Financial Planning
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College Strategies: Best Way to Help With the Tuition Bill

College costs have almost hit the absurd. For the 2014-15 school year, tuition, room and board averaged $42,419 for students at private, four-year colleges; $32,762 for out-of-state students at four-year public-colleges; and $18,943 for in-state students at public four-year colleges, according to the College Board.

It's almost impossible for many parents to cover 100% of tuition and other costs. That's where family (or even friends) may want to step in. "College planning can be quite complex," says Paul Litchfield, a wealth advisor at Ferris Capital in Marlborough, Mass. "It's not just buy a 529 plan and let it run."

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But remind clients that helping out isn't as easy as writing a check, either. Giving money the wrong way could throw off a client's taxes and hurt a student's chances for financial aid.

Here are a few strategies to help wealthier clients pay for a non-child's college — without wrecking that child's chances for aid.

529 EDGE FOR GIVERS

Section 529 plans are particularly attractive to wealthy clients because of high contribution limits, potential state-level income tax deductions and the ability to use them as a part of estate planning.

But there are several complications grandparents and other would-be benefactors should understand. For instance, any student's 529 plan contributions will be capped — generally at $300,000, though limits vary by state.

High-net-worth clients should also know that giving any individual more than $14,000 per year (for 2015) by a single person or $28,000 by a married couple would trigger the gift tax.

If a client wants to give in one fell swoop, advisors can direct clients to give up to $70,000 for a single person or $140,000 for a married couple — but that's the max. In that case, "the gifts are reported as equal installments over five years," says Jake Loescher, an advisor with Savant Capital Management in Rockford, Ill. "No further gifts can be given without tax filings and offsetting the lifetime gift-tax credit amount."

That option may appeal particularly to clients with taxable estates, says Michael Brady of Generosity Wealth Management in Boulder, Colo. — since 529 plans present a way to move money out of an estate immediately.

To find the greatest tax advantages, Brady says, help clients determine whether their own state offers a local plan with an edge. For example, he says, contributions to Colorado's plan are deductible against Colorado state income tax for the calendar year the money is contributed — if the client is also a state resident.

If the in-state plan doesn't offer any local advantages, advisors can "state shop" for plans with the best investment options at low rates. Brady suggests New York's plan, which has program management fees of 0.16%.

"It's almost Vanguard level," he says.

TIMING OF DISTRIBUTIONS

If the student will also be receiving some financial aid, another key question will be when to use the money. Assets in any nonparent-funded 529 plan are not considered on a FAFSA before the money is spent — but once that first distribution gets made, it counts as income to the student. And student income reduces aid eligibility by 20%, which could mean a lot less aid for the next year.

One way to minimize the aid hit is to give money in the parents' name, up till the point at which the student files the last FAFSA form. This way, the additional money reduces aid eligibility by only 5.64%, Litchfield says.

Another strategy: If clients plan to cover part of a relative's education, and the student will be receiving some form of financial aid, have the client wait to release money from the 529 until as late as possible, Loescher says. The best-case scenario would be after the middle of the student's junior year, he adds — after students have filed their last FAFSA forms. Then that money won't be considered in calculating financial aid at all, unless the child applies to graduate school and plans to apply for financial aid there.

For clients with multiple children in their lives, 529 plans also offer flexibility in who gets the money, Litchfield says. Should the original intended beneficiary not go to college, clients can then shift funds to cover another student's college costs. "It's not use it or lose it," he says.

For clients who like flexibility — both in how they invest and how the money can be used — some advisors recommend opening Uniform Transfer to Minors Act custodial accounts — or the similar Uniform Gift to Minors Act accounts — in a child's name. (The key difference: UTMAs terminate when the child is 21 or 25; UGMAs terminate when the child is 18.)

With these accounts — which shift money to a minor (under the custodianship of an adult) without requiring an attorney — clients can invest in such products as stocks, bonds, funds, annuities and insurance policies; UTMAs also allow real estate, fine art, patents, limited partnership interests and royalties.

These accounts also offer an option for clients who want to teach children about investing, says Loescher, since the account is in the child's name, and that child can add money to it, too.

There are no contribution limits on UTMA accounts, but gift-tax limits still apply. These funds are also generally taxed like other investments: The child must pay tax annually on almost all income from dividends and interest, and capital gains taxes could be triggered if the investment is sold. "These earnings are taxed to the child, and if the total income from dividends, interest and capital gains exceeds a fairly low threshold, the income may then be subject to the nonparent's tax rate," Loescher says. For 2015, that threshold is $1,050.

The income will also be counted as student income on the FAFSA form, which could affect financial aid.

The UTMA account offers one advantage, though — particularly if clients aren't sure the recipient will actually need the help.

With 529 plans, investors face a 10% penalty and must pay taxes on any earnings from a 529 used for nonqualified college expenses. But with a UTMA account, if a student doesn't need the money for tuition, it can go toward other expenses — a car, living expenses, a semester abroad, food from anyplace other than the cafeteria — so the student doesn't also need to work while in school.

CASH DRAWBACKS

Of course, some clients may just want to write a check to help students with school costs — but cash, too, comes with strings attached.

Once a student is in school, Loescher says, clients should write the check directly to the school to be applied to a child's tuition. "It never counts as a gift to the child," he says, which means that gift-tax limits aren't applicable.

However, a college could count that money coming directly to them when calculating the student's financial aid the following year. If the students are receiving financial aid and can afford to wait, clients should time the gift to the second half of the junior year or later.

Loescher offers one more suggestion for clients who should be more focused on saving for their own retirement. If would-be benefactors are early into retirement or still figuring out if they've saved enough, they can help graduates by offering to pay off loans once the clients know their own future is secure.

"You have to assess with [your clients] whether or not they're able to give financial gifts, and make sure their own retirement is intact before they start giving away the farm," he says.

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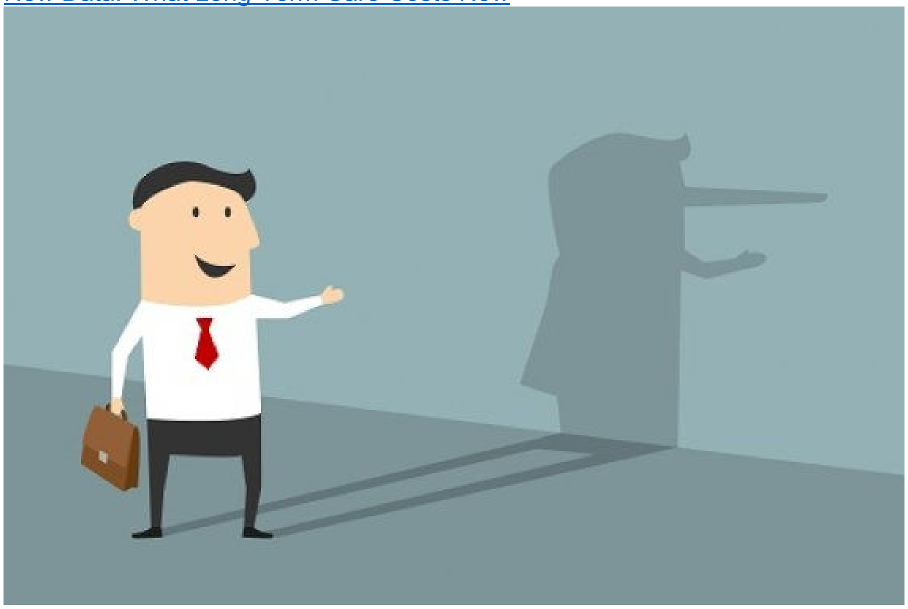

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