Chapter 1

Education Goals: Constructing a Plan

In general, this book focuses on education planning in the context of planning for a beneficiary's K–12 or college education.[1] The *beneficiary* is usually the client's child or grandchild. However, in some instances the intended beneficiary is the client himself/herself. With the exception of purchasing a home, no single financial expenditure is likely to exceed (in importance and in size) the cost of a college education. *Education* for our purposes means not only college and graduate education but K–12, including private and parochial schools.

Planning Pointer

This book does not recommend any planning techniques that are considered abusive under the Advance Notice[2] of proposed regulations under Section 529. These proposed rules are discussed in **Chapter Eight: Federal Income Tax Planning with Section 529 Savings Plans** and **Chapter Nine: Estate Planning with Section 529 Savings Plans**.

The benefits of a good education are substantial, but the costs are often out of reach for the typical family. The benefits of a good education include better odds of achieving economic success, job satisfaction, job flexibility, the opportunity to discover new ideas, and the ability to meet new people. However, over the last decade, private K–12 as well as college educational costs have increased dramatically, outpacing increases in both the cost of living and median annual income of

1. Although the book covers some aspects of education planning for K–12 expenses, the major focus of this book is planning for college.

2. Advance Notice of Proposed Rulemaking (for regulation under I.R.C. § 529), 73 Fed. Reg. 3441 (Jan. 18, 2018).

the typical parent. Parents have found that a quality education can provide their children with an early start for a successful later life. Fortunately, parents (and grandparents) have numerous tax and other strategies available to them to help finance these rising education costs.

Education planning promises to become a staple in most families' long-term comprehensive financial strategy. Education planning is on the precipice of a movement reminiscent of that which has radically transformed the world of retirement planning in the past two decades. The combination of new financial aid developments and new tax laws makes choosing the best strategy and coordinating the rules particularly complex for the practitioner and client. The complexity of education planning coupled with its increasing importance affords legal professionals a unique opportunity to play a significant role in bettering their clients' lives and futures. Ransacking savings accounts or invading retirement plans for education purposes may not serve anybody's best interests. At a minimum, the advisor must understand that education planning is inextricably intertwined with retirement planning, estate planning, tax planning, financial planning, and financial aid issues.

A. Goals of Education Planning

The first thing that the practitioner needs to do is determine the goals of the client. The goals of education planning can include the following: (1) saving enough money so that the right K–12, college, or graduate school can be chosen when the time comes, (2) obtaining subsidies—in the form of financial aid, scholarships, grants, and loans—when savings prove to be inadequate, (3) effectively utilizing any tax advantages for education, (4) maximizing one's investments to ensure good returns, maximum control, asset protection, and minimal administrative hassles, and (5) having a flexible plan that can be changed easily.

In an ideal world, the client will have enough savings to pay for all costs of any K–12, college, or graduate school. Such a client will not need to worry about financial aid or loans. Such a client might consider tax-free scholarships and would want to ensure all savings investments obtain maximum returns with all accompanying tax advantages. The wealthy client might consider setting up an inter vivos incentive or other trust to provide incentives or pass on wealth with gift, estate, and generation skipping tax benefits.[3]

In the real world, however, most clients will probably not have enough savings to pay for all education costs. Consequently, grants, loans, pay-as-you-go tax techniques and after-college tax benefits become very important. These clients will still want any savings to have good returns, to have maximum control over investments, asset protection of funds, and minimal administrative hassles to utilize savings, as well as tax advantages. Although this client may not want to establish an inter vivos trust, proper estate planning will necessitate a testamentary trust that assures effective education planning in the unfortunate event of death.[4]

3. *See* Nancy E. Shurtz, Education Planning: Taxes, Trusts, and Techniques ch. 17 (ABA 2009).
4. *Id.*

Education plans must be flexible because the client's goals may evolve based on changed circumstances. For example, a taxpayer's education planning may change if: (1) the taxpayer has more children or grandchildren, (2) the taxpayer or the beneficiary becomes disabled or unemployed, (3) the taxpayer gets divorced, declares bankruptcy, retires early, or dies, (4) the taxpayer's child or grandchild decides to enroll in a different school, to delay college, or to not attend college at all, (5) the taxpayer's savings are depleted due to market fluctuations or other circumstances, or (6) the law changes. The COVID-19 virus and ensuing recession can illustrate just how quickly circumstances can change. Lost jobs, failed businesses, savings depleted, and long-distance learning have all changed education plans. For some, education planning may result in a realization that higher education is not the best plan for the intended beneficiary. Perhaps the resources that would have been used to fund education may better serve the beneficiary if used for another purpose.[5]

Education planning also means not compromising one's financial or retirement goals. When college goals conflict with other goals, such as financial security or retirement, some compromises may be necessary. In some situations, planning to share costs with the student may prove to be the best strategy for paying for college and safeguarding the family's other financial needs.

