

College Planning for High Income Clients

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SHIFTING INCOME AND ASSETS FROM PARENTS TO A CHILD

PARENTS' TAX:

Stock Value	\$30,000
Stock Basis	<u>-20,000</u>
Taxable Gain	\$10,000
Parents' Tax Rate	<u>15%</u>

Parents' Tax

\$1,500

CHILD'S TAX:

Stock Value	\$30,000
Stock Basis	<u>-20,000</u>
Taxable Gain	\$10,000
Child's Tax Rate	<u>5%</u>

Child's Tax

\$ 500

FAMILY TAX SAVINGS

\$1,000

Qualifying Parameters

Parents' Income	\$100,000	\$100,000	\$150,000	\$150,000	\$150,000	\$150,000	\$200,000	\$200,000
Assets	\$100,000	\$100,000	\$100,000	\$100,000	\$200,000	\$200,000	\$100,000	\$100,000
Number in College	1	2	1	2	1	2	1	2
Number in family	5	5	5	5	5	5	5	5
EFC	\$20,200	\$ 10,100	\$ 39,700	\$ 19,850	\$ 45,300	\$ 22,700	\$ 53,800	\$ 26,900

Introduction to Affluent Clients

- Tax benefits equal funds for college
- Awareness of education tax incentives
- Combination income strategies and tax incentives
- No penalty for shifting income and assets
- Opportunities in the child's tax return
- “Affluent” client definition

Understanding the Child's Tax Capacity

- Birth through age 13
- Age 14 through high school
- College years

Birth through Age 13 – Kiddie Tax Years

- Reduces the tax benefits of shifting income
- Child is allowed a \$850 standard deduction
- Next \$850 of investment income at child's rate
- Tax-deferred or tax-exempt investments until age 14 to keep child's unearned income at \$1,700 or less
- Earned income is not subject to Kiddie Tax

Age 14 through High School Years

- Standard deduction of \$5,150 for 2006
- Low tax bracket threshold of \$30,650
- Total tax capacity of \$35,800

College Years

- Child can claim personal exemption
- Tax capacity of \$39,100 for year 2006
- Availability of Hope Credit or Lifetime Learning tax credit to offset tax

Income Shifting Strategies

- Effective for accumulating college funds
- Tax benefits equal a “tax scholarship”
- Income and estate tax savings

Methods of Income Shifting

- Gifts of appreciated assets
- Compensating the child
- Gifts of assets that will earn and grow
- Other methods of shifting income

Gifts of Appreciated Assets

- Control is kept until college years
- Possible assets:
 - ISOs and non-qualified stock options
 - Appreciated stock
 - Ag commodities
 - Hold commodity at least 1 year to get LTCG
 - Livestock gifts may be subject to SE tax
- I.R.D. rules
 - Qualified retirement plans
 - EE Bonds
 - Annuities
 - Installment sale receivables

Compensating the Child

- Not subject to social security tax if under 18 (21 for household services)
- Earned income not subject to “kiddie tax”
- Utilize the child’s full standard deduction
- Eligible to contribute to an IRA

Giving Assets that Earn and Grow

- Custodial Account holds the assets
- The “kiddie” tax may apply
- Simple and inexpensive to establish
- Contributions eligible for \$12,000 gift exclusion
- Assets must be distributed at age of majority (age 18 to 21, as determined by state law)
- Account must be used for the child’s benefit

Investments for Deferring Income to College Years

- Coverdell Education Savings Accounts
- Qualified Tuition Plans
- I Bonds/EE Bonds
- Traditional IRAs/SIMPLE IRAs
- Roth IRAs
- Tax-Efficient Funds
- Annuities
- Life Insurance
- Real Estate