33. Family 3: Financing Children's Education and Missions

Introduction

In the LDS faith, in addition to education goals, single young men ages 18–25 and single women ages 19–25 are encouraged to have another goal: to serve a mission. A mission is an opportunity for service as they go to a place assigned by Church leaders and serve for 24 months for men and 18 months for women. These young men and women put school and dating on hold during this service and work full-time in the service of their Savior Jesus Christ. The cost is covered by the young men or women individually or with help from the family if available. I served in Taipei, Taiwan nearly 40 years ago, two daughters served in the Washington, D.C. South and Rome Italy, a son served in the Arkansas Little Rock, my parents served in Manchester England, and my brother and his wife served in Nauvoo Illinois. When we talk of missions, we are referring to this service opportunity to forget yourself in the service of others for a specific period of time.

L. Tom Perry commented on the challenge facing families for financing education and missions. He wrote:

> Today a long-range family financial plan is clearly needed if children are to have the blessings of missions and education. It would need to be carefully worked out and prepared to meet these requirements. The avoidance of debt is essential; living within [your] income, fundamental.[1]

Clearly, a long-range family financial plan is needed. But how do you plan for the large expenses that educations, missions, and other goals entail?

We have a responsibility to continually improve ourselves so we can be a blessing to ourselves, our families, and the world around us. Education can help us fulfill that responsibility. Gordon B. Hinckley said the following about the importance of education:

> It is so important that you young men and you young women get all of the education that you can. The Lord has said very plainly that His people are to gain knowledge of countries and kingdoms and of things of the world through the process of education, even by study and by faith. Education is the key which will unlock the door of opportunity for you. It is worth sacrificing for. It is worth working at, and if you educate your mind and your hands, you will be able to make a great contribution to the society of which you are a part, and you will be able to reflect honorably on the Church of which you are a member.[2]

Regarding serving missions, Spencer W. Kimball said:

> The question is frequently asked: Should every young man fill a mission? And the answer has been given by the Lord. It is "Yes." Every young man should fill a mission.[3]

Clearly, both education and missions are important, whether for yourself or for your children. For parents, the challenge is knowing how to prepare a family financial plan today to help pay for the steadily rising costs of education and missions. This chapter offers a few ideas to help you as you put that plan together.

Objectives

When you have completed this chapter, you should be able to do the following:

1. Decide how education relates to your financial goals
2. Understand the principles of financing education and missions
3. Understand the process of selecting investment vehicles for financing education and missions
4. Recognize how to save for your children's education
5. Recognize how to save for your children's missions
6. Know how to reduce the cost of education and apply for aid
7. Understand ideas on how to prepare a mission and education plan.

Decide How Education Relates to Your Financial Goals

The following table depicts the average earnings and estimated lifetime earnings according to level of education in 2012. While the absolute numbers have changed slightly since 2012, the relative importance of education has not (see Table 1).

Table 1. Annual and Lifetime Earnings by Level of Education[4]

Level of Education	Annual Earnings*	Lifetime Earnings
Not a high school graduate	$24,325	$973,000
High school graduate	$30,600	$1,304,000
Two-year vocational	$38,675	$1,547,000
Associate's degree	$43,175	$1,727,000
Bachelor's degree	$56,700	$2,268,000
Master's degree	$66,775	$2,671,000
Doctorate	$81,330	$3,252,000
Professional	$91,200	$3,648,000

*Annual earnings is lifetime earnings divided by 40 years.

Generally, as a person's level of education increases, so does his or her potential for higher lifetime earnings. But why obtain a college education rather than a vocational degree? And is education a good investment? Gordon B. Hinckley said:

> You young people, the little decisions that you make can so affect your lives. Shall I go

> to school or not? Shall I continue on with my education? That is a big decision for some of you. Our doctrine suggests, although there may be some circumstances that would affect that decision . . . that the more education you receive, the greater will be your opportunity to serve. That is why this Church encourages its young people to get the schooling that will qualify them to take their places in the society in which they will become a part. Make the right decisions. Take a long look.[5]

Understand the Principles of Financing Education and Missions

While education is important, it is costly. The average costs for schooling are high and are steadily rising. However, the cost of ignorance is even higher. How can you save funds for your own education or your children's education? What is your vision for your children and grandchildren?

There are two parts to saving for education. The first is the actual saving. How do you save for education in the least painful manner? The second part is the investing of that money wisely so you can eliminate or minimize taxes, leaving more money for your children's education when it is needed.

There are six important principles of financing education and missions:

1. Teach your children to learn to seek, receive and act on the Spirit's guidance. This includes seeking diligently through study and prayer, living worthy of the Spirit's guidance, and then acting on it once it is received.

2. Teach your children to be financially responsible. Parents should teach children to work and to earn in a manner consistent with their age and abilities, particularly during summer months. Help them see the joy that comes from a job well done.

Teach them to share the things they have. Remind your children that none of what they have is their own; all they have belongs to God. Teach them the principles of using wealth wisely: ownership, stewardship, agency, and accountability.

Teach your children to be accountable for their spending. Help them learn to save some percentage, as much as 20 to 50% of everything they earn, for their goals, including missions and education.

Teach them that they earn money based on their working, not their whining. Work is a critical part of success in this life. Teach them to work and to enjoy it.

3. Help your children to save for their own (and other family member's) education and missions consistent with their abilities to earn. Encourage your children to set savings goals that will help them save for their own missions and education. Goals are critical for children at every age. Many of the goals I set as a child are the same goals I have today—my age has not changed my goals.

Set up investment or savings accounts for your children when they are young and encourage them to contribute their savings to these accounts as they are able. Help them by contributing to these accounts on a monthly basis as well. Give your children opportunities to earn money that is earmarked, after paying the Lord, specifically for their missions and education. I also recommend using this goal as a means of teaching your children about investing for the long-term.

4. If you choose to help, develop Education and Mission Plans consistent with your personal vision, goals and budget. Nothing happens without a plan. Develop a savings plan to help save for your children's education and missions. Plans that require work and contributions by children have a better chance of teaching the principles discussed than those that rely solely on parental contributions. Share your savings plan with your children as to what you will do and what you expect your children to do in saving for their education and missions. Then follow through on your plan.

5. If you choose to help, start saving for your children's education and missions NOW. The best time to begin saving for your children's education and missions is now. Begin early. In our family, once a child was born we immediately opened an education and mission account. Saving earlier and saving more has been a blessing in our children's lives.

