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# Client Bulletin

Smart Tax, Business & Planning Ideas *from your Trusted Business Advisor*<sup>SM</sup>

## Facing College Costs



How much does it cost to send a child to college now? For the 2014–2015 academic year, the College Board puts the average cost of tuition, fees and room and board at private nonprofit four-year schools at over \$42,000. The College Board estimates other expenses (including books, supplies and transportation) at \$4,000–\$5,000. Thus, sending your child away to a private institution costs an average of around \$47,000 this year; at universities considered “elite,” the total tab is generally well over \$60,000. Those numbers likely will be even higher in the 2015–2016 school year, and they will certainly be higher for youngsters entering college in the future.

Parents of collegians can reduce their concerns a bit by considering the College Board’s report on “net prices.” These prices are determined by subtracting grant aid (reductions in direct college costs) and education tax benefits (savings from tax deductions and credits related to higher education). As reported by the College Board, such reductions bring down the cost at private institutions from the published price of \$42,000+ to a net price of \$23,000+. Including the other expenses mentioned previously, sending your child to a private university might cost “only” \$28,000 a year, rather than \$47,000.

Be aware, though, that the net price offsets will vary enormously from family to family. The higher your net worth and your income, the less need-based grant aid your student is likely to receive. The higher your income, the smaller your tax savings from education tax breaks, many of which have income-based phaseouts. Our office can help you determine how much relief you can expect from grants and tax benefits.

### Higher and lower

The numbers mentioned previously in this article are national averages.

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## Helping Hands

*An Employee Benefit Research Institute survey finds that 3 in 10 workers and 2 in 10 retirees are currently providing financial support to a relative or friend.*

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Therefore, at some schools, the total cost will be much higher, whereas others will have much lower costs. Regional differences can be huge. According to the College Board, total costs for private institutions in New England are well over \$50,000 a year, yet costs average less than \$40,000 in the South, Southwest and West.

Moreover, all of those figures are for *private* colleges and universities. Costs come down dramatically when you send your children to public institutions. The College Board puts the average total cost for in-state students at four-year public colleges and universities at just over \$23,000; about half the cost of private schools. After grants and tax benefits, the net price at these public institutions is under \$13,000 a year. At two-year public colleges, including community colleges, costs are even lower.

### Charting a course

Even relatively modest costs for higher education can be daunting for many families. Therefore, parents should consider starting college funds for their children as early as possible. Creating a designated account for higher education may help you avoid “dipping in” for other purposes.

Under the federal formula, a family is more likely to qualify for need-based financial aid if savings and investment accounts are held by the parent, rather than in the student’s name. For example, a parent might be the owner of a 529 college savings plan, with the child as the beneficiary. Such plans,

offered by nearly all states and some private firms, can generate tax-free investment earnings to pay college bills.

Once children are finishing their high school careers, it may make sense to apply to multiple colleges—some more expensive than others. Private and public institutions could be in the mix. If students are interested, applications to virtually no-cost military academies and Reserve Officers’ Training Corps (ROTC) program scholarships also might be included, along with other specialty schools.

Accomplished youngsters may receive more than one college acceptance, allowing the family to decide among the various opportunities. Published costs, net of any aid and tax benefits, might not be the main reason for making a decision, but they also should not be ignored. Everyone—students and parents—should have a reasonable idea of how the costs will be covered.

Keep in mind that your child’s first college might not be his or her last place for higher education. Your youngster might start at a less expensive institution and wind up graduating from or getting a postgraduate degree from a more prestigious college or university.

Regardless of a student’s path through higher education, it’s possible that family cash flow plus grant aid won’t be able to cover all the expenses that arise. Consequently, as is the case for many, your family may need to explore loans as an option to

## Trusted Advice

### Taking Credit

- ❖ The American Opportunity Tax Credit (AOTC) is among the most valuable higher education tax benefits.
- ❖ This tax credit (a direct reduction in your tax bill) equals 100% of the first \$2,000 of qualified education expenses you paid for each eligible student and 25% of the next \$2,000 of such expenses you paid for that student.
- ❖ Thus, the maximum annual credit is \$2,500 per student.
- ❖ If the credit reduces your tax to zero, 40% of the remaining credit amount (up to \$1,000) can be refunded.
- ❖ To claim the full credit, your modified adjusted gross income (MAGI) must be \$80,000 or less (\$160,000 for married couples filing jointly). Partial credits are available with MAGI up to \$90,000 (\$180,000 on a joint return).

pay for the desired schooling. Take a look at the article “What You Should Know About Student Loans” in this issue for more information on college funding through student loans. ■

## Correction

In the May 2015 issue of the *CPA Client Bulletin* in the article, “Finding a Low-Tax State,” we regret an error in the text. Under the heading “Income taxes,” the second sentence should have read, “Some states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming) have no personal income tax, whereas *New Hampshire* and Tennessee tax only certain amounts of investment income.” We sincerely apologize for the error and any confusion it may have caused.

