"How Are We Going To Pay For College?"

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BobFrohlking is a Certified Public Accountant licensed in California. He helps families develop financial strategies to navigate the college years as well as the retirement years.

1. **When you talk with parents about paying for college, what is the most important question you ask them?**

    a. How old will you be when your youngest child graduates from college?

2. **Why is this such an important question?**

    a. Most families are thinking about sending the first child through college and then the second child, but they haven't really thought through the entire process and what will happen after all the children graduate. When parents realize that they may be in their fifties or even over 60, when their youngest has graduated, they suddenly realize that paying for college has become a retirement issue. So, our goal is to help develop a plan to navigate the college years as well as the retirement years.

3. **First, can you tell us some ways to save money on college?**

    a. Finish in 4 years – it goes without saying that an extra year or two will increase costs by 25 -50%. That's why choosing the right college is so important – to avoid transferring or dropping out!
    b. AP & IB Tests - Advanced Placement or International Baccalaureate - If your student took AP or IB classes in HS, check with each individual collegeto see their policy on accepting AP or IB classwork.
    c. CLEP Tests – College Level Examination Program
        i. These tests are unfamiliar to many families.
        ii. The CLEP Test is administered by the College Board.

iii. Students can receive college credit for successfully passing the CLEP Test.
iv. These are courses students will generally take during their first 2 years in college.
v. Not all colleges and universities accept CLEP but many do.
vi. Check with each individual college to see their policy on CLEP tests.

d. Community College – Starting out in Community College provides Excellent opportunities for students.

4. Do you have any advice for Students who will be attending Community College?

a. Treat it as college and not “grade 13.”
b. Be involved in campus activities because this may help you get priority class registration.
c. Take advantage of any internship opportunities that may be available.
d. Use the on-campus academic counseling department to learn exactly what classes you will need to complete your associate’s degree and find out all the options for transferring to either a 4 year State university or a private college or university.

5. The US government provides some tax credits and tax deductions which families can take on their Federal Income Tax Return.What is the difference between a tax credit and tax deduction?

a. A tax credit reduces the amount of income tax you may have to pay unlike a deduction which reduces the amount of income subject to tax.

6. Can you tell us about the two Education Tax Credits?

a. The American Opportunity Credit and the Lifetime Learning Credit.

7. What are the highlights of the American Opportunity Credit?

a. Up to $2,500 credit per eligible student – this means that if the family has 2 students in college who qualify for the maximum amount of the American Opportunity Credit, the family will receive a $5,000 tax credit on their tax return.
b. It is only available for 4 years of undergraduate study.
c. Student must be in a degree program and enrolled at least half time.

d. Student must have qualified expenses which would include tuition, fees and books.
e. 40% of the credit is refundable, which means even if the family doesn't owe any tax, they could still receive up to $1,000 cash.
f. There are income limits to receive the credit. If the family files married filing joint, the credit phases out when their Modified Adjusted Gross Income is over $180,000.
g. Here is an example – The Family has MAGI income of $150,000&2 children in college. Each student is eligiblefor the maximum American Opportunity Credit of $2,500 - for a total credit of $5,000. The Parents owe tax of $5,000. The Tax Credit of $5,000 would go directly against the Tax owed with a result of zero tax owed.
h. Refundable Credit Example – If a family owes no tax and has one student eligible for the$2,500 American Opportunity Credit, the family would receive a $1,000 check from the government (40% of the American Opportunity Credit is Refundable.)

8. Can the American Opportunity Credit be used for Community College?

a. Yes, The American Opportunity Credit can be used for Community College expenses, so even if the student receives no Financial Aid, the American Opportunity Credit can really help. For example, the national average for one year of Community College is $3,347. If the student can take advantage of the eligible American Opportunity Credit, the credit will be $2,337 which reduces the tuition and fees to $1,010.

9. What about the Lifetime Learning Credit?

a. The Maximum credit is $2,000 per return – for qualifying expenses such as tuition, fees, and certain related expenses required for enrollment.
b. Available for all years of postsecondary education and for courses to acquire or improve job skills.
c. There is no limit on the number of years the lifetime learning credit can be claimed for each student.
d. There are Income Limits to receive the credit. If the family files Married Filing Joint, the credit phases out when their Modified Adjusted Gross Income is over $128,000.

e. There are no double benefits allowed. A student can receive either the American Opportunity Credit or the Lifetime learning Credit in the same tax year, but not both.

10. Let's move on to the Tuition & Fees Deduction. First of all, what is a Tax Deduction?

a. A deduction reduces the amount of income subject to tax.