6. Invest wisely and tax-efficiently. **Use wisdom in your investments as you save for your children's missions and education. Follow the process of selecting investment vehicles discussed earlier in the chapters on Investments. Carefully think through your decisions and write a good Investment Plan for your assets—then follow that plan (see the chapters in this course on Investments). Decide now not to use the money in these accounts except for their assigned uses.**

I recommend setting aside separate investment accounts specifically labeled "Mission Fund" or "Education Fund" for each child. With personal finance software, such as Quicken, it is easy to manage multiple accounts for different children at multiple financial institutions.

Finding Balance

As you work on preparing for your children's missions and education, finding balance among doctrines, principles and application are important in helping you become better and better prepared. Below are ideas for doctrines on which the principles are based.

Principles	Doctrines
Teach to seek, receive and act on the Spirit's guidance	Obedience

Teach financial responsibility	Agency
Teach children to save	Stewardship
Develop mission/education plans	Accountability
If you choose to help, start now	Stewardship
If help, invest your funds wisely	Accountability

From Obedience to Consecration

If you choose to help with your children's education and mission expenses, you are not only saving for our children's missions and education,

> We are children of the most high God (identity), trying to live worthy of the Spirit (obedience), with the decision to help our children save for missions and education (agency). For those who choose to help (at least with part), we believe in the importance of helping our children work toward worthy mission and education goals (Plan of Salvation). We will help our children as planned by saving and investing resources wisely (accountability), so we can help offset some of the costs of these worthy goals (agency), so we can help ourselves and our children attain their individual missions and our personal and family vision and goals.

Understand the Process of Selecting Investment Vehicles for Financing Education

In financing education, there are some sources of money that should be used before other sources. Following the correct priority refers to the process of determining the least costly sources of money for education and taking advantage of these sources first. The following list outlines the process of selecting investment vehicles for financing education:

1. Free Money

Free money does not need to be paid back and consists of scholarships, grants, and tax savings. Free money is the best type of money for education.

Scholarships are generally awarded based on merit and do not need to be repaid. Encourage your children to keep their grades high and to apply for as many scholarships as they can. Remind them that every dollar they receive in scholarships is a dollar they do not need to earn themselves.

To receive scholarships from schools and private sources, students must complete an additional application, which may be completed online or in hard-copy form. Use a scholarship search engine to learn which scholarships and grants your children are eligible for, and apply for each individually. Inquire at local recruiting offices about how to obtain armed forces scholarships. Use the Internet to view additional scholarship information—reliable sources that offer this information free of charge are provided at the end of this chapter. Do not pay for scholarship information, and be aware that you may get lots of advertisements selling scholarships—if you have to pay money to get a scholarship, it is usually a scam.

Grants are generally awarded based on financial need. Encourage your children to apply for grants and scholarships—even if they don’t think they have a chance. They may be surprised. Pell Grants are federal grants that are awarded based on need; the amount students receive varies from $606 to $5,920 per year for the 2017–2018 school year. In order to apply for a Pell Grant, students must fill out a FAFSA (free application for federal student aid) form at www.fafsa.ed.gov. Applying online streamlines the application process considerably.

Tax savings are given by states to encourage investment in education. For example, some states, such as Utah, allow parents to take a percentage of their contributions to the state’s 529 Savings Plan as a tax credit from their state taxes. For 2018 in Utah, if parents sign up for the 529 Savings Plan before their child turns 19, parents, grandparents, or other relatives (the account owners) can deduct five percent of their contribution to the 529 Savings Plan from their state taxes per child, up to $1,960 per individual ($3,920 if married filing jointly). If parents and grandparents contribute $3,920 a year at a five percent tax credit, that equates to $196 in free money ($3,920 × 5 percent) to save for your children’s or grandchildren’s education in 2018. 529 Plans will be discussed in greater detail later in this chapter.

2. Personal and Family Savings

Personal and family money is that contributed from your children’s personal savings and any other help contributed by parents, grandparents, and other relatives.

Personal savings consists of your children’s personal money. Generally, if your children help pay for their own education, they will use their resources more wisely. Start the process of teaching your children to become financially self-reliant as soon as you can, and help your children to finance as much of their own education as possible.

Family savings: Saving for your children’s education should be a family activity. After you have started saving for your retirement, find ways to save for your children’s education.

- *Tax-eliminated investing* involves investing money for your children’s education in investment vehicles for which you pay no taxes on the earnings from your investment savings. Examples of these investment vehicles include 529 Savings Plans, which offer the broadest category of things that can be purchased with these funds; Coverdell Education Savings Accounts, or Education IRAs, which are the next best alternative; and certain types of U.S. savings bonds, which are highly restrictive. Investment earnings on these vehicles are not taxed.

- *Tax-efficient investing* means saving for your children’s education in a tax-efficient and wise manner. Invest in mutual funds that are no-load, have low expense ratios, are diversified, and have low turnover ratios. Keep your money in these funds until needed.

- *Tax-deferred investing* means saving for your retirement and using some of your retirement money to help pay for your children's education. While I do not recommend this alternative, you can take up to $10,000 of your retirement 401(k) and Roth 410(k) for your children's education without the normal 10 percent penalty. However, if you take the money from a tax-deferred account, such as a 401(k), you will have to pay taxes on the distribution as ordinary income.

3. Employment

Have children work when possible to offset educational expenses. Most colleges offer federal work-study programs to help with education costs. Some universities provide thousands of student employment opportunities from their own school funds.

Studies show that working fewer than 20 hours per week will not typically have a negative impact on grades. I recommend that undergraduate students enrolled in 12 or more credit hours should work no more than 20 hours per week. This should help cover rent and food expenses.

4. Loans

Loans are debt. If you must use loans to help cover your educational expenses, borrow only the amount you need and not the amount you may be eligible to receive. Use loans wisely and pay them off quickly.

There are five key questions you should ask about any loan:

1. Does the borrower or the government pay the interest on the loan during school?
2. Do you have to start repaying the loan immediately or after graduation?
3. Do the students or the parents take out the loan?
4. Is the interest rate fixed or variable? If it is variable, what is the highest rate you would potentially pay over the life of the loan?
5. What are the costs and loan fees? Are they negotiable?