## Did You Know?

**S**tudents and parents borrowed \$106.0 billion in education loans in 2013–14, down from a peak of \$122.1 billion in 2010–11. Non-federal loans made up 9% of the total in 2013–14, far below the record 26% of the total in 2006–2007.

Source: collegeboard.org

# What You Should Know About Student Loans



Recently, concerns about student loans have been in the headlines. In 2015, the Federal Reserve Bank of New York put total student loan debt at \$1.16 trillion, greater than outstanding auto loans or credit card balances. Publications such as the *New York Times* have published articles about “A Generation Hobbled by the Soaring Cost of College.”

The reason for the growth in student loan debt is straightforward: Many families need to borrow money in order to cover the expense of higher education. If you're in that situation, knowing your choices can help you make practical decisions.

Today, most higher education loans come from the U.S. Department of Education. Broadly, they fall into one of two categories: student loans or parent loans.

## Student loans

The most common federal loans, formerly known as Stafford loans, are now called Direct Loans. Students are the borrowers; in order to be eligible for these loans (in fact, for any federal education loans), the student must fill out the Free Application for Federal Student Aid (FAFSA). There is no credit check, but there are limits on how much students can borrow. Typically, annual loans to undergraduate students who are parents' dependents can be as large as \$5,500 for freshmen, \$6,500 for sophomores, and \$7,500 for others.

Besides an origination fee of approximately 1% of the amount borrowed, Direct Loans have fixed rates, set each summer, based on then-current interest rates. As of July 2015, the fixed rate for Direct Loans is 4.29%.

Direct Loans are either subsidized (for students who demonstrate financial need) or unsubsidized. If a student has an unsubsidized loan, payments are due after the funds are disbursed. Borrowers can choose not to make payments until six months after leaving school, but all unpaid interest will be added to the loan balance. With subsidized Direct Loans, the federal government pays the interest until six months after the borrower leaves school.

Students with exceptional financial need may qualify for a federal Perkins Loan. If so, no interest will be charged until nine months after leaving school. The fixed interest rate is 5%, and loans to undergraduates go up to \$5,500 a year.

For federal student loans, the standard repayment period is 10 years, but there are various extension, deferral, and even loan forgiveness opportunities. For example, some loans can be forgiven if a borrower teaches full time for at least five consecutive years in a school classified as “low-income” by the Department of Education.

## Parent loans

Formerly known as Parent Loans to Undergraduate Students, federal Direct PLUS Loans are offered to parents of undergraduates. (PLUS Loans also are available to graduate students.) Again, a student must fill out the FAFSA in order for a parent to get a PLUS Loan.

## Trusted Advice

### Deducting Student Loan Interest

- ❖ To deduct interest paid for education loans, you must have borrowed solely to pay qualified education expenses for yourself, your spouse, or a dependent.
- ❖ Loans from a related person or a qualified employer plan don't qualify.
- ❖ The maximum annual student loan interest deduction is \$2,500.
- ❖ To get the maximum tax deduction, your modified adjusted gross income (MAGI) must be not more than \$65,000 for a single filer, or \$130,000 on a joint return. Reduced deductions are allowed with MAGI up to \$80,000 or \$160,000.

PLUS Loans can be as large as the total amount of college costs, minus any financial aid.

**Example:** Dave Evans attends a college where the posted cost of attendance is \$40,000 for this academic year. Including a student Direct Loan, Dave receives financial assistance that totals \$16,000. Thus, Dave's parents can borrow up to \$24,000 (\$40,000 minus \$16,000) with a PLUS loan for that year.

The origination fee for a PLUS Loan is 4.292% (4.272% on or after October 1, 2015), and the fixed interest rate is 6.84% for the 2015–2016 academic year. In order to receive a PLUS Loan, a parent must pass a credit check. If the parent's application is rejected, the child may be able to receive larger student loans.

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## Private loans

Although most student loans come from the federal government, some banks, credit unions, and other lenders offer education loans as well. Private loans can supplement or even replace federal education loans. Interest rates on private loans can be lower than federal rates for creditworthy borrowers—some are in the 3% range now.

However, private loans often have variable rates, which can rise if prevailing interest rates move higher. Private education loans may have relatively high fees, so borrowers should read all the fine print before making any decisions. Our office can help you determine the true cost of a private student loan you're considering.

Keep in mind that any loan can be an education loan, if the proceeds

are used to help pay college bills. You might use a home equity loan or a home equity line of credit, for instance. Besides a relatively low interest rate, home equity debt may offer more opportunities to take a tax deduction for the interest you pay. Of course, you always should use home equity debt with caution because your home might be at risk if you default. ■

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# Restructuring Education Debt

With interest rates down for several years, many homeowners have refinanced their home mortgages. Why keep paying, say, 6% on your old home loan when you can save money by replacing it with a new loan charging less than 4%?

Does that same reasoning apply to student loans? Can you take advantage of today's low interest rates by trading in existing education debt bearing higher rates? It's possible, but you should proceed with care.

## Choosing consolidation

Federal education loans can't be refinanced. The government offers Direct Consolidation Loans, but that's not really an opportunity to refinance. Instead, you can combine all federal education loans into one outstanding loan. There's no fee for consolidating but there's also no saving on interest because your new rate will be a mix of all the existing rates.

**Example:** Ellen Benson has \$10,000 of outstanding student debt with a 5.6% interest rate and \$10,000 of outstanding debt with a 6.8% rate. When Ellen consolidates into one \$20,000 outstanding loan, those rates will be combined to 6.2%. (Technically 6.25%, because consolidated federal loans are

rounded up to the nearest one-eighth of 1%.)

Although federal loan consolidation won't save on interest rates, it can simplify your life. Going forward, borrowers will have only one monthly bill to remember to pay, rather than multiple existing loans with different payment amounts and different deadlines.

In addition, consolidating federal student loans allows you to extend repayment to as long as 30 years. Various repayment options are offered. A longer repayment period will reduce your monthly obligation, if cash flow is an issue. Extending the loan term may not be a drawback because you always can prepay a federal student loan, in part or in full, with no fee. However, there may be some drawbacks to federal loan consolidation, including the loss of borrower benefits such as possible loan cancellation.

## Going private

Although federal student loans can't be refinanced via the federal government, many private lenders offer the opportunity to do so. In essence, you borrow enough money to pay off your existing federal loans—as mentioned, federal loans can be prepaid without penalty. Then you are left with one private loan to

pay down. (Refinancing might cover private student loans as well.)

You typically must pass a credit check to refinance with a private lender. The higher the interest rates on your existing education loans and the higher your credit score, the more it may make sense for you to refinance with a private lender. If you're deemed creditworthy, you probably can save money by lowering the amount of interest you pay. That's especially true if you hold existing PLUS loans, which have relatively high interest rates.

Nevertheless, refinancing with a private lender is not always a good idea. Interest rates usually are variable, so you'll pay more if rates move higher. What's more, private loans can come with fees, reducing the financial advantage of the lower posted rate. As is usually the case when you get a loan, you should read the fine print carefully. Our office can help you determine the true cost of a private loan.

You may lose some valuable federal loan benefits if you move to a private lender; you can't change your mind afterwards and revive a paid-off federal student loan. Therefore, you should crunch all the numbers and weigh all the consequences before refinancing federal education debt. ■

# Why You Need a Will

You may think that your estate plan should include a will in order to handle the disposition of your assets. That's true: If you die "intestate," meaning without a will, some or all of your assets probably will be distributed according to state law.

In reality, though, having a will may have less of an impact on asset disposition than you think. That said, there are still multiple reasons why you should have a will.

## Beyond your will

An IRA or any other tax-advantaged retirement account will pass to the beneficiary you've named.

Assuming you have filled out the beneficiary designation form—and you haven't named your estate as the beneficiary—at your death that account will go to the individual or individuals or trust you've selected.

The same principle often applies to assets you own jointly.

**Example 1:** The principal residence of Walt and Vera Young is titled as joint tenants with right of survivorship (JTWROS). When one spouse dies, the other spouse will inherit the house as surviving co-owner. The outcome will be the same if any combination of people, related or not, own assets as JTWROS.

Similar situations apply to many other types of assets. Annuities and life insurance proceeds go directly to beneficiaries. Payable-on-death bank accounts and transfer-on-death investment accounts pass to

beneficiaries as well. In addition, any bank or brokerage or mutual fund accounts held as JTWROS will be owned by the surviving owner or owners after one of the joint tenants dies.

Assets owned as JTWROS or with beneficiary designations won't be controlled by your will; in fact, an instruction in your will is likely to be ignored when it comes to JTWROS property or assets with a designated beneficiary.

**Example 2:** Martha Owens and her brother Ned Parker bought a vacation home together when they were young adults. They titled the property as JTWROS and never changed it. At Martha's death, her will included a bequest of her share of the house to her children, but it didn't matter. As the surviving co-owner, Ned was the one who inherited it.

