rated gift exclusion based on the number of years survived.

Potential investor of 529 may get more favorable tax benefits from 529 plans sponsored by their state. Consult your tax advisor for how 529 treatment would apply to your particular situation.

^{##}All Assets, including earnings, under all 529 plan accounts established for the benefit of a particular beneficiary must be aggregated when applying the limit. New contributions will not be allowed once this limit is reached. Earnings, however, will continue to accrue. Maximum contribution limits are adjusted periodically.

Please contact your financial professional for more information on 529 plans and/or obtain the appropriate disclosure statements and the applicable prospectuses for the underlying investments of the 529 Plans available. Investors are asked to consider the investment objectives, risks, charges and expenses of a portfolio carefully before investing or sending money. The disclosure statements and prospectuses contain this and other information about the investment options and their underlying investments. Please read this material carefully before investing or sending money.

Pre-Paid Tuition Plans

Some state universities have set up innovative programs where college expenses may be paid in installments over many years, or in a lump sum prior to attending the school. The advantage is that you can lock in the current price. Again, earnings are tax-deferred, and since 2002, distributions are excludable from gross income if used to pay for qualified higher education expenses. This may be a convenient way to meet expenses, but it takes the choice of school away from your child. If your child chooses not to attend the state university, it may be a problem.

Coverdell Education Savings Accounts

You can put up to \$2,000 per year into a Coverdell Education Savings Account (formerly known as Educational IRAs) for each child, until he or she is 18. There are limitations: The contributor (if married, filing jointly) can have an adjusted gross income of no more than \$190,000 (\$95,000 if single) before the contribution amount begins to decline. It is phased out completely at \$220,000 and \$110,000 respectively. Money contributed to a Coverdell Education Savings Account will grow, tax-deferred, and may be withdrawn federal tax-free for any qualified higher education expense incurred by the child before age 30. After that time, the account owner will incur a 10% tax penalty with the required withdrawal, and earnings are taxed as income. There are still state taxes. The account owner can retain control of the money in the account, if desired. The beneficiary can even be renamed in some cases.

The Uniform Transfers to Minors Act (UTMA) and the Uniform Gift to Minors Act (UGMA)

These custodial accounts allow you to set up an account in the child's name. You can make a transfer of up to \$11,000, per year per child, without affecting your lifetime estate or gift tax exemption. Since your spouse can do the same, together you can give each of your children up to \$22,000 per year, shifting all or part of the investment earnings to the child's tax rate, which may be lower than your own. Even if your transfer is less than \$11,000, the strategy may offer potential tax benefits. There are no lifetime limits on contributions. Because you may pay tax on part or all of the accounts' earnings (due to the "Kiddie Tax"), you might want to shoot for long-term growth.

Setting up an UTMA account in a child's name is easy. The account will involve a custodian; your registered representative can guide you in completing the application. Separate accounts are required for transfers to each child. Be sure to provide the child's Social Security number (not that of the person making the gift or of the custodian). The custodian will have full authority to make decisions, including control over the assets. Since transfers must be permanent, parents can't gain access to the money for their own use. Also, all assets in the UTMA account will belong to the child when he or she reaches the age of majority. You may also want to consider the possibility that assets held in your children's names could affect the level of financial aid they'll be eligible to receive when they apply to schools.

Loans

These days, most people borrow at least a portion of the money needed to cover college expenses. You may want your children to look for student loans with special lower rates and repayment terms for college.

The government offers Parent Loans to Undergraduate Students (PLUS Loans), where eligible parents can borrow the full amount of the tuition of a dependant child from the federal government at rates not exceeding 9%. For details, check out the U.S. Department of Education's site at www.ed.gov.

Stafford Loans, named for Vermont Senator Robert Stafford, are low-interest loans for students. You apply at any financial institution or the U.S. government, depending if they are Direct or FFEL (the Federal Family Education Loan) Stafford loans. Again, more information is available at www.ed.gov.

Named after former Kentucky representative Carl Perkins, a Federal Perkins Loan is a low-interest (5%) loan for both undergraduate and graduate students with exceptional financial need (with household income under \$30,000). You borrow directly from your school.

Interests on student loans may be deductible as well – up to \$2,500 annually of interest on student loans. To read more about student loans from a tax standpoint, go the "Forms and Publications" section of the IRS Web site.

However, repaying a large loan for many years after graduation can be a burden for some recent graduates. Tapping into your 401(k) plan may be an option, but you may want to take a loan rather than a withdrawal to avoid tax consequences. Of course, a loan will impede the potential growth of your retirement nest egg.

You may want to take a look at your permanent life insurance policies, such as whole life, universal life, and variable universal life, which offer cash value accumulation in addition to their essential financial protection. Over the long term, the cash value accumulation may be

significant enough to be borrowed against to help fund a portion of college expenses if it is determined that the full death benefit is no longer needed. And the interest rates may be a lot lower than a loan from a bank. In addition to accruing interest, policy loans against the cash value reduce the available death benefit and cash value by the amount of the outstanding loan and interest.

Investments

You can invest money in an account earmarked for your child's education costs. Generally, it is better to invest when the child is young (less than 5 years old).

Many people buy zero-coupon Treasuries – known as STRIPS (separate trading at registered interest and principal of securities) – as they are backed by the U.S. government and are non-callable, which means they can't be called, or redeemed, before the maturity date.

There are also savings bonds, including the Series EE Savings Bonds, or education bonds.

Grants

The U.S. Department of Education has the following Student Financial Assistance Programs:

A Federal Pell Grant, unlike a loan, does not have to be repaid. Pell Grants are awarded only to undergraduate students who have not earned a bachelor's or professional degree. For more information, visit the U.S. Department of Education's Pell Grant Web site.

There are also Federal Supplemental Educational Opportunity Grants, or FSEOGs, for \$100 - \$4,000. Priority is given to Pell Grant recipients. These grants do not need to be paid back. For more information, visit www.ed.gov.

Tax Credits

Tax credits are better than tax deductions, as you subtract the credit from your total taxes due.

The Hope Credit (more information at the IRS Web site) is a \$1,500 tax credit to help with the first two years of tuition.

For junior and seniors and continuing education students, the Lifetime Learning Credit (more information available at the IRS Web site) is \$1,000 (20 percent of tuition up to \$5,000). The maximum credit is \$2,000 (20 percent of up to \$10,000 of tuition).

With both programs, your income must not exceed a certain amount to qualify. In 2005, these credits were phased out for single taxpayers with adjusted gross income between \$43,000 and \$53,000, and for married taxpayers filing jointly with adjusted gross income between \$87,000 and \$107,000. These two credits cannot be claimed if you are married and file separately.

Financial Aid

There are billions of dollars available each year in scholarships, grants, and work-study programs. Financial aid to middle income families may be tough to come by, but some universities are more willing to offer generous financial aid packages. There are literally thousands of different types of aid programs available, in three general categories: federal, state and campus-based grants (grants are free money generally offered on a financial-need basis); student loan programs (from special rate guarantees to special repayment schedules); and "special situation" scholarships (given for achievement without regard to income or assets). It's certainly worth contacting your child's high school and prospective college financial aid office to see if you're eligible.

- **Helpful Hint...**

Insure your ability to help pay your children's college expenses. Your role in providing financial support is crucial. Life insurance can help assure that, if you die and, as a result, your income is lost, your children's dreams of college degrees need not be lost as well.