

Q3

2007

SC&H | financial perspectives

A quarterly newsletter for the clients and friends of SC&H Financial Advisors, Inc.

Upcoming SC&H Financial Seminars

A series of seminars will be held at our Sparks, MD headquarters at 6:30 p.m.

- Feb. 7, 2008

Tax-Favored Investment Strategies

- Date to be determined

Wealth Transfer

For more information or to register, call Katie Lochte at (410) 785-8052 or visit www.scandh.com/events.

To schedule a consultation, please contact Greg Horning, Audrey Drossner, Robin Patalon, or Jay Bittner at 410-403-1500.

To Our Readers

In this quarter's *Financial Perspectives*, we discuss the important issue of college education financing. By properly planning and saving for your child's education now, you can provide the resources necessary to pay for continuing education while minimizing your child's student loan burden.

Fortunately, there has never been a better time to begin planning, because there have never been more savings and investment options available. You may have heard about:

- 529 Plans
- Coverdell Education Savings Accounts
- Custodial Accounts
- Savings Bonds
- Taxable Investment Accounts

Although each of these options has advantages, we favor 529 plans and will focus most of this newsletter on helping you to understand this excellent option.

As always, please contact us if you have questions regarding these or other financial planning issues.

Regards,

Greg

Greg Horning, President, SC&H Financial Advisors, Inc.

(410) 403-1512, GHorning@SCandH.com.

529 Plans: A Better Way to Save for College

Choosing the best way to save for your child's college education can be difficult because there are so many options to choose from. However, we believe that the 529 College Savings Plan is the best choice for most people.

There are two types of 529 plans—the prepaid tuition plan and the college savings plan. Each state offers at least one 529 plan, and most 529 plans are available to out-of-state investors. The amounts you can contribute are substantial – over \$300,000 per beneficiary in many state plans, subject to limitations discussed below. Some of the significant highlights in contributing to a 529 plan include:

- Qualified individuals of all income levels are eligible to contribute on behalf of anyone, including children, nieces, nephews, grandchildren and non-relatives.
- The contributor may own the account and retain control over the distribution of monies and investment selections.
- Earnings are income tax deferred.
- Withdrawals from the plan that are used for qualified educational purposes are exempted from federal income tax and often state income tax. This became permanent with the Pension Protection Act of 2006.
- Some states offer a tax deduction for contributions.

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Education Planning,

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- The owner can change the beneficiary to another member of the same family, including first cousins of the original beneficiary.
- Contributions are generally excluded from the estate of the contributor for federal estate tax purposes.

Individuals can contribute up to \$12,000 per year without triggering a gift tax. They can also make contributions as large as \$60,000 (\$120,000 for joint gifts) without triggering the gift tax as long as they elect on a gift tax return to treat the gift as having been made over a five-calendar-year period. However, part of the contribution is pulled back into the donor's estate if they die before the fifth year following the gift.

Uniform Gift to Minors Act (UGMA) and Uniform Transfer to Minors Act (UTMA) assets can be transferred into most 529 plans. However, this transfer usually requires the child be named as the owner of the account, and will preclude future beneficiary changes. In addition, the assets in the UGMA or UTMA account must be liquidated before being contributed, which may have income tax consequences.

In the event that 529 plan assets are not used for college expenses, the account owner can either reclaim the money for their own use or change the beneficiary on the account. Reclaiming assets would result in taxation of the investment gains, as well as a penalty of 10% of the earnings. This 10% penalty will not apply if the beneficiary died, became disabled, or received a scholarship. Because the account owner can change the beneficiary, many parents will elect to retain unused monies in their 529 account, and eventually name their grandchildren as future beneficiaries.

Overall, the 529 Plan is a sensible investment option for many individuals who are saving for educational purposes. This plan is extremely flexible and offers many attractive contribution

IRS Circular 230 Notice:

Please note that any tax advice contained in this newsletter is not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed by any governmental taxing authority or agency ♦



options. To find out if a 529 Plan is right for you, contact one of the SC&H financial advisors to review your specific situation and options.

Important Notes:

For more complete information about the 529 savings plan, including investment objectives, risk, fees and expenses associated with it, please read the issuer's official statement.

The issuer's official statement can be obtained from your financial advisor. Please read it carefully before investing. Please consider, before investing, whether your home state offers any state tax or other benefits that are only available for investments in your state's qualified tuition program. Other benefits may include reduced or waived program fees, matching grants, and scholarships to state colleges. Any state-based benefit offered with respect to a particular 529 college savings plan should be one of many appropriately weighted factors to be considered in making an investment decision.