There are three main types of loans. The most cost-effective type is a subsidized loan, where someone else pays the interest while the student is in school. Generally, these have lower interest rates as well. The next-best loan is an unsubsidized loan, where the borrower pays the interest while the student is in school. Unsubsidized loans also tend to offer lower interest rates. The third type is a private, or alternative, loan, which are not recommended because of their substantially higher costs.

Subsidized loans are those where the interest payments are made by the sponsoring institution until the student graduates or leaves school. The following is for the 2017–2018 school year:

- *Subsidized federal loans* are subsidized by the U.S. federal government, which pays the interest while the student is in college. As a general rule, federal loans are generally less expensive than private, non-federal loans and a better choice, as federal loans enjoy some tax-payer subsidy. A federal loan recipient must be a citizen, permanent resident, or eligible non-citizen with a valid social security number. Recipients must also have a high school diploma or a GED equivalent; be admitted as a regular student in an eligible degree or certificate-seeking program; register or have registered for Selective Service for males; complete the FAFSA; be making satisfactory academic progress (SAP); and not be in default on a federal student loan or grant.

- *Direct Subsidized federal Stafford loans* are low-interest loans that the student begins to repay six months after he or she graduates or drops below half-time enrollment for a full six months. Therefore, the student controls when repayment begins. The government pays the interest on the loan while the student is in school. A Stafford loan is signed in the student's name, and the student is responsible for repayment. Annual loan limits are based on class standing and range from $100 to $5,500 for undergraduate students.

  For the 2017–2018 school year, the interest rate on Stafford loans is fixed at 4.45%, and there is a 1.069% origination fee. An independent student (a student who doesn't have to provide parent information on the FAFSA), may be eligible for even more loan money.

- *Subsidized university loans:* The college or university a student attends may have its own institutional short-term loan program. For example, loans available to BYU students include short-term loans that are used to cover tuition. These loans are taken out in the student's name and must be repaid the same semester they are borrowed. They charge no interest but do require a $20 processing fee and a credit check.

  Sometimes specific university departments offer loan programs as well. These university-sponsored, long-term, subsidized loans are similar to the subsidized Stafford loan in that interest does not accrue on the loan until the student begins to repay the loan 9 months after he or she graduates. These loans are in the student's name and require a cosigner. The interest rate on repayment is 6.50% and they are generally paid off in 120 months.

Federal unsubsidized loans are loans where borrowers are responsible for the paying the interest while they are in school.

- *Direct Unsubsidized Stafford loans* are low-interest loans that a student must begin to repay six months after he or she drops below half-time enrollment and stays below for a full six months—regardless of whether or not he or she has graduated. With unsubsidized Stafford loans, interest grows while the student is in school. The student may either choose to pay the interest while in school or let it accumulate and be added to the original amount borrowed. An unsubsidized Stafford loan is signed in the student's name and the student is responsible for repayment. Annual loan limits are based on class standing and range up to $12,500 for undergraduate students and $20,500 for graduate students. A fixed interest rate of 4.45% for undergraduates and 6.00% for graduates applies, with a 1.069% origination fee.

- *Direct Parental Loans for Undergraduate Students (Direct PLUS)* are available to the parents of undergraduate students to help with school-related expenses. In this type of loan, the parent is the borrower, receives the loan funds, and is responsible for repayment. To apply, students must complete the FAFSA. Interest rates on the PLUS loan are fixed at 7.00%. The parent can borrow the amount of the cost of attendance minus any other financial aid the student is receiving. Repayment begins six months after the student graduates, discontinues, or drops below half-time status. A 4.276% origination fee applies, so these are more expensive.

- *Grad PLUS loans* are available to graduate students as a supplement to the Stafford loan. The Grad PLUS loan is based on credit worthiness and does not require a cosigner. This loan is especially helpful for expensive graduate programs because students can borrow any amount up to the full cost of attendance minus other financial aid received. The 7.00% fixed interest rate makes it less expensive than private or alternative loans, although there is a 4.276% origination fee. Repayment begins six months after the student graduates, discontinues, or drops below half-time status.

Private alternative loans (also referred to as alternative loans) should be avoided. They are based on credit worthiness and may require a cosigner. They are much more expensive than federal unsubsidized loans. Currently, many of these loans have a 14.5% variable interest rate, which means the interest rate could rise above an already high rate. Private alternative loans have higher interest rates and may have up-front or back-end fees. Interest starts to accrue on the loan immediately. While the student does not have to begin repayment until he or she graduates, the interest accrues while he or she is in school. If the student did not pay the 14.5% annual interest on the loan while he or she studied for five years, the loan amount borrowed could double in size. Read the fine print carefully before signing for this type of loan.

As a general rule, federal loans are less expensive that private, non-federal loans and a better choice if borrowing is necessary. Federal loans enjoy some tax-payer subsidy and more flexible payment options. Be aware of aggressive marketing campaigns of private-alternative loans. They are very expensive and often catch the unprepared or unaware.

5. Individual Development Accounts (IDA)

Individual development accounts provide matched savings to low income savers. The Utah plan is a public-private partnership funded by a broad spectrum of community partners to encourage savings. In 2018, they match $3 for every dollar students save up to a maximum of $4,500. For example, if a student saves $1,500 over 24 months ($62.50 per month), the program will match the savings up to $4,500 for the program. They can also save lesser amounts. To be eligible for this match, students must be in the program for 12 to 36 months, attend a basic money management course (the BYU Finance 418 Financial Planning course meets this criteria), have income to save, and meet the income eligibility criteria (see Table 2). Participants must have no more than $10,000 in net assets excluding one car and one house. Proceeds from the account may be used to purchase one of four productive assets: first homes, business start-ups, post-secondary education including vocational training, and assistive technology for work related activities. More information can be found at **www.uidan.org** or at (877) 787-0727.

6. Credit Cards and Payday Loans

Although you may be tempted to use credit card funds to finance education, credit cards are a very expensive way to borrow money. I strongly discourage you from using them to cover tuition or other school expenses. This is one of the worst and most expensive way to finance schooling and is most often the result of poor planning.

The worst way to finance your education is through Payday Loans. These are short-term loans of two weeks, and should NEVER NEVER even be considered.

Table 2. Individual Development Account Earning Limits for 2018

The following are income eligibility by family size.

Family size	Income	Family Size	Income
1	$24,120	5	$57,560
2	$32,480	6	$65,920
3	$40,840	7	$74,280
4	$49,200	8	$82,640

* For families with more than 8 children, add an addition $8,120 for each person.