11. What can you tell us about the Tuition & Fees Deduction?

a. You can reduce your income subject to tax by up to $4,000.
b. The deduction phases out with a Modified Adjusted Gross Income of $160,000.
c. You can deduct Tuition and Related Fees. Books are only included if you are required to purchase the books directly from the college. Purchasing books from the campus bookstore or online are not considered qualified expenses for this deduction.
d. One again, there is no double benefit allowed. You cannot combine the Tuition & Fees deduction with either of the Education Credits.
e. The Tuition & Fees Deductions reduces the Adjusted Gross Income.
    i. This deduction may help families receive more Need Based Aid.
    ii. For some families, reducing Adjusted Gross Income may be more beneficial than the Tax Credit.
f. Although you cannot combine the Education Tax Credits with the Tuition & Fees Deduction, you can choose which one makes the most financial sense for your family. Ask your Tax Professional.

12. What is Form 1098-T?

a. Form 1098-T is issued by each eligible institution (college) the student attends each year. The 1098-T will show:
b. The amount billed for Tuition and Qualified Expenses.
c. Payments received for Qualified Tuition and Related Expenses.
d. The amount of Scholarships and Grants received.
e. You will need Form 1098-T to prepare your 1040 tax return.

13. What is the Student Loan Interest Deduction?

a. This is a tax deduction once you start to repay your student loans.
b. You can reduce your income subject to tax by up to $2,500.
c. The loan must have been taken out to pay qualified education expenses and cannot be from a related person, like your parent or grandparent.
d. You may be able to deduct interest you pay on a qualified student loan. Generally, the amount you may deduct is the lesser of $2,500 or the amount of interest you actually paid.
e. The deduction phases out with a Modified Adjusted Gross Income of $160,000 if married filing a joint return.

14. How do I find out how much Student Loan Interest I paid?

a. You will receive a Form 1098-E, Student Loan Interest Statement. You will need this form to complete your 1040 Tax Return.

15. Where can families find out additional information about these credits & deductions?

a. Go to www.irs.gov and search for IRS Publication 970.

16. We've covered the basics of Education Tax Credits and Tax Deductions. Now the real question becomes "How are we going to pay for College?" Do you have any ideas that can benefit every family as they are planning for college?

a. Yes, the first thing is to use EFC calculators to arrive at the Expected Family Contribution. The EFC determines how much money the family will have to pay.
b. Net Price Calculator - Each college website has a Net Price Calculator on their website. This helps families determine how much the college will cost them based on the financial information that they enter into the Net Price Calculator.
c. Monthly Cash Flow - Can you free up money for college?
   i. Is there a way to increase income coming into the household?
   ii. Can you generate additional income from your existing job? For example, can you work an extra shift once or twice a month? Work overtime?
d. Do you know where you spend your money?
   i. Is there a gym membership that is automatically withdrawing money from your bank account, but nobody is using it?
   ii. Have you shopped around for auto insurance lately?

  iii. Can you increase your deductible?
  iv. Does buying or leasing a car make more sense?
  v. Do you know how much money you really spend eating out?

e. This strategy has absolutely nothing to do with receiving financial aid, but families are often surprised at the amount of money that can be freed up just by examining where they spend their money.

17. Are there any strategies that business owners can implement to help pay for college?

a. As we covered in the previous discussion of tax credits and deductions, families who earn over the Phase Out amounts need to find other ways to manage education expenses. These include income shifting techniques. One income shifting technique is hiring your child in your business. If you are a sole proprietor, or a corporation you may be able to hire your child. It can be a good tax planning strategy and great way to teach them about business.

18. How do you hire your child?

a. There are very specific steps that the business owner needs to take to follow.
b. The youngest age for hiring your children is 7 years old (can be even younger if used for advertising)
c. Duties must be in connection with the business and age appropriate. Wages must also be appropriate for the duties performed.
d. This strategy is beneficial to business owners whose income is too high to receive Need Based Aid. The child can then help pay for college out of their earnings.
e. This strategy is also beneficial for Middle Income Business owners. It may reduce their AGI and increase their eligibility for Need Based Aid.

19. What are some of the Benefits?

a. Shifts income from the parent’s higher bracket to child’s lower tax bracket. The family has saved on taxes and can use the child’s earnings to pay for college.
b. Tax Savings - If you are self-employed and your child is under age 18, you generally don’t pay Social Security or Medicare payroll taxes on their wages and if they are under age 21 you don’t generally have to pay unemployment taxes on them.
c. Reduce AGI - Additionally, paying your child may reduce your own AGI which could allow you to claim other tax deductions and credits for which you might not

otherwise qualify. Reducing your AGI may increase your eligibility for Need Based Aid.

d. Earned Income - Because the student has earned income, money can be contributed towards an IRA that can later be used for education.

