INSURANCE PROFESSOR.NET

OFFICE ADDRESS
7500 E Arapahoe Rd, #374
Centennial CO 80112

MAILING ADDRESS
7500 E Arapahoe Rd, #374
Centennial CO 80112

PHONE
303.912.5490

FAX
866.837.1248

EMAIL
AJ@InsuranceProfessor.net

WEB
www.insuranceprofessor.net

Saving and Paying for College

The cost of earning a college degree has increased, generally above the cost of consumer inflation, for many years.

The options for paying college costs include obtaining grants or scholarships, loans, savings programs (such as a 529 college savings plan), using the cash value of a life insurance policy, or distributions from an annuity. A word will be added at the end of this report regarding other, less formal, options.

Keep in mind that there are no perfect investments or strategies that address every contingency. In addition, there are no guarantees that changes in public policies might alter your approach. Rather, you need to consider your circumstances and goals in determining the best approach to saving for future needs.

This paper will examine three popular options for college savings:: 529 plans, life insurance, and annuities.

529 Plans

Namesaked for a section of the IRS code, 529 plans are tax advantaged programs, helping families save for college expenses. Specific tax advantages, investment options, restorations and fees vary by program and by state.

Types of 529 Plans::

- Prepaid tuition plans
- College savings plans

Prepaid tuition plan:: this plan allows an individual to lock in today's tuition rates for a future student beneficiary at any of a state's eligible state universities or colleges. There are residency requirements. Colorado does not have a pre-paid tuition plan.

College savings plan:: permits investment in various established options on a tax advantaged basis. Options can only be changed once per year, and include actively managed funds, index fund accounts, stable value funds, ETFs, FDIC insured savings and CD accounts.

These programs can be state-based, and are also available from other financial services companies.

Cash saved and earned from these programs can be used for tuition, room and board, books, supplies, required equipment, certain fees —- qualified educational expenses.

Funds can be used at any college, university, vocational school, or trade school.

Who can participate? Anyone with a social security or federal tax ID number. No age restrictions, no income limitations.

Each plan has an *account owner* and *beneficiary*. Beneficiaries can be changed at anytime within a family with no penalty. Accounts may be held without a beneficiary in the case of scholarship accounts or with 501c(3) organizations as owners. The account owner maintains full control of the account (ie. investment choices and distributions).

Contributions to a Colorado plan by a Colorado taxpayer are deductible in the year they are made, up to the amount of Colorado taxable income that year.

Contributions up to $13,000 by an individual can be made in a single year without incurring gift taxes. A maximum of $280,000 per beneficiary can be made before new contribution limits are imposed. (Colorado state CollegeInvest 529 plan. Other plans may allow higher limits)

Contributions between $13K-$65K can be pro-rated for tax reasons over a five year period without incurring gift taxes or reducing the contributor's unified estate and gift tax credit.

Distributions made for qualified educational expenses are free from state and federal taxes.

Insurance policies can name the beneficiary of a policy to be an account owner and beneficiary of a 529 plan.

Upsides of a 529 Plan::

- An account can be opened for anyone, regardless of income
- Contributions within the caps are exempt from state income tax
- Withdrawals for qualified expenses are exempt from federal taxes
- Account owner controls the account investment choices and distributions
- Beneficiary changes within families are allowed
- No underwriting is required

Restrictions of a 529 Plan::

- An investment account is exposed to market value loss. Performance is not guaranteed
- Annual contributions are capped
- Investment choices/changes can only be made once per year
- Withdrawals for non-qualified expenses are subject to penalty and tax
- Fees are generally higher than for comparable mutual funds
- Fees for 529 plans can include:: enrollment, annual maintenance, front end or back end sales loads, administrative or management, underlying expenses
- Generally not appropriate for a student that will begin higher educational within about 2–4 years
- Not federally insured

- Amounts saved in a 529 plan are considered in a financial assistance determination, which can vary by institution
- Investment choices may be limited by the 529 plan and require the scrutiny by the account owner
- If the account owner dies, state law determines the status of the account

Fixed Index Universal Life Insurance

Life insurance is available in two flavors:: term and permanent. Permanent policies are designed to last for the insured's entire lifetime, and have the ability to accumulate value free from taxation. Once such permanent policy type is called universal life, and certain of these (fixed index universal life or FIUL) can track the performance of market indices, without directly investing in the market. Such a policy allows for growth, without the possibility of loss of value.