7. Parent's Retirement Accounts

Taking money from your (or your parents) retirement accounts is absolutely not recommended to help pay for your children's education. Your first priority is to save for retirement for you and your spouse. Then and only then, if you have resources available, should you help your children with their education. Try to find other alternatives. Taking from your retirement accounts is expensive and not tax-efficient. Do not consider this as an option.

Recognize How to Save for Your Children's Education

There are a number of different financial vehicles and financial assets that can help you save for your children's education. The key is to begin saving as soon as you possibly can, setting aside a certain amount of money each month and investing that money wisely.

The following are investment vehicles or accounts that can help you save for your children's education; the first three have tax benefits while the final two do not.

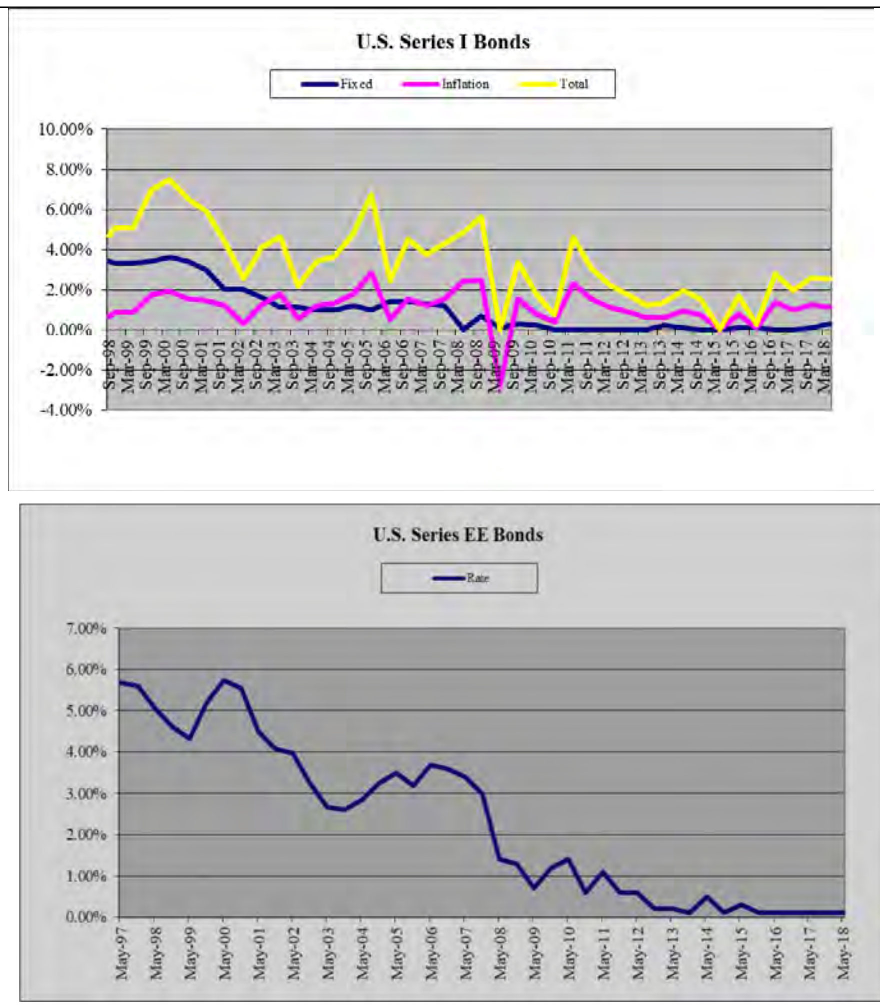
1. Series EE and Series I Bonds

Series EE and Series I bonds are issued by the U.S. government. These bonds are generally taxable, can be purchased by anyone with a social security number, and are available in amounts up to $5,000 per year for paper bonds and $5,000 per year for online bonds. A benefit of purchasing these bonds for educational purposes is that the earnings are tax-free if the principal and earnings from these bonds are used to pay for qualified educational expenses (these expenses are restrictive and include only tuition and required fees). If the earnings are used for other purposes, the interest from the bonds will not be taxed until the bonds are cashed and then the earnings will be state tax-free. I bond rates are 2.52% and EE bond rates are 0.1% until October 31, 2018 and reset every 6 months (see Charts 1).

These bonds have competitive interest rates that change every six months and can be purchased in small denominations (as low as $25) online at www.treasurydirect.gov. They have a minimum maturity of five years; if they are cashed before that time, there is a three-month interest penalty. (Savings bonds are discussed in more detail in the Cash Management chapter).

It is important to note that if your modified adjusted gross income is above specified limits in the year bonds are cashed, you cannot exclude the interest income from your income taxes. These limits are listed in Table 3.

Chart 1. I and EE Bond Interest Rates Over Time



Your modified adjusted gross income is your adjusted gross income, adding back certain items such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions, and deductions for higher-education costs.

2. Coverdell Education Savings Account, or Education IRA

An Education IRA is a type of individual retirement account that allows parents to save money for their children's secondary and higher education. Funds in an Education IRA accumulate interest tax-free, and the account creator determines how to invest the funds and how the funds will be spent. Eligible expenses include college tuition, elementary school tuition, secondary school tuition, and the purchase of books and supplies. If the money is withdrawn for expenses that are not related to education, federal taxes will be incurred at the creator's tax rate and the creator must pay a 10 percent penalty charge.

Table 3. U.S. Government EE/I Savings Bonds MAGI Income Limits

Year	**Filing Single**	**Married Filing Jointly**
2014	$76,000–91,950	$113,950–143,900
2015	$77,200–92,199	$115,751–145,749
2016	$77,550–92,550	$116,300–146,300
2017	$78,150–93,150	$117,250–147,250
2018	$79,700–94,700	$119,550–149,550

A Coverdell Education IRA has a contribution limit of $2,000 per year in 20187, which may be phased out as your income increases beyond specific limits (see Table 4). While funds must be used by the time a child reaches age 30, they can be transferred to other children.