Chart 1-1 sets forth an example of a questionnaire that could be given to the client. Many of the chapters in this book will address these issues in more detail.

CHART 1-1 Client Questionnaire

Demographic information, such as name, address, number of children, wealth of grandparent(s), wealth of client, income of the client, etc.
I. What is the client's education goal for his/her children (or grandchildren)? 1. What type of K–12 education is the client expecting (boarding school, private school, public school)?[6] 2. What type of college does the client expect the child to attend? 3. Is the client expecting to pay for graduate or professional school?
II. Has the client saved?[7] 1. How much is the current value of the savings? 1. What form has the savings taken? 2. What is the expected future value of this savings?[8] 3. Should Coverdells, savings bonds, or custodianships be converted to Section 529 plans?[9] 4. Is the client maximizing returns with asset protection and other benefits?

(*continued*)

5. With COVID-19, students have greater opportunities to negotiate the reduction of tuition costs. Many are deciding to attend college closer to home, choosing to take a gap year, or just forgoing college altogether.
6. *See* **Chapter Two: The Benefits and Costs of a Good Education**, A.1.
7. *See* **Chapter Four: The Best Ways to Save**.
8. *See* **Chapter Three: It Is Never Too Late to Save**.
9. *See* **Chapter Seventeen: Coordinating Section 529 Plans with Other Savings Techniques**, E.

III.	How much should the client be expected to have saved for K–12, college, or graduate school in the future? 1. What are the current costs of the desired education?[10] 2. What are the expected costs of the desired education?[11] 3. What is the time before the expected education expense? 4. What are the client's risk/return factors?[12]
IV.	Can the client pay for all or part of the education costs as these costs are incurred? 1. What are the client's annual earnings and savings? 2. Does the client expect any gifts from relatives?
V.	Will the client be entitled to use "pay-as-you-go" tax techniques?[13] 1. Will the client be entitled to the American Opportunity Credit? 2. Will the client be entitled to the Lifetime Learning Credit?
VI.	Is the client (or beneficiary) likely to qualify for scholarships, grants, loans, or other financial aid?[14] 1. Has the client investigated scholarship opportunities?[15] 2. Are subsidized or unsubsidized grants or loans likely?[16] a. What is the client's expected loan amount? b. What is the client's credit rating? c. What is the expected interest? d. What is the time frame for payment? e. Are there possible after-college loan deductions?[17] 3. If the client will apply for financial aid, what are strategies for qualifying for aid?[18] a. Titling assets in the parent's name. b. Consumption, conversion, etc.
VII.	How important are gift, estate and generation skipping tax considerations to the client?
VIII.	Does the client have any specific nontax wishes that should be considered? 1. Control a. Investment[19] b. Not wanting child to control the education fund at age 18. c. Incentives 2. Asset Protection[20] 3. Perpetuity 4. Disability[21] 5. Retirement Goals 6. Death
IX.	What is the exit strategy if the contemplated plan fails? 1. What circumstances could occur that could pose risks to the client's educational goals? 2. How does the plan change to meet these circumstances?

10. *See* **Chapter Two: The Benefits and Costs of a Good Education**, **Charts 2-3, 2-4,** and **2-5**.
11. *See* **Chapter Two: The Benefits and Costs of a Good Education**.
12. *See* **Chapter Fourteen: Choosing the Right Section 529 Savings Plan**.
13. *See* **Chapter Five: When Savings Are Not Enough**.
14. *See* **Chapter Nineteen: Coordinating Section 529 Plans with Financial Aid**.
15. *See* **Chapter Five: When Savings Are Not Enough**.
16. *See* **Chapter Five: When Savings Are Not Enough**, **Chart 5-4**.
17. *See* **Chapter Five: When Savings Are Not Enough**.
18. *See* **Chapter Nineteen: Coordinating Section 529 Plans with Financial Aid**.
19. *See* **Chapter Thirteen: Investment Planning with Section 529 Savings Plans**.
20. *See* **Chapter Twelve: Nontax Aspects of Section 529 Savings Plans**.
21. *See* **Chapter Eleven: Disability Planning with Section 529 Savings Plans**.

Planning Pointer

Planning to pay for K–12 or college education is best accomplished with a comprehensive financial plan that assures the client's ability to live and retire comfortably yet provides for adequate savings for anticipated college expenses. The advisor can provide a most valuable service by recommending to the client the importance of savings and by advising the client on what savings strategy is best, given tax and nontax factors and the client's particular circumstances.