20. What are some examples of jobs children could do?

a. Web Design, Social Media Marketing or Advertising
b. Record Keeping &Filing
c. Clean-up
d. Office Work
e. Working alongside the parent at the job site

21. How do you implement this strategy?

a. There are very specific IRS rules that need to be followed.
b. Job Description - Draw up an employment agreement documenting the duties your child will perform and a reasonable wage.
c. Employment Forms- Make sure you have completed all the necessary hiring forms including Employment Application, W-4 and I-9 Forms.
d. Set up a separate bank account in the child's name – separate from the parent's bank account.
e. The child must fill out a time sheet.
f. Pay the child with a business check and deposit into child's account.
g. Payroll Service - I recommend having a Payroll Service prepare allthe Payroll Reports and issue the W-2.
h. Tax Preparer - Have your tax preparer fill out the child's 1040 tax return.

22. What is another strategy a business owner could use?

a. Tuition Reimbursement Plan – IRS Section 127 plan – This is a fringe benefit supplied by the Employer for employees who want to further their college studies. It is a way to pay for college using money that has never been taxed.

23. What are the benefits to the employee&employer?

a. It is a Tax Free Benefit to the Employee – The employee does not have to report the amount of education assistance as income on his tax return – up to $5,250 per year.
b. It is a Tax Deduction for Employer - Employer receives a current tax deduction for the education assistance paid.

24. How do you implement this strategy?

a. Once again you need to follow all the IRS guidelines.
b. Complete all necessary Employment Documents - Make sure you have completed the necessary Employment documents W-4, I-9, etc
c. Use Company Check - Make sure to use a company check when you reimburse the employee or the education provider directly for the cost of the tuition and fees.
d. Deduct on Business Tax Return - Make sure that the cost of the education assistance plan benefits is properly reported on the business IRS tax return.
e. The employee must be at least 21 and cannot be your dependent.
f. The benefit must be available for all eligible employees.

25. Let's focus on some strategies that families can use if their income is too high to receive any need based financial aid. I've heard of Gifting Appreciated Assets. What does this mean?

a. This is really a tax savings and income shifting strategy used to maximize the funds available for a child's college tuition because the income tax is typically less when the income generated by the appreciated assets is taxed to the child rather than the parents.

26. How does it work?

a. First, we must understand the IRS tax code relating to gift tax. A person can gift $14,000 per year without incurring any gift tax liability or exposure. So, a married couple can gift up to $28,000 per year (each gifting $14,000 per year).
b. You can gift appreciated assets to a child – this shifts the taxable appreciation of that asset from your higher tax bracket to the child's lower tax bracket in order to reduce taxes. This is a great way to save or pay for college tuition if you planned on cashing in the asset to pay for college.

27. What are the benefits?

a. If you had already planned to use that asset for education expenses for your child or grandchild then gifting the investment to the lower tax bracket child can yield desirable tax savings.
b. You can wait and gift the investment after college to pay off student loans.
c. Let's say the family has $25,000 market value of stock which they are planning to sell to pay for college.
d. The purchase price of the stock was $13,000 and the gain is $12,000. If the parents are in the top capital gains tax rate of 20% then the amount of capital gains tax they would pay is $2,400, but, if the child is in the zero tax bracket, the child would have no capital gains tax. This is a savings of $2,400.

28. What are the steps that you need to do to make this happen?

a. Identify the assets to gift.
b. If your child is under the age of majority you may need to have your attorney draft a trust to hold title (if title is required).
c. Determine the value of the gifted asset.
d. Execute the Assignment of Interest – a legally binding document which transfers the ownership.
e. Retitle the property, if applicable.
f. File an IRS form 709 to report yearly taxable gifts over $14K – or $28K for joint gifts
g. Example – How to determine value of gifted asset such as stock. The family has stock which was purchased for $5,000 and is now worth $30,000. The Gift is valued at the original purchase price of $5,000 not the current market value of $30,000.

29. Do you have any other strategies to pay for college?

a. Yes, and this one involves Rental Properties and Real Estate.
b. Here is the how it works.