Table 4. Education IRA MAGI Phase-Out Range

Year	Amount	Single Range	Married Filing Jointly Range
2014	$2,000	$95,000–$110,000	$190,000–$220,000
2015	$2,000	$95,000–$110,000	$190,000–$220,000
2016	$2,000	$95,000–$110,000	$190,000–$220,000
2017	$2,000	$95,000–$110,000	$190,000–$220,000
2018	$2,000	$95,000–$110,000	$190,000–$220,000

Your modified adjusted gross income is your adjusted gross income, adding back certain items such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions, and deductions for higher-education costs. Earnings beyond these limits ($95,000 single and $190,000 jointly) result in a phase-out of allowable interest deductions, which totally phase out at $110,000 and $220,000.

3. 529 Plans

529 plans are college savings plans created by state governments. These differ from state to state

and from year to year. Their purpose is to help parents and others prepare for the future costs of education or to prepay tuition costs for a specific in-state university. In Utah, parents can save up to a maximum of $446,000 per child in these accounts in 2018. There are two major types of 529 plans: 529 Prepaid Tuition Plans and 529 Savings Plans.

With a **529 Prepaid Tuition Plan**, parents pay a specific amount of money in exchange for a promise that tuition is guaranteed to be paid when the child enters college. The advantage of having this plan is that you know tuition will be covered, regardless of increases in tuition cost. This plan may be useful if you think your child will not be eligible for financial aid by the time he or she is ready to enter college.

The disadvantage of this plan is that it may not be offered in the state where your child wants to attend school. Additionally, it does not allow you to choose your investments. Given your different investment options when your children are young, you could be more aggressive with your money and gain higher returns. Also, remember that having assets in this plan reduces your child's eligibility to receiving financial aid.

With a **529 Savings Plan**, the control of the funds resides with the parent, who chooses the investments from among a set of approved investment alternatives that are set up in each state. Earnings are tax-free if the principal and earnings are used for approved higher-education expenses, which are generally quite broad in scope. Some states may even offer tax deductions on contributions made to your local 529 funds; check the guidelines in your state. Assets in these plans are not considered the student's funds, which increases a student's eligibility for financial aid. Most investment advisors would agree that this is the best way to save for your children's education.

A disadvantage of the 529 Savings Plan is that it may not cover all college expenses. Also, since you choose the investments, there is a risk of loss involved. Parents can save up to a maximum of $446,000 per child in 2018.

4. Tax-Efficient Investing

Tax-efficient investments do not offer any tax advantages to help you save for education expenses. Wise investors know they will have to pay taxes and transaction fees on any investment they make, so they work to minimize these costs as much as possible. They also monitor their investments' performance by comparing their returns after taxes and transaction fees to the appropriate benchmarks. The following are five important suggestions for investing tax-efficiently and wisely to save for your children's education.

- **Know the impact of taxes.** As an investor, you must be particularly concerned about the effects of taxes because they represent one of the largest expenses you will have to pay when you invest. To invest in a tax-efficient manner, you must understand how taxes influence your returns (capital gains, dividends, and interest). You can use the following formula to calculate your after-tax return:

$$\text{Return}_{\text{after tax}} = \text{Return}_{\text{before tax}} * (1 - \text{marginal tax rate})$$

Your after-tax return is equal to your before-tax return multiplied by the result of one minus your marginal tax rate. It is important for you to know your marginal tax rate. Your marginal tax rate encompasses your federal, state, and local taxes and is the tax rate you pay on your last dollar of earnings. (See the chapters on Tax Planning for a more in-depth explanation).

You want to invest in assets with the highest after-tax return. Remember that different types of earnings are taxed differently. Bond interest is taxed at your marginal tax rate, stock dividends are taxed at 15 percent, and unrealized capital gains (the capital gains on an asset that has not been sold yet) are not taxed until the asset has been sold. To understand the impact of taxes, you must calculate the estimated after-tax return of each asset you are considering. Remember that just even though an asset may have some tax advantages, it may not be the best asset to invest in for future education expenses.

- **Replace ordinary income with long-term capital gains.** Long-term capital gains are taxed at a much lower rate than ordinary income. Earn as much of your income as possible in the form of long-term capital gains. Spend your time picking good, diversified, and tax-efficient mutual funds, and then hold those funds for a long time.

- **Minimize turnover and taxable distributions.** Every time you sell an asset, you set up a taxable event (a transaction that has tax consequences). Using a buy-and-hold strategy minimizes the impact of taxes and reduces your transaction costs.

  You can also minimize turnover and taxable distributions by selecting your mutual funds wisely. Invest in those funds that do not have a history of trading actively (i.e., funds that have low turnover or trading, such as index funds or low turnover mutual funds). These funds will reduce the amount of taxes you must pay each April.

- **Replace interest income with stock dividend income.** Changes in the tax law made in 2004 have reduced taxes on dividends from individual company stocks or stock mutual funds to 15 percent. However, interest earned on bonds or bond mutual funds is taxed at your ordinary income rate. If you put more emphasis on stock dividend income than interest income, you will potentially increase your portfolio's return and pay less in taxes as well. These steps should only be taken if they are appropriate for your risk-tolerance level.

- **Invest tax-free.** If you are in a high marginal tax bracket, you can invest in assets that do not require you to pay federal or state taxes. For example, municipal bonds are federal tax-free and may also be state tax-free if you are a resident of the state that is issuing the bonds. Treasury bonds are state tax-free, and certain government savings bonds, such as Series EE and Series I bonds, are both federal and state tax-free if the proceeds are used for tuition expenses.

5. Custodial Accounts

Custodial accounts are set up by parents or grandparents with the help of a brokerage house or bank for their children or grandchildren. These accounts have the benefit of the estate and gift tax exclusion that allows individuals to give $15,000 per year ($30,000 per couple) in 2018 to any number of recipients without any effect on the giver's estate tax threshold amount. (This concept is discussed further in the chapter on estate planning). Parents, friends, and others can put money in these accounts to help children save for education or other personal goals.

An advantage of this type of account is that the funds can be invested in all types of financial assets: stocks, bonds, mutual funds, and so on. Money from these accounts can also be used to pay for many purchases not covered by other types of education savings vehicles, including miscellaneous fees, travel costs, and so on.

However, this type of account has no tax advantages, and the money is considered the child's money as soon as he or she is of age, so the issuer cannot take the money back to use it for other purposes. Also, since this money is considered the child's money, it may reduce the amount of additional financial aid that is available to the child. Based on these disadvantages, I do not recommend the use of custodial accounts.

