

# College Planning: Know the Rules for Education Funding

Charlotte A. Dougherty, CFP®  
Dougherty & Associates

4030 Smith Rd.  
Suite 400  
Cincinnati, OH 45209

513-745-7007

charlotte@dougherty-associates.com  
www.dougherty-associates.com



Dougherty & Associates  
WEALTH PLANNING & MANAGEMENT

By Amy E. Buttell

**As college tuition continues to skyrocket, it's becoming more important than ever to know how the various savings plans work. This handy reference outlines the latest rules on the most popular college savings programs, and how to use them to save money on your children's education.**

Aside from retirement, saving for a child's college education is one of the biggest expenses a family encounters. And with college savings vehicles multiplying all the time and tax laws changing, the landscape of college education funding rules can be downright bewildering.

In deciding how much to contribute to college savings accounts, when to contribute, and where to invest those contributions, you'll need to remain aware of all your options and their accompanying rules. Hence, this handy guide.

## College savings plans

The biggest college savings plans are the Qualified Tuition Programs (QTPs) or Section 529 plans, education savings accounts (ESAs) or Coverdell savings accounts, and the Education Savings Bond program.

As the cost of college continues to climb, these college savings vehicles keep gathering assets. The College Savings Plan Network reported in March 2013 that 529 savings plan assets grew by 15.7% to \$190 billion in 2012. Fiscal Cliff legislation enacted in January permanently extended what were previous temporary enhancements to Coverdell Savings Accounts. Parents and grandparents can continue to contribute \$2,000 a year to a Coverdell account and use those funds for kindergarten through 12 grade expenses.

## College Savings Programs

	<b>Section 529 Plans (Qualified Tuition Programs)</b>	<b>Coverdell savings accounts</b>	<b>Education Savings Bond Program</b>	
	529 College Savings Plans	529 Prepaid Plans	Series EE or Series I	
<b>Contribution limit</b>	Amount necessary to pay for qualified educational expenses	Amount necessary to pay for qualified educational expenses	\$2,000 a year per beneficiary	\$10,000 face value per year per owner per type of bond
<b>Who can contribute or purchase</b>	Anyone	Anyone	Anyone whose MAGI is less than \$110,000 single or \$220,000 joint for the year; also organizations, such as corporations and trusts (no income-related requirement)	Parent, spouse of student, or student; must be at least age 24 on bond issue date; married parents must file jointly
<b>Account ownership</b>	Parent or guardian	Parent or guardian	“Responsible individual” (generally the parent or guardian)	If purchased by parents, must be registered in parents’ names (child cannot be listed as co-owner)
<b>Tax deductibility</b>	Not on federal level; state deduction depends on plan	Not on federal level; state deduction depends on plan	No federal or state tax deduction	Income exempt from state and local taxes; federal exemption phases out at MAGI of \$89,700 single, \$142,050 joint
<b>Beneficiary change</b>	Can be changed to any relative of initial beneficiary	Can be changed to relative of initial beneficiary	Can be changed to relative of initial beneficiary	Can be changed to another beneficiary
<b>Financial aid treatment</b>	Asset of parent	Asset of parent	Asset of account holder; low impact on dependent student owners	Asset of bond owner
<b>Contribution income limits</b>	None, although states set limits on total contributions ranging from \$200,000 on up	None, although often limited to current cost of 4-year degree program	Contribution limit reduced for MAGI between \$95,000-\$110,000 single, \$190,000-\$220,000 joint	Income phaseouts based on year redeemed—not purchased. Contribution limit begins to phase out for MAGI of \$74,700 single and head of household, \$112,050 joint
<b>Rollover eligibility</b>	Can be rolled over to another 529 plan without penalty once every 12 months	Can be rolled over to another 529 plan without penalty once every 12 months	Can be rolled over to a 529 plan or another Coverdell for same beneficiary or another in beneficiary’s family who is under age 30	Can redeem and roll proceeds over to 529 plan
<b>Distributions/ Interest</b>	Not taxed if used for qualified purpose; non-qualified subject to income tax and 10% penalty	Not taxed if used for qualified purpose; non-qualified subject to income tax, 10% penalty	Not taxed if used for qualified purpose; non-qualified subject to income tax and 10% penalty; distributions must be taken by the time beneficiary reaches age 30	Interest exempt from state and local taxes; no federal tax if used for qualified purpose and MAGI is below \$89,750 single, \$142,050 joint

