A Creative Way To Fund A College Education

Most people think that the only way to pay for college is to pay money out of pocket and borrow the rest with student loans.

This past month I was able to work with Jack, a client who found a much more effective way to pay for the first year of his son's college education.

I got a phone call from Jack this past June. His son, Jake, was graduating from high school that upcoming Friday night and he was already working on where the money due the end of July for the first semester of college was going to come from.

Jack is a very informed person who does his homework when it comes to his family finances. He wanted to know what I thought the best way would be to pay for the first year of his son's college. We talked about several ideas he had that involved taking some loans and some monies from savings. I told him I would think about the situation and get back to him.

Jack has been a client for almost a year. He started his BOY plans as a means of diversifying his holdings and having something that was not dependent on the stock market. He has a large amount of IRA money saved while working at his previous employer and some savings earmarked for college. He has done a very good job of savings money in qualified plans and trust accounts for his children's education. Jack has a very good job but had to take a 20% pay cut right before I met him to help his company through the bad economy.

Here's what I was seeing:

1. Jack has way too much money in IRA plans compared to his other savings.
2. Jack is in a better than usual tax situation this year because of the pay cut.
3. Jack's BOY plan is only about a year old and need times to crank up.
4. Jack has a car loan with under a year to go which is paid for by his company car allowance.

How could I help Jack pay for college in such a way as to improve his overall situation and provide more money for financing college in the future?

Here is what I recommended:

1. Withdraw enough money from his largest IRA account to pay for the balance due for college after all loans and financial aid is received.
2. Pay off the car loan with a BOY loan and put the car allowance towards the repayment of the BOY loan. Pay interest over and above the interest charged by the insurance company by adding money to the paid up additions rider.

By doing things this way Jack can get money out of his IRA account on a very favorable basis with lower taxes than what would be possible in the future. Jack's exit strategy on his IRA plans has been to take the money at retirement and pay the taxes then. Who knows what taxes will be in 20 years when Jack wants to retire? We do know what they are today. We do know that they will be lower for Jack today due to a reduced income. I certainly don't expect that to be the case in Jack's situation too much longer.

I know some of you are wondering why he should pay off the car loan. Very simply, we want to use the car loan payoff as short term loan to give Jack a chance to charge himself excess interest and create a larger potential pool of money to borrow from after the loan is paid off in ten months.

So what are the lessons learned from looking at Jack's situation?

- The IRS code allows IRA participants to withdraw money from their accounts for college without penalty.
- The money taken is added to your taxable income at the end of the year and only regular income tax is due.
- Taxes can be withheld from IRA distributions in the amount of the estimated tax due on the transaction.
- Paying taxes today on IRA money is a good idea if your tax situation is favorable, especially if your income is lower today.
- BOY loans can be laddered so that doing a short term loan now will actually provide you with more money to borrow in a year or two when the short term loan is paid off.
- The amount of money available for borrowing increases at a faster rate over time as additional premiums are paid and is directly related to the amount of money paid in.

JUNE 2010 NEWSLETTER

ALAN J. ECKSTRAND,CLU,ChFC
GREGORY M. KAY, CEP
ALAN J. ECKSTRAND, LLC
977 E. MAIN STREET, SUITE 2
TORRINGTON, CT 06790
PHONE: (860) 496-1941
TOLL FREE: (866) 496-4677 FAX: (860) 496-4677
Email: alan@thefinancefixer.com
Websites: www.thefinancefixer.com & **www.bankonyourself.com**