Recognize How to Save for Your Children's Missions

While there are a number of different investment vehicles with specific tax advantages to help you save for your children's education, there are no similar vehicles to help you as you save for your children's missions. For most families, the two main investment strategies for saving for your children's missions will be using tax-efficient, wise investing and using custodial accounts.

Tax-Efficient, Wise Investments

Since there are no tax advantages to help you save for mission expenses, it is critical that you invest wisely and tax-efficiently. Wise investors know they will have to pay taxes and transaction fees on any investment they make, so they work to minimize these costs as much as possible. They also monitor their investments' performance by comparing their returns after taxes and transaction fees to the appropriate benchmarks. See the five suggestions for investing tax-efficiently on the previous pages.

Custodial Accounts

See previous section entitled "Custodial Accounts."

Know How to Reduce the Cost of Education and Apply for Aid

The following list outlines some ways you can reduce the cost of your children's education and apply for financial aid:

1. As discussed previously in this chapter, begin early. I recommend parents begin saving for their children's education and missions as soon as the children are born.

2. Fill out the FAFSA on the Internet at www.fafsa.ed.gov during your child's junior or senior year of high school. Follow the instructions and take action early (usually after your federal tax forms are completed). To have your federal aid in place by fall semester, it is wise to submit the FAFSA by January 1, unless you are planning to marry. Make an appointment with a counselor if you have questions.

3. Talk with the financial aid representatives at your child's preferred college during his or her senior year of high school. These representatives will guide you through the application process and help you determine your child's eligibility for aid.

4. If you are going to BYU, contact your OneStop Counselor (D-148 ASB) at 801-422-7075.

5. Look on the Internet for other sources of available aid. The following are some helpful websites that offer information about financing your education:

BYU specific:

- www.onestop.byu.edu—BYU's website for commonly accessed student services (D-148 ASB). Call their direct line for an appointment at 801-422-7075.
- www.scholarships.byu.edu—BYU's scholarship guide.
- Financialaid.byu.edu—BYU's financial aid guide.
- nsfp.byu.edu—National Scholarships, Fellowships, and Programs office.

Other:

- www.fafsa.ed.gov—The Free Application for Federal Student Aid form must be filled out to apply for any federal financial aid.
- www.nslds.ed.gov—Provides the student a centralized, integrated view of their Title IV loans and grants.
- www.fastweb.monster.com—Matches student profiles to a database of scholarships.
- www.collegeboard.com—Connects student profiles to a database of scholarships, internships, and loans.
- www.srnexpress.com—Contains resources on scholarships, fellowships, internships, and loan forgiveness programs.
- www.wiredscholar.com—Provides good information on college preparation.
- www.finaid.org—Contains comprehensive information on loans, scholarships, and savings plans.

Understand and Create Your Mission and Education Plans

As you think about developing mission and education plans, consider the questions from the creative process discussed earlier. They are:

Chart 1. Summary Education and Mission Plans

2018 Education and Mission Savings Plans Comparison Chart						
	Education or Mission: No Tax Benefits		Education Saving: With Tax Benefits			
	Taxable Account	**Custodial Account**	**Series EE/I**	**Education IRA**	**529: Prepaid Tuition**	**529: Savings Plan**
Highlights:	Can be opened by anyone	Can be opened by anyone	Can be considered a cash management, savings, and educational vehicles by contributor.	An investment account available to contributors who earn less than $110K (for single filers) and $220K (for joint filers)	Contributions today are guaranteed to cover tuition costs in the future.	A state-sponsored investment account for the benefit of anyone -- your child, your cousin, your neighbor, yourself
Offered by:	Brokerages, mutual fund companies, banks	Brokerages, mutual fund companies, banks	US Government	Brokerages, mutual fund companies, banks	States	States (usually with help from a financial services companies)
Contribution limits:	None	None	$10,000 per year for EE and I bonds and $5,000 more if use tax refund	$2,000 per student per year	Depends on plan -- Up to $446,000 max per student	Depends on plan -- Up to $446,000 max per student
Income limits:	None	None	Income limits apply if earnings are above limits in the year cashed MFJ $119.55-149.55k	Contribution limits phase out if income exceeds MFJ $190-220k	No income limits	No income limits
Qualified expenses:	None	None	Tuition, fees, supplies and special needs. Room and board are not qualified expenses. Qualified expenses are reduced by scholarships and other aid.	Tuition, room, board, fees, supplies, and special needs related to the attendance of a qualified elementary, secondary, or post-secondary institution	Tuition at a college within the plan (some plans will also cover room and board)	Tuition, fees, room, and board at qualified higher-education institutions
Tax-deductibility:	None. However, wisely investing assets in low-cost and tax-efficient mutual funds can reduce taxes substantially	None. However, wisely investing assets in low-cost and tax-efficient mutual funds can reduce taxes substantially	Contributions are already taxed, so earnings and capital gains are state tax-free. However, if principle and interest are used for eligible education expenses, then both federal and state tax free.	Contributions are already taxed. If earnings and principle are used for eligible education expenses, then earnings are both federal and state tax-free.	Contributions are after-tax. Some states give a tax deduction for contributions to a certain limit. If principle and interest is used for qualified expenses, then earnings are both state and federal tax free.	Contributions are after-tax. Some states give a tax deduction for contributions to a certain limit. If principle and interest is used for qualified expenses, then earnings are both state and federal tax free.
Effect on financial aid:	Considered to be an asset of the parent, which means the assets will be considered in the financial aid calculation	Considered to be an asset of the student, which means a large portion of the assets will be considered in the financial aid calculation	Assets are considered to be property of the account owner, which unless the owner is also the beneficiary means only a small portion of the assets will be considered in the	Considered to be an asset of the student, which means a large portion of the assets will be considered in the financial aid calculation	Considered to be the student's resource and thus reduces financial aid dollar-for-dollar	Assets are considered to be property of the account owner, which unless the owner is also the beneficiary means only a small portion of the assets will be considered in the
Investment flexibility:	Assets can be invested in stocks, bonds, mutual funds, and cash equivalents available from the financial institution. Investments can be bought and sold as often as desired.	Assets can be invested in stocks, bonds, mutual funds, and cash equivalents available from the financial institution. Investments can be bought and sold as often as desired.	Bonds must be held at least 5 years for full interest. An interest penalty of 3 months will be assessed on all bonds cashed before 5 years.	Assets can be invested in stocks, bonds, mutual funds, and cash equivalents. Investments can be bought and sold as often as desired within the financial institution.	Plan administrators invest all assets.	Assets are professionally managed. Depending on the plan, participants can choose from two to almost 30 mutual fund-type investments. Investment choice may be changed once every 12
Ability to transfer account:	Very flexible	Very flexible	None	Account may be transferred to other brokerage or mutual fund, or to a 529 plan, subject to fees and penalties.	Depends on plan	May transfer to another 529 plan once every 12 months
Interaction with Hope and Lifetime Learning Credits:	None	None	None	Credits can be claimed in the same year as tax-free withdrawal provided that the distribution is not used for the same expenses for which a credit is claimed.	Credits can be claimed in the same year as tax-free withdrawal provided that the distribution is not used for the same expenses for which a credit is claimed.	Credits can be claimed in the same year as tax-free withdrawal provided that the distribution is not used for the same expenses for which a credit is claimed.
Control of the account:	Contributor has full control of the assets	***In most states, account assets become property of the student at age 18.***	In most states, control of account will always remain with contributor.	In most states, account assets become property of the student at age 18.	In most states, control of account will always remain with contributor.	In most states, control of account will always remain with contributor.
Must use funds by:	No age limit	No age limit	No age limit	Age 30	Varies by plan	Varies by plan
Assignability to other relatives:	Can be assigned to others	Cannot be assigned to others	Cannot be assigned to others	Immediate family, including cousins, step-relatives, and in-laws	Immediate family, including cousins, step-relatives, and in-laws	Immediate family, including cousins, step-relatives, and in-laws
Penalty for non-qualified withdrawals:	None	None	Selling before 5 years results in a 3 month interest penalty	Earnings are taxed as ordinary income to contributor, plus a 10% penalty	Earnings are taxed as ordinary income to account owner, plus a 10% penalty	Earnings are taxed as ordinary income to account owner, plus a 10% penalty
Contribution deadline:	None	None	None	Tax-filing deadline for the year of the contribution	Depends on the plan	Depends on the plan
Sources:	**schwab.com**	**schwab.com**	**Treasurydirect.gov**	**www.irs.gov**	**UESP.org**	**UESP.org**

1. Vision: How will you help? What do you want this help to accomplish? Why are you doing this?

2. Goals: How much will you provide? How much is necessary? What is the purpose for these funds? When will the funds be needed?

3. Plan: How will you save that amount? How much will you need? How much must you save each month?4. Constraints: Who is this help available for? What must they do to obtain the help you are planning to give? Are their limits on the amount of available help per person?

4. Constraints: What will keep you from your vision and goals? How will you prepare to mitigate the possibility of this happening?

5. Accountability: How will you let your children know what you will and will not do? As you think through these five areas, this will help you to build the foundation for your mission and education plans for your children (and grandchildren)

These decisions should be made carefully and prayerfully with your spouse and within your family goals and budget. Following are a few ideas to help as you put your mission and education plans together for your children and grandchildren.

If you choose to help with education, ideas include:

- Vision: We believe that getting an education will make a great difference in life and make you better spouse, parent, and a contributor to the Kingdom and the world.
- Goals: We will contribute $____ per month to help you with tuition, books, and room and board. It will not cover your entire education but it will help you get through.
- Plans and Strategies: We will set aside __% of our income to help pay for your education through funds invested in I bonds, Education IRAs, 529 Plans, and taxable accounts invested tax efficiently.
- Constraints: This help is available for full-time students at an institute of higher learning (or trade school) as long as your previous semester GPA is a "C" or better and you are taking an LDS institute class.
- Accountability: We will help you with this worthy goal as long as you meet our constraints for help.

If you choose not to help with education, ideas include:

- Vision: Because we love you and believe in your ability to go on your mission and achieve your educational goals without our help, we're choosing not to contribute to your education and mission goals.

- Goals: We believe a mission and education are great goals but will mean more to you if you sacrifice to achieve them yourself, not if we make it too easy to attain.
- Plans and Strategies: We will allow you to save for this goal and will give you opportunities to earn and save money.
- Constraints: None.
- Accountability: We currently do not plan to have the resources saved to be able to contribute to these worthy goals, but we will help when and if we can.

If you choose to help with missions, ideas include:

- Vision: We believe serving the Lord for 18 or 24 months will make a great difference in your life. It did mine.
- Goals: We will contribute $____ per month to help you with your mission. It will not cover your entire mission but it will help you get through with reduced needs.
- Plans and Strategies: We will set aside __% of our income after each child is born to help attain this important goal. We will pay for your mission with appreciated mutual funds which we have put in each child's taxable account (not custody accounts).
- Constraints: If you are willing and worthy to go on a mission, we are willing to help.
- Accountability: We want to help you with this worthy and wonderful goal once you are worthy and prepared.

As you can tell from the previous examples, you can be very creative in the requirements to receive this help.

Summary

Education is important. Generally, as a person's level of education increases, his or her amount of lifetime earnings increases as well. There are many different ways to finance an education; reduce the cost of education as much as possible by utilizing available investment vehicles and financial assets.

There are five important principles of financing education and missions: (1) teach your children to be financially responsible, (2) help your children save consistent with their abilities to earn, (3) develop a savings plan consistent with your personal goals and budget, (4) start saving for your children's education and missions early, and (5) invest wisely and tax-efficiently.

In financing education, there are some sources of money that should be used before other sources. Following the process refers to determining the least costly sources of money for education and taking advantage of these sources first. The following list outlines the priority investment vehicles for financing education:

1. Free money
2. Personal and family savings
3. Employment while attending school
4. Loans
5. Individual development accounts
6. Credit cards (strongly discouraged)
7. Retirement accounts (very strongly discouraged)

There are several ways to reduce the cost of education and apply for financial aid. Begin the process early, fill out the FAFSA form, talk with financial aid representatives at your child's preferred college, and look on the Internet for other types of aid available.

Assignments

Financial Plan Assignments

Helping finance your children's education and missions is an important part of helping your children prepare for life. Whether you can help out a lot or just a little, every little bit helps. The key is to save wisely using available investment vehicles and to save the most you can in the most tax-efficient manner.

Your assignment is to review the investment vehicles you can use to save for your children's education. What are your priorities of money for education? Which vehicles should you use first and why?

Review the investment vehicles you can use to save for your children's missions. Which vehicles should you use first and why?

Planning now for your children's education and missions and following through on that plan will go a long way to helping make sure the resources are available when your children go to school and on missions.

If you or a child will attend BYU in the coming two years, go to go financialpath.byu.edu and map out your or your child's customized financial plan for college and see whether you are on track to graduate financially well-positioned for life, or whether you may be on a path to graduate with excessive debt.

Review Materials

Terminology Review

529 Prepaid Tuition Plan. This is an education plan where you can prepay tuition for a child and you know tuition will be covered, regardless of raises in costs of tuition. May be useful if you think your children will not be eligible for financial aid.

529 Savings Plan. This is an education plan where you can put money aside after tax and it grows tax free if principle and earnings are used for qualified educational expenses. Control of the funds resides with the contributor, who chooses the assets within options provided.

Custodial Accounts (UGMA/UTMA). These are investment vehicles that are managed for the child until the child turns a certain age. They can be invested in all types of financial assets, stocks, bonds, mutual funds, etc. UTMA (Uniform Gift to Minors Account) has fewer restrictions and may include real estate. These can be used for any educational or other expenses, including missions. The risks are there are no tax advantages and it is considered the child's money as soon as the child is of age—it cannot be taken back by the issuer. I prefer a tax-efficiently invested account.

Direct PLUS Loan. These are loans available for parents of undergraduate, dependent students to help with school-related expenses, and the parent is responsible for interest during school. Repayment begins six months after student graduates, discontinues, or drops below half time, and the parent is the borrower.

Direct Subsidized Loans. These are loans direct from the Federal government. The government pays interest while student is enrolled in school at least half-time, and repayment begins 6 months after student graduates or drops below half-time enrollment.

Education Savings Account (Coverdell or Education IRA). The investment vehicle is similar to a Roth IRA where you invest in this account with after tax dollars, and if you use the proceeds for qualified educational expenses, distributions are tax-free. You choose your investments and the proceeds can be used for eligible elementary, secondary and post-secondary education expenses.

Employment. This is working during college to help offset the cost of educational expenses.

Family Money. This refers to the use of personal savings and help from parents or other family.

Find out which ones you are eligible for on a scholarship search engine and apply for each

Free Application for Federal Student Aid (FAFSA). This is the application form for obtaining government student aid.

Free Money. This is money you do not physically work for and is not paid back. It includes scholarships and grants.

Grad PLUS Loan. These are loans available for graduate students to help with school-related expenses. The student is responsible for interest during school, repayment begins six months after student graduates, discontinues or drops below half time, and the graduate student is the borrower.

Grants. Money given to individuals for education on the general basis of need.

Individual Development Accounts (IDA). These are matching resources from local and other sources to encourage saving for specific goals including education. They must be used for education, or home purchase, or to start a business, you must be in the program for 12 to 36 months maximum, and must attend a basic money management class (Fin418 and MBA620 both count), reside in Utah, be 18 or older, have income to save and meet needs criteria.

Modified Adjusted Gross Income. This is your adjusted gross income adding back certain items such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions and deductions for higher-education costs.

Pell Grant. A type of government grant to help students attend college.

Private Alternative Loans. These unsubsidized loans are much more expensive than federal unsubsidized loans, interest starts immediately and accrues, and you must begin paying the loan back immediately. The student is the borrower. These have higher up-front fees and may require a cosigner. Read the fine print VERY CAREFULLY.

Scholarships. Money given to promising students because of their shown abilities in specific areas. There are many scholarships available, but you have to find and apply for them individually.

Series EE and Series I Bonds. US savings bonds with the special tax advantage that earnings on the bonds are tax-free if used for paying tuition and fees

Subsidized Loans. Loans where another party pays the interest while the student is in school. Interest begins 6 months after the student graduates or drops below half-time enrollment.

Subsidized University Loans. These are loans offered by the university to students attending school.

Unsubsidized Federal Loans. These are loans for both grads and undergrads where the student responsible for interest during school, repayment begins six months after student graduates, discontinues, or drops below half-time enrollment for a continuous 6 months.

The interest is not subsidized.

Review Questions

1. What is the general trend of education costs?
2. What is the relationship between education level and annual earnings?
3. What are the recommended priorities of money for financing an education?
4. What are some examples of "free money"?
5. What is the most important part of saving for your children's education and missions?

Case Study 1

Data

Anne and Bryan, ages 35 and 38, are planning for their children's educations. They are looking at the Education IRA, Series I bonds, and the 529 Savings Plan. They have three children, ages 2, 4, and 7, and earn a combined income of $50,000 per year. They save 20 percent of their income for their goals, of which 3 percent is earmarked for their children's education. They would like any tax breaks they can receive, as their cash flow situation is tight. Since they live in Utah, the Utah 529 Plan allows participants a 5 percent tax credit on contributions up to $1,960 for individuals and $3,920 filing jointly in 2018 on their Utah State taxes.[6]

Application

Which education vehicle should they use, and how much will they save in taxes?

Case Study 1 Answers

If their intent is to save money, the preferred vehicle is the Utah 529 Savings Plan. They can contribute up to a maximum of $446,000 total per child (aggregate maximum) in 2018. For current benefits, they can receive a 5% tax credit on contributions up to $1,960, totaling $95 ($3,940 and $196 for married filing jointly in 2018). Assuming they put the entire planed amount in the 529 Savings Plan ($50,000 * 3%), they can contribute $1,500 total, or $500 per child. They would be able to deduct the $1,500 * 5%, or $75, as a tax credit from their Utah state taxes and save that $75 as free money.

The Education IRA and Series I bonds have no current tax advantages, but they will save money on taxes in the future if principle and earnings are used for qualified education expenses.

[1] "For Whatsoever a Man Soweth, That Shall He Also Reap," *Ensign*, Nov. 1980, 7
[2] "Inspirational Thoughts," *Liahona*, Jun. 1999, 3
[3] "When the World Will Be Converted," *Ensign*, Oct. 1974, 8

[4] Anthony P. Carnevale, Stephen J. Rose, and Ban Cheah, "The College Payoff: Education, Occupations, Lifetime Earnings," Georgetown University Center for Education and the Workforce, 2012.
[5] Pocatello, Idaho, Regional Conference, Idaho State University, Jun. 4, 1995
[6] http://www.uesp.org/About-UESP/Plan-Benefits/Tax-Advantages.aspx, August 8, 2014.