NEWSLETTER

Tips on planning for college financial aid

Scholarships, grants, student loans. Learning about the options available to help you pay for your child's college expenses requires a lot of homework. Here's one more thing to study: how to coordinate those sources of funds with your overall financial plan.

As you probably know, your income and assets, as well as those of your child, affect eligibility for federal student aid. What may not be so obvious is the role early financial planning can play.

Expected family contribution. For instance, say your tax plan includes shifting assets to your child as part of a family-wide savings strategy. When you intend to apply for federal educational assistance, you'll also want to consider the way money and property owned by your child affects the amount of aid you may be eligible to receive.

In general, assets owned by your child equate to less potential student aid. That's because a larger percentage of those assets counts toward the amount of college expenses you're expected to pay out of pocket, also known as your "expected family contribution."

Currently 20% of student-owned assets are included in the expected family contribution, versus a maximum of 5.64% of certain assets owned by you and your spouse.

Tip: Depending on the scheduled enrollment date, you may want to use some of your child's assets for upcoming expenses, such as school supplies or dorm furnishings.

529 college savings plan. What about putting money in a 529 college savings plan? In addition to being a good estate and income tax planning move, 529 savings plans are treated favorably under financial aid rules, too.

For one thing, the value of the 529 account is considered an asset of the parent in financial aid calculations. That's true whether you own the account or your dependent child does.

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Tax filing reminders

* September 17 – Third quarter installment of 2012 individual estimated income tax is due.

* September 17 – Filing deadline for 2011 tax returns for calendar-year corporations that received an automatic extension of the March 15 filing deadline.

* September 17 – Filing deadline for 2011 partnership tax returns that received an extension of the April 17 filing deadline.

* October 1 – Generally, the deadline for businesses to adopt a SIMPLE retirement plan for 2012.

* October 15 – Deadline for filing 2011 individual tax returns on extension.

College Financial Aid

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For another, qualified distributions from 529 plans you own are not counted as income on the federal aid application.

Income management. Managing your income is another tax planning move that requires consideration of student aid rules. An example: Deciding to recognize capital gains to take advantage of lower rates can add to your "available income" and reduce potential financial assistance.

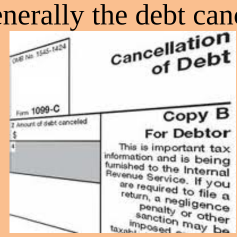
Increasing your tax-exempt interest can have the same result, as can hiring your child in your family business. Up to 50% of your child's income (after certain adjustments) may be counted in the financial aid calculation.

Maximizing contributions to your qualified retirement plans also affects the financial aid formula. The balance in your 401(k) or similar account is not included as part of the assets you have available for paying your child's college costs.

Cancelled debt can result in taxable income

With the recent economic downturn experienced by many taxpayers, there is a tax concept that is very important: cancellation of debt. You would think that the cancellation of debt by a credit card company or mortgage company would be a good thing for the taxpayer. And it can be, but it can also be considered taxable income by the IRS. Here is a quick review of various debt cancellation situations.

* Consumer debt. If you have gone through some type of credit "workout" program on consumer debt, it's likely that some of your debt has been cancelled. If that is the case, be prepared to receive IRS Form 1099-C representing the amount of debt cancelled. The IRS considers that amount taxable income to you, and they expect to see it reported on your tax return. The exception is if you file for bankruptcy. With bankruptcy, generally the debt cancelled is not taxable.



Even if you are not legally bankrupt, you might be technically insolvent (where your liabilities exceed your assets). If this