You should consult with your financial, tax or other advisor to learn more about how state-based benefits (including any limitations) would apply to your specific circumstance and you may also wish to contact your home state or any other 529 college savings plan to learn more about the features, benefits and limitations of that state's 529 college savings plan ♦

Top 10 Education Planning Mistakes

1. Not starting to save when the child is a toddler.
2. Failing to utilize 529 plans.
3. Saving in the child's name.
4. Not understanding the numerous financial aid options available, including private scholarships.
5. Believing that high school counselors can provide all of the financial aid information that a parent would need.
6. Not filing the Free Application for Federal Student Aid (FAFSA) each year.
7. Missing financial aid deadlines.
8. Using retirement account money to pay for college.
9. Assuming that you will not qualify for any financial aid.
10. Not asking the college if additional money is available.

The Facts

- Average annual cost of private college in 2006 was \$31,000 per year.
- 63% of all college undergraduates received some type of financial aid during the 2003-2004 school year.
- College financial aid officers have great latitude in determining the aid package that your child ultimately receives.
- Federal Government Education Loans are classified into two main categories. Need based loans are available thru the Stafford Loan Program; Non-need based loans are available thru the Federal Parent PLUS Loan Program. As of July 1, 2006 the interest rates for these loans were fixed at 6.8% and 8.5% respectively.

Source: Excerpts from "Family Guide to College Savings" (www.savingforcollege.com).

Paying For College An Interview With Greg Horning



Q: Why do you feel so positive about 529 Plans?

Greg: *There are numerous positives to 529 plans and no significant disadvantages.*

Q: Would you comment on some of the other savings options?

Greg: *Sure. Other good options include Coverdell Education Savings Accounts, Custodial Accounts, Savings Bonds, and Taxable Investment Accounts.*

A Coverdell Education Savings Account (ESA) is a tax-advantaged account that allows individuals to save money to cover future college education expenses. With an ESA, you may contribute up to \$2,000 per year (by April 15th) for a beneficiary who is below the age of 18 at the time of the contribution. There are income limitations for the donor, and the contribution is treated as a gift. Individuals can contribute to both an ESA and a 529 Plan for the same beneficiary. Qualified withdrawals can be made for ALL levels of formal education and can also include expenditures for computers and other educational supplies. Any unused balance must be distributed to the beneficiary within 30 days of his/her 30th birthday.

A Custodial Account is designed to allow adults to make irrevocable gifts to minors in the form of cash or securities. Once the transfer is made from the donor to the minor, the minor actually owns the securities and the donor/transferor sacrifices legal access and authority over the funds. The downside of Custodial accounts is that the earnings may be taxable each year and at age 18 or 21 the funds may be used at the child's discretion. In 2006, the Kiddie tax applied to children under age 18 whose unearned income was in excess of \$1,700. The tax was recently expanded to include individuals under age 19 and students under age 24, effective for tax years beginning after May 25, 2007. Under the Kiddie tax, the excess income is taxed at the parents' highest marginal rate.

Investing in a U.S. Savings Bonds is a tried and true method of saving money to pay for future educational expenses. For instance, interest income earned on redemption of U.S. Savings Bonds in a year in which qualified educational expenses are paid may be eligible for the interest income exclusion. For this to occur, the bonds must have been issued after 1989 to an individual over 24 years old. The interest income exclusion is subject to income limitations in the year of redemption.

The final option I mentioned above are Taxable Investment Accounts. These accounts, in general, are not an attractive option to pay for educational expenses, because taxes paid on the account earnings could reduce the funds available for college by 15% to 40%. That represents money paid to the federal government that could have been used to pay for college.

Q: What suggestions do you offer regarding financial aid?

Greg: *While current income is the primary consideration for federal financial aid, additional factors are considered including assets, years until retirement, and the number of children in college at the same time. Unless you are quite certain that you will not qualify for financial aid, we suggest that you go ahead and apply. We also suggest that parents pursue financial aid opportunities from the college itself as well as aid that could come in the form of privately sponsored scholarships.*

Q: Are all of the parent's assets included when applying for federal financial aid?

Greg: *No, excluded from consideration are "non-assessable assets" such as retirement accounts [e.g. IRAs, 401(k)s, 403(b)s]; equity in a primary residence; annuities; and cash value life insurance ♦*

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Contact SC&H Financial Advisors to schedule your estate planning review or financial check-up.

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910 Ridgebrook Road
Sparks, MD 21152
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