The primary purpose of a life insurance policy is to pay a specified benefit upon the death of the insured. Due to the accumulation benefits of a FIUL policy, the policy's cash value can be used for other "living benefits." One such benefit is using the cash value to pay for college expenses.

In addition, the benefits are free from limitations and taxes (tax laws as of 2012). So, a family can use a FIUL policy to accumulate cash that can be used for purposes while the insured is still alive, all the while protecting the family in the event of the death of the insured.

Upsides of a FIUL Policy::

- Cash value can accumulate and grow without loss, as provided for in the life insurance contract, free from taxes
- The cash value account of the policy can grow by tracking market gains, but will never lose value
- A death benefit protects the family in the event of the loss of the insured
- Cash value can be used in the form of partial withdrawals or as income tax free loans
- A properly constructed policy can be overfunded to build the cash value more quickly, without exposing the beneficiaries to tax consequences
- The policy can be kept in place to provide living advantages later in life, such as retirement income, and provide lifelong protection for one's family
- In many cases, the cash value of a life insurance policy is not considered in a financial assistance determination
- No gift tax consequences when the insured is also the owner of the policy
- Amounts paid in as premium are not limited, except that one needs to avoid the tax consequences of a modified endowment contract

Restrictions of a FIUL Policy::

- The cash value account must be regularly reviewed. If cash value is reduced or withdrawn, additional premium may be require to avoid policy lapse
- The growth of the policy tracks selected market indices and may not grow at the rate of other direct market investments
- Requires underwriting of the insured
- Premium charges, cost of insurance, and surrender charges may apply
- The value of the life policy may be considered in the estate of the insured
- The value of a life insurance policy may be considered by some institutions in a financial assistance determination
- Not federally insured

Fixed Index Annuities

An annuity is a financial instrument issued by a life insurance company, the primary purpose of which is to create an income stream. Like a life insurance policy, an annuity can be used for additional life purposes.

Creation of an annuity requires a minimum deposit. The owner of the annuity is not subject to underwriting. An annuity can be started with either qualified or non-qualified funds, and the earnings grow tax-deferred.

Fixed index annuities (FIAs) use selected indices to track market performance, and can increase value when the market gains, but by contract, will not lose value when the market declines. In addition, some annuity contracts offer an upfront bonus to enhance the cash value account, upon which all gains in value are calculated. FIAs also permit the account holder to alter the fractions of the premium that track market gains versus guaranteed returns on an annual basis.

Upsides of a FIA::

- Cash account will never lose value, even when overall securities market performance declines
- No underwriting is required
- Premium bonuses are available on some contracts
- Limited cash value annual withdrawals are available on many contracts
- Flexible premium payments are available on many contracts
- Riders can be added to provide enhanced retirement income options
- Contributions are unlimited; no annual caps

Restrictions of a FIA::

- Gains in value will generally be less than gains in selected market indices and may be limited by other contract requirements
- Surrender charges may apply if cash is withdrawn within as stipulated in the annuity contract
- Taxes will be paid on deferral when cash is withdrawn. A federal tax penalty will be assessed if cash value is withdrawn prior to age 59.5, except for the annual allowed free withdrawal
- Income tax rules require that withdrawals are made on a last-in, first-out basis, meaning that accumulation is withdrawn and taxed first
- Not federally insured

Other Options

Some investment advisors do not always recommend the use of 529 plans, citing the lack of flexibility in fund choice. Some of these advisors recommend investing in stocks, paying capital gains when they come due (this option is not tax deferred), and engaging in active fund management to provide an optimized return o investment.

An important consideration for any monies being saved for a future use, is inflation. Inflation not only diminishes the value of the original contribution made to savings, but also decreases the purchasing power of the saved funds once withdrawn for use. The abilities of any of the options presented here to match or “keep up” with inflation are limited by the restrictions of the instruments. For example, while a market investment can grow in advance of inflation, any significant loss of value can eliminate much or all of that advance. Moreover, while recovering from market value loss, real gains against inflation are, at best, marginalized during the regrowth period.

While life insurance and annuities can be structured to avoid loss of value due to market conditions, they are not specifically designed to deal with inflation. Some annuities, contain provisions allowing for some inflation protection, but, in general, the most common manner of dealing with inflation effects is to overfund the policy contracts involved.

In summary, your specific needs and goals will dictate which option will work best for you and your children in planning for college expenses. We’ve presented three approaches here that can be used singly or in combination. Please contact us at your convenience so we can assist you in understanding the options, and crafting your best solution.