B. Planning Based on Income Categories

Low-income families have the fewest education planning options available to them. These families are likely to have not saved at all, or not nearly enough, to pay for the rising costs of a college education. In contrast, *middle-income families* have the greatest variety of educational planning options. The *wealthy families* have the best ability to save for all levels of education, from K–12 boarding schools to expensive professional education.

1. Low-Income Families

Attending college can be extremely important to students from *low-income families.*[22] The fact may very well be that college is the only means by which a low-income child can escape poverty. The costs of college for them, however, may be daunting. All too often, the children in these families are relegated to community colleges and trade schools. Advisors, however, should make these clients aware of the liberal financial aid packages of many major elite colleges, if the student can qualify for admission.[23]

Taxpayers in low-income brackets have virtually no ability to save. However, if they do save, complex planning issues arise as to whether savings will reduce financial aid eligibility. In general, saving in the student's name will have a more adverse tax consequence than saving in the parent or grandparent's name.[24] However, both assets and income from assets can reduce financial aid.

This low-income group does not have a lot of assets. They probably rent their homes and most likely do not have adequate retirement savings. They are also not likely to receive gifts from relatives. In fact, they are probably struggling just to pay the cost of health care and other necessities of life.

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22. Low-income families usually have adjusted gross income (AGI) of less than $50,000.
23. *See* **Chapter Five: When Savings Are Not Enough**, **Chart 5-6**.
24. *See* **Chapter Nineteen: Coordinating Section 529 Plans with Financial Aid**.

Low-income families are also not likely to have the ability to pay for immediate college expenses. In fact, they may not even be taxpayers. Thus, income tax, estate, and gift taxes are not going to be major considerations for this group. They may, however, qualify or partially qualify for educational credits, particularly the refundable American Opportunity Tax Credit (AOTC).[25]

The good news is that most low-income taxpayers will be eligible for financial aid in the form of grants and loans. Also, scholarships and student employment will be an essential part of their education plan. Furthermore, upon graduation and commencement of work in the marketplace, the low-income student may be able to take advantage of several tax benefits, such as the above-the-line loan interest tax deduction and loan forgiveness when working in the public interest.[26]

2. Middle-Income Families

Middle-income families[27] have a wide variety of education planning options available to them. This family can benefit from almost all the savings tax techniques—the 529 plan and Coverdell—but must be careful to save in a way that does not significantly reduce financial aid. This family may also be able to pay part of their child's education expenses currently, thus benefiting from the education credits. Thus, careful planning should enable this family to qualify for the various tax benefits as well as financial aid.

The middle-income family may have a home with significant equity, so they can take out a home equity loan to pay for any education costs. However, after the *Tax Cuts and Jobs Act of 2017*, a deduction for the interest on that loan will not be allowed until 2026. They may also have significant retirement savings that could be used for education purposes without penalty. However, care must be taken not to deplete this valuable resource that might be needed in later life. Lastly, they may have a life insurance policy that does not count for financial aid purposes which may be tapped for a possible loan.

Many middle-income families will qualify for need-based federally subsidized loans, either because the family has more than one child in college or their child is planning on attending an expensive school. Those middle-income families who may not qualify for need-based financial aid may be in the hardest position to finance future college costs if they have not saved. Unsubsidized loans and scholarships may, therefore, be the major means by which they pay for college. Numerous elite schools offer favorable aid packages that benefit middle-income families. And loan forgiveness after graduation is always a possibility.

25. *See* **Chapter Five: When Savings Are Not Enough**.
26. *See* **Chapter Five: When Savings Are Not Enough**.
27. Middle-income families usually have AGI of $50,000 to $150,000.

3. High-Income Families

The *high-income taxpayers* or *wealthy families*[28] have the best ability to save for college education. They can take advantage of the Section 529 plans to cover qualified higher education expenses, including up to $10,000 for K–12 tuition. They can combine these with traditional investments, like stocks and bonds, to cover non-qualified education expenses. They will definitely be interested in using custodianship accounts, trusts, and other entities to take advantage of overall income, gift, and estate tax benefits. They may be able to pay for college from current earnings, savings, or gifts from relatives. In addition, the children of the wealthy can qualify for scholarships based on merit, and the student may benefit from the student loan interest deduction as well as the federal loan forgiveness programs after graduation. On the other hand, students of high-income families will not be eligible for government need-based grants, subsidized loans, or pay-as-you-go tax code benefits. They can, as can their parents, take out unsubsidized loans (such as PLUS loans) in the event current earnings, savings, and scholarships do not adequately cover the costs of college.

C. Conclusion

The goals of the particular client with respect to education may vary, and thus the strategies for reaching those goals may vary as well. Low-income families may *not* be able to save and may be more dependent on financial aid. Middle-class families have the widest variety of options. The wealthy clients have the ability to save or pay as they go for any education goals they may want to pursue.

28. Higher-income families generally have AGI over $200,000.