Sources: “IRS Publication 970; “Tax Benefits for Education,” IRS; FinAid; SavingforCollege.com; Sallie Mae

Copyright © 2013 by Horseshoeth, LLC. All Rights Reserved.

**IMPORTANT NOTICE** This reprint is provided exclusively for use by the licensee, including for client education, and is subject to applicable copyright laws. Unauthorized use, reproduction or distribution of this material is a violation of federal law and punishable by civil and criminal penalty. This material is furnished “as is” without warranty of any kind. Its accuracy and completeness is not guaranteed and all warranties expressed or implied are hereby excluded.

## Student loan availability and limits

For many children of high-net-worth families, much of a financial aid package from colleges comes in the form of student loans. These loans take a variety of forms and have limits on how much a student or parent can borrow, the interest rates charged, and repayment terms.

An important distinction with student loans is whether they are “subsidized” or not. Interest on

unsubsidized loans starts accruing when the loan is disbursed, although no payments are required while the student is enrolled in school at least half time (unpaid interest is capitalized at the end of the grace period). Interest on subsidized loans does not accrue while the student is enrolled at least half time. With both types of loans, payments must start six months after graduation (nine months for Perkins loans) or after dropping to less than half-time status.

### Student Loan Options

Loan Type	Source	Limits		Interest rates (2013-2014 school year)	Repayment
<b>Undergraduate Stafford, dependent students</b>	Federal government	1st yr	\$5,500 (\$3,500 subsidized, \$2,000 unsubsidized)	3.86% subsidized; 3.86% unsubsidized, plus 1% loan fee	6 months following graduation or if enrollment drops below half time
		2nd yr	\$6,500 (\$4,500 subsidized, \$2,000 unsubsidized)		
		3rd & 4th yrs	\$7,500 (\$5,500 subsidized, \$2,000 unsubsidized)		
		Lifetime limit	\$31,000 (up to \$23,000 subsidized)		
<b>Undergraduate Stafford, independent students</b>	Federal government	1st yr	\$9,500 (\$3,500 subsidized, \$6,000 unsubsidized)	3.86%, subsidized; 3.86% unsubsidized, plus 1% loan fee	6 months following graduation or if enrollment drops below half time
		2nd yr	\$10,500 (\$4,500 subsidized, \$6,000 unsubsidized)		
		3rd & 4th yr	\$12,500 (\$5,500 subsidized, \$7,000 unsubsidized)		
		Lifetime limit	\$57,500		
<b>Graduate Stafford, subsidized and unsubsidized</b>	Federal government	Graduate	\$20,500 (\$8,500 subsidized, \$12,000 unsubsidized)	5.41%	6 months following graduation or if enrollment drops below half time
		Lifetime limit	\$138,500 (up to \$65,000 subsidized) or \$224,000 (health professionals)		
<b>Perkins loans</b>	Federal government	Undergrad limit per year	\$5,500	5%	9 months following graduation or if enrollment drops below half time; repayment assistance available in exchange for service (i.e., certain teaching positions, military, etc.)
		Grad limit per year	\$8,000		
		Undergrad limit	\$27,500		
		Combined undergrad and grad limit	\$60,000		
<b>PLUS loans for parents and grad students</b>	Federal government	Student's cost of attendance minus other financial aid		6.41% plus 4% loan origination fee	Can make payments during school or defer to graduation; interest accrues on disbursement
<b>Private or alternative loans</b>	Financial services companies incl. banks, credit unions	Student's cost of attendance		Variable rates (Prime or Libor plus or minus a margin) depending on credit score, origination, and other fees	Immediate or deferred, depending on lender and terms

Sources: FinAid; SavingforCollege; Sallie Mae

## Education tax credits

Fiscal cliff legislation extended the American Opportunity Tax Credit for an additional five years. Eligible taxpayers can claim only one of these credits in a given tax year for a single student. However, if a taxpayer claims two eligible students on a return, one credit can be claimed for each student.