The student is in college. The family purchases a 3 or 4 bedroom home or condo close to the campus that the student is attending. The student lives there and rents the other 2 or 3 bedrooms to other students. Additionally, the student is also the landlord/ manager and performs all the duties of collecting rent and managing the property and gets paid a management fee. Now the student has earned income. He can put the money in an IRA and later use the IRA money to pay for college. The renters are helping to pay for the mortgage, the student is no longer paying room and board to the college and has earned income because he is managing the property. Once the student graduates, the home can either be sold or can continue to be rental property – although this time with a property management company. This strategy is best for families who are familiar with rental properties. In fact, if the family already has a rental property, they can use the IRS 1031 Tax–Free Like Kind Exchange to acquire the new property.

30. You talked about the student having earned income. Why is this important?

a. Earned Income can mitigate Kiddie Tax. Some of the strategies we outlined are less effective if the child's investment income is not offset by earned income.
b. Additionally, the Student's Earned Income is important for families whose income is too high for Need Based Financial Aid and too high to receive the American Opportunity Credit – remember the American Opportunity Credit phases out once the Modified Adjusted Gross Income of the family is over $180,000. If the student can document that they provide over half of their support, they can be taken off the parent's income tax return. The student can then take the American Opportunity Credit on their own income Tax Return. The credit can be as much as $2,500.

One very important item that cannot be overemphasized is that all the financial and tax strategies we have talked about must be documented and every aspect of the plan must be followed exactly - any deviation and the strategy will be disallowed by the IRS. We have outlined general strategies, but each strategy must be evaluated for each family.

Additionally, it is also important for families to check with their various insurance(s) to make sure that the student is still covered by the insurance if he or she is no longer a dependent. Check with your CPA or Tax Advisor to review all the details and determine if it is a good strategy for your family.

31. Finally, do you have any strategies for families to pay off student loans?

a. Yes, we have a strategy to pay off loans. Student loan debt is $1.2 trillion dollars in the US – more than even credit card debt. It can be crippling to students just starting out and to parents who are nearing retirement. It makes it difficult for young families to qualify for mortgages to buy their own home.
b. Our loan strategies will work on any type of loan and it all starts with cash flow.

c. It is a unique cash flow strategy that can help you accelerate debt reduction and equity growth and save a huge amount of interest expense over the life of the loan.

32. How does it work?

a. Well, it is a long term solution to paying off debt in less time and it works on any type of debt - student loans, mortgages, credit cards. The family needs positive cash flow. This means they must be able to pay more than just the minimum payments. We set up a very specific payment schedule and if followed, it can cut the repayment time by half – saving the family thousands of dollars in interest.
b. You may have heard that if you make just one extra house payment per year, you should save about 6 years on a 30 year mortgage.
c. Here is an example of our loan repayment strategy using a mortgage. You have a $300,000 mortgage with a 6% interest rate. If you were to make a once per year payment of $12,000 on the $300,000 loan, in addition to your regular monthly payment, the time it would take to pay off the loan would be about 10 years. Each year a one-time payment of $12,000 would be made. The $12,000 comes from $1,000 of cash flow put away each month for 12 months.
d. For this strategy to work, you need to generate $1000 of cash each month by reducing expenses or increasing income and a good deal of discipline. And if $12,000 one-time annual payment doesn't work for your family, then do what you can…even if it is just an annual one-time payment of $2,400. It will help.
e. This strategy is used by millions of people throughout the world where mortgage interest is not deductible on the income tax return and where the goal is to pay off the mortgage as fast as possible.
f. This strategy can be used to pay off any type of loan, including student loans and credit card debt.
g. Once again, consult with your tax and financial professionals to determine if this strategy is right for your family.

33. Do you have any final thoughts for our listeners today?

a. Yes, start planning for college early and if you haven't started yet, start now. Paying for college is not just saving for college –
   i. It is finding the right college so you graduate in 4 years.
   ii. It is career planning to make sure you have job prospects when you graduate.

iii. It is searching for Merit Aid to minimize the amount you have to pay.
iv. It is making sure you have filed all the Financial Aid Forms to receive Need Based Aid.
v. It is cash flow planning and tax planning.
vi. It is minimizing the amount of student loans that the family is borrowing, making sure the family understands the loans and developing a plan to pay back student loans efficiently.
vii. It is a lot of moving pieces that when taken together, can help the family navigate through the entire college process and proudly watch their student graduate from college and start on their own life journey.

34. How do you work with clients and how can people contact you?

a. Our tag line is "Making College Affordable for all Families." We educate families about how to get into and pay for college and we develop a family financial strategy for the college years and the retirement years. Every family has a unique financial situation and not every strategy we talked about today will work for every family.

b. Our Website is www.refcpapc.com
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