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Outsmarting Your Kids (Or at Least Their College Tuition)

Common mistakes in college funding and how to avoid them.

by *Neal Frankle, CFP*

If your clients' children just graduated from high school, this could be the longest summer of your life. No kidding. Your phone will be ringing off the hook because your clients will want your help to figure out how to pay for Junior's higher education.



Of course, many people turn to grants, scholarships and loans. A lot of financial aid is available: Tens of billions of dollars go out every year to students. But since much of it is needs-based, your clients may not qualify.

So how should you handle those calls for help?

Ideally, your clients will turn to the money they've been saving just for this occasion. You know: that pot of gold they squirreled away ever since their progeny graced their living room with the scent of his soiled diaper. Just in case that happy day didn't prod them into a savings plan, let's examine other alternatives.

Don'ts:

- **Borrowing From IRAs.** This is usually the worst strategy as most CPAs already know. Every dime your clients withdraw from their retirement accounts will be taxed at income rates. Remind your clients that when they withdraw \$20,000 from their IRAs to pay for little Timmy's college and (if they are in the 30 percent tax bracket) they'll be writing a check to Uncle Sam for 6,000 smackers. And of course, to make matters worse, if they are under 59½-years old, they can add another 10 percent on top of that tax. It's the penalty they pay for early IRA withdrawals. Friends don't let friends take early IRA withdrawals!
- **Turning to credit cards.** This is a very silly thing to do, so please don't let your clients do it. The credit card companies will charge 18 percent interest, and that's if they like your clients. Enough said. This is actually worse than an IRA withdrawal.

Dos:

- **Gifts.** Here's an idea you will love. Suggest that grandparents help pay for it. Let's face it; the odds are that your clients' parents like their grandchildren a heck of a lot more than they like their own children. They might be willing to help out. If they can afford it, they can gift to your clients and the clients' children each year. and that

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year income and the income earned each year, and that should be more than enough to pay the freight. Plus, the grandparents get the money out of their estates. In fact, if they make the payments directly to the college, they can remove huge amounts from their taxable estate. This could be a tax bonanza for them.

- **Equity line of credit.** The benefits are that the interest may be tax-deductible for your clients and the rate is usually lower than most of the alternatives. The obvious downside is that your clients will be saddled with debt. However, if they have no other alternatives, this may be a good source for some of the expense.
- **Job Experience.** Don't overlook the sweet child's ability to get off his derriere and work a little.

In fact, if possible, have the client give the kid a job. If the client owns their own business, this works out great tax-wise. Some folks refer to this as income shifting. It works when the children are in a lower tax bracket than your clients are, and in most cases, this is true. Think about it: If Junior's on the payroll, your client gets to deduct the labor expense (at their presumed high tax bracket) and Junior declares the income at a very low tax bracket. Then Junior uses the income to pay his own college costs. Sweet! The benefits are plentiful. First, your client gets some tax benefits. Next, they finally witness that, yes, their child *can* help out and get off the computer. And don't forget that your client will be paying for services rendered. Little Timmy will get something done for the client that maybe they didn't have time to do. Even if your clients don't have their own businesses, consider giving (or getting) Junior a job.

In fact, even if your client can afford to pay for college for their children, suggest that they have their kids work to pay some of those costs and possibly loaning them the balance with the understanding that they must repay your client after college. This gives them ownership in the college experience. This one thing alone can make the difference for the children between using college as a gateway to a successful and responsible life or just a very long toga party.

**Editor's Note: In future issues, 529 Plans and Coverdales will be discussed.*

*[Neal Frankle](#) is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. To receive a free report on how to find the best funds, contact him by sending [e-mail](#).*

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