Credits can be selected on a per-student, per-year basis, which means taxpayers can switch between the American Opportunity Credit and the Lifetime Learning Credit for their children in different tax years, if they desire to do so. The HOPE Credit still exists, but only applies to 2008 and earlier tax years.

Education Tax Credits						
	American Opportunity Credit			Lifetime Learning Credit		
<b>Income limits</b>	Single & HOH	Credit phases out with MAGI between \$80,000 and \$90,000	Credit can't be claimed with MAGI of \$90,000 or more	Single & HOH	Credit phases out with MAGI between \$53,000 and \$63,000	Credit can't be claimed with MAGI of \$63,000 or more
	Joint	Credit phases out with MAGI between \$160,000 and \$180,000	Credit can't be claimed with MAGI of \$180,000 or more	Joint	Credit phases out with MAGI between \$107,000 and \$127,000	Credit can't be claimed with MAGI of \$127,000 or more
<b>Applies to</b>	Students pursuing a degree or federally recognized educational credential; must be enrolled at least half time; can't also claim Lifetime Learning credit for same student			Students enrolled in postsecondary education classes or those to acquire or improve job skills		
<b>Qualified expenses</b>	Tuition, fees, course materials			Tuition, fees, supplies, and equipment		
<b>Availability</b>	Only for first 4 years of postsecondary education for this and the Hope Credit			No limit		
<b>Maximum amount of credit</b>	100% of first \$2,000 plus 25% of next \$2,000 for maximum credit of \$2,500 per eligible student per year; 40% of credit is refundable (up to \$1,000)			20% of qualified expenses up to \$10,000 for maximum \$2,000 credit per tax return		
<b>Filing status</b>	Ineligible if married filing separately			Ineligible if married filing separately		

Sources: "IRS Publication 970; "Tax Benefits for Education," IRS; FinAid; SavingforCollege.com; Sallie Mae

## **Student loan interest deduction**

Eligible taxpayers are permitted to deduct a certain amount of student loan interest. You may take this deduction if the interest is eligible—that is, from a qualified educational institution and the purpose was education—and if your modified adjusted gross income is less than \$75,000 (phaseout between \$60,000 and \$75,000) for a single taxpayer and \$155,000 (phaseout between \$125,000 and \$155,000) for married filing jointly.

The maximum deduction is \$2,500 and claimed directly from gross income. The student must be the taxpayer, the taxpayer's spouse, or a dependent enrolled at least half time in a degree program. Qualified educational expenses include tuition, room and board, books, supplies, equipment, and other necessary expenses.

## **Tuition and fees deduction**

Finally, eligible taxpayers can deduct up to \$4,000 in tuition and fees (without having to itemize) from their annual tax returns if they earn less than \$65,000 single or \$130,000 joint. However, this tax break is set to expire at the end of 2013, unless Congress extends it.

---

Amy E. Buttell is a freelance journalist who lives and works in Erie, Pa. She's been published in the *Journal of Financial Planning*, the *Financial Planning Association's Practice Management Solutions Journal*, the *New York Society of Security Analysts' journal*, and *The Investment Professional*.

---

Charlotte A. Dougherty registered representative of Lincoln Financial Advisors Corp. Securities and advisory services offered through Lincoln Financial Advisors Corp., a broker/dealer (Member SIPC) and registered investment advisor. CRN201309-2085136