Moreover, individuals increasingly are creating revocable trusts to hold assets during their lifetime. When the trust creator dies, assets in the trust will go to recipients under the terms of the trust document. Again, instructions in your will won't matter.

The message is that you should be careful in your estate planning.

## Abate probate

Assets with JTWROS titling, with beneficiary designations or in a revocable trust pass directly to the surviving owners and beneficiaries without the time and expense of going through the probate process.

Nevertheless, you still should have a will, even if you believe most of your assets won't be covered. People rarely have all of their assets titled in such a way that everything will pass outside of probate.

Some personal assets (including vehicles, collectibles and furnishings) probably will be owned outright at your death, rather than as JTWROS or in trust. Those assets should be listed in your will to make sure they wind up with the people or charities of your choice. Also, not all forms of joint ownership will have the same result as JTWROS. Property titled as tenancy in common, for instance, will pass under the terms of a will. Therefore, you should make sure your estate plan is in sync with the way your property is titled.

## Naming names

In your will, you also can name the executor who will wind up your financial affairs. That might include paying outstanding bills, arranging for tax returns to be filed, making the necessary notifications, and so on. If there is no relative or friend likely to perform those tasks effectively, you might name a professional adviser or a financial institution.

Moreover, if you have minor children when you create your will, you can name guardians who will raise them until they come of age, or alternatively, you can name those you wish to exclude. ■

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## SIMPLE 401(k) Plans May Appeal to Employees

Many workers value employer-sponsored 401(k) retirement plans. Consequently, offering a 401(k) may help a small company attract and retain high-quality employees. Offering a standard 401(k)

plan can involve considerable administrative time and expense, but business owners with fewer than 100 employees may find a practical solution in a SIMPLE 401(k).

SIMPLE 401(k) plans are very similar to the traditional 401(k)s from major employers. Eligible employees can contribute part of their compensation to the plan; workers owe no income tax on the

contributed amount and can choose how the money is invested, picking from a menu of choices.

### Describing the differences

There are differences between SIMPLE 401(k) plans and the traditional version. In 2015, the maximum employee contribution to a SIMPLE 401(k) plan is \$12,500, or \$15,500 for those 50 or older. (In a traditional version, those numbers are \$18,000 and \$24,000.) In a traditional 401(k), employer matching is optional, but SIMPLE 401(k) plans require a match.

The required SIMPLE 401(k) match can be dollar-for-dollar, up to 3% of compensation for all participating employees. Alternatively, employers can contribute 2% of compensation for all eligible employees, regardless of whether they contribute to the SIMPLE 401(k). All SIMPLE 401(k) contributions, from employers and employees, are fully vested.

### Assessing the advantages

Why would you offer a retirement plan that requires an employer



match? Especially a plan with lower contribution limits than a traditional 401(k)?

For one reason, the 401(k) label can help send the message that your company provides excellent employee benefits. Pointing out the required employer match can emphasize that idea, as some traditional 401(k) plans don't have matching contributions.

In addition, SIMPLE 401(k) plans live up to their names because they don't require discrimination testing. In the traditional version, employers must go to considerable

lengths to show their plan doesn't favor highly-paid executives. If lower-paid workers fail to participate adequately in a traditional 401(k), key employees may find their permissible contributions reduced. That won't be an issue with a compliant SIMPLE 401(k).

### Simple selections

Compared with SIMPLE IRAs (which are similar in many respects), SIMPLE 401(k) plans require more administration. You must file IRS Form 5500 each year, for example. Still some employees and prospective employees may respond more favorably to the 401(k) label, which might sound more like a workplace plan and may offer plan loans, which SIMPLE IRAs don't have. That flexibility can add to a plan's appeal to workers (but may add to an employer's paperwork burden).

If this type of simple retirement plan might work for your company, you have until October 1 to decide on establishing a plan for 2015. ■

## TAX CALENDAR

### AUGUST 2015

#### August 10

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2015. This due date applies only if you deposited the tax for the quarter in full and on time.

#### August 17

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in July if the monthly rule applies.

### SEPTEMBER 2015

#### September 15

**Individuals.** If you are not paying your 2015 income tax through withholding (or will not pay in enough tax during the year that way), pay the third installment of your 2015 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in August if the monthly rule applies.

**Corporations.** File a 2014 calendar year income tax return (Form 1120) and pay any tax, interest, and penalties due. This due date applies only if you timely requested an automatic 6-month extension.

Deposit the third installment of estimated income tax for 2015. Use the worksheet Form 1120-W to help estimate tax for the year.

**S corporations.** File a 2014 calendar year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic 6-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) or a substitute Schedule K-1.