Special Topics

BIRCH HILL
INVESTMENT ADVISORS LLC

Paying for College

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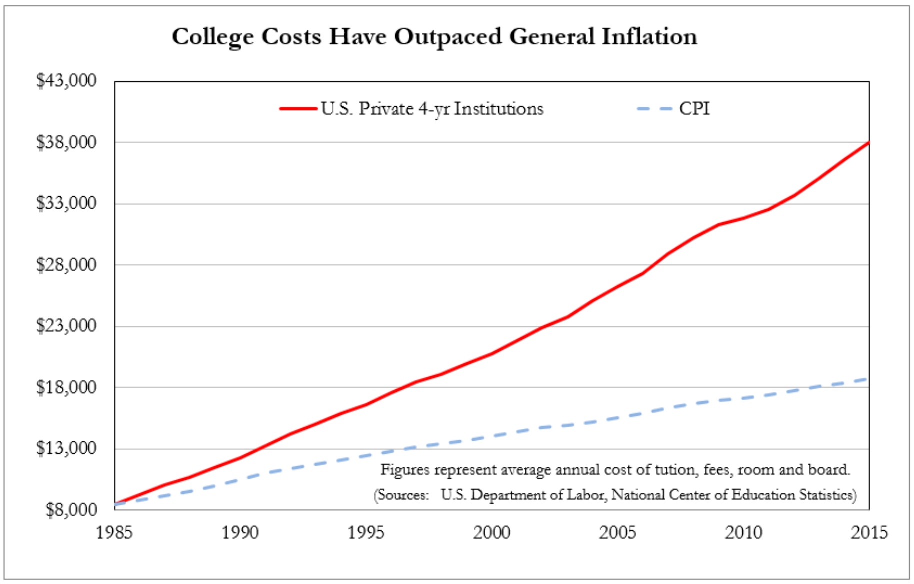
The annual cost of attending many private colleges now approaches or exceeds $60,000. While this cost will be reduced for many families through needs-based scholarships and tuition discounts, families with accumulated financial assets will spend close to the full amount. Here are six basic approaches to saving and paying for college.

Uniform Transfers to Minors Act (UTMA) accounts are custodial accounts established for the benefit of a minor. The person serving as the custodian of the account has the legal obligation to manage the funds in a prudent fashion for the benefit of the minor. State rules vary, but UTMA accounts generally end when the minor reaches age 21.



Advantages: Establishing a UTMA account is easy. Funds in the account may be used to benefit the child as long as expenditures are not parental obligations such as food, clothing, medical care and shelter. Income from a UTMA account is reported on the child's tax return at potentially favorable rates on the first $2,100 of income (in 2017). ***Disadvantages:*** When the child reaches age 21 (depending on State rules) he or she will have complete control of the funds. If you are the UTMA custodian, have funded the account, and you are the child's legal guardian, the value of the UTMA account is counted as part of your taxable estate. This pitfall can easily be avoided by asking another individual to serve as custodian.

529 Plans provide a tax advantaged method of saving for college. 529 Plans are sponsored by either a state or an educational institution. Nearly every state has at least one plan.. Investment income in 529 Plans is not taxed at the Federal level when it is earned and not taxed when withdrawn and used to pay tuition, room, board and other qualified college costs at eligible institutions. Contributions to 529 Plans are limited to the Annual Gift Tax Exclusion amount ($14,000 in 2017) but gifts may be made up to five years in advance so that one individual may contribute $70,000 to a 529 Plan in 2017 representing annual gifts for 2017 through 2021. Contributing more than the Annual Gift Tax Exclusion will trigger the need to file a Gift Tax Return (Form 709) and may or may not result in a tax liability. State tax is exempt for qualified distributions except in the state of Alabama.

Advantages: 529 Plans allow the donor to limit the use of the funds even after the beneficiary reaches age 21. Investment earnings are tax free as long as the funds are used for qualified college costs. Thirty-four states and the District of Columbia currently offer tax incentives for residents who make contributions to their in-state 529 Plan and some others offer incentives for all 529 Plans. If the initial beneficiary does not need the funds for college expenses, the beneficiary designation may be reassigned to certain other family members. ***Disadvantages:*** If the 529 Plan funds are used for purposes other than qualified college expenses the investment earnings will be subject to taxes at ordinary income rates plus a 10% penalty. Investment options are generally limited to the mutual funds approved by the individual state. Mutual fund and administrative fees negate a portion of the tax advantages of 529 Plans.

Coverdell Education Savings Accounts (ESAs) are similar to 529 Savings Plans in that investment earnings are tax free as long as the funds are used for qualified educational costs. ESAs differ from 529s in other respects such as paying K-12 education costs, low annual contribution limits and income eligibility requirements.

Advantages: ESAs are available at many banks and other financial institutions. Elementary, secondary, and higher education costs are qualified uses of ESA funds. ***Disadvantages:*** Contributions are limited to $2,000 per year per child. Individuals earning greater than $110,000 (2017) may not contribute to an ESA. Contributions may not be made after the beneficiary turns age 18. Funds must be used or transferred to a relative before the beneficiary turns age 30.

Creating an Irrevocable Trust for the benefit of a child or grandchild is another method of allocating funds for future college expenses. Trusts may be created to cover a range of financial needs including education costs, healthcare costs and providing a source of income after the beneficiary reaches a pre-determined age.

Advantages: Trusts are customized to the particular instructions of the Grantor (the person creating and funding the trust). An independent Trustee carries-out the trust's instructions but is generally given latitude to use judgment in situations that cannot be foreseen by the Grantor. A Trust provides a level of on-going control as well as certain legal protections. A Trust may serve as a very effective vehicle for the transfer of wealth from one generation to the next (or the generation after that). The wealth transferred may be well in excess of the costs of college. ***Disadvantages:*** Trusts incur initial legal costs and on-going administrative costs. Irrevocable Trusts may pay taxes in a higher tax bracket than the beneficiary.

Direct Payment of Tuition Expenses may be the best method of paying for college when the family goal is intergenerational transfer of accumulated wealth. For example, when a grandparent has more than sufficient wealth for his or her future needs and wishes to limit potential estate taxes, the grandparent may pay tuition costs (and health care costs) in excess of the Annual Gift Tax Exclusion ($14,000 in 2017) without incurring a gift tax.

Advantages: This approach is straightforward and flexible while also helping to achieve an estate planning goal. ***Disadvantages:*** This strategy requires coordination between generations well before the beginning of college and is limited to tuition (not room & board). Parents may need the help of their financial advisor to facilitate the discussion.

The above descriptions provide a broad overview of methods of saving and paying for college. There are many nuances of such planning that cannot be explained in a brief paper. There are other strategies that include funding from IRAs and Roth IRAs, which could make sense in certain applications. Also 529 Plans offer Prepaid Plans available for a limited number of schools to pay for future education in today's prices. Please consult with your Birch Hill investment manager to determine which strategy is right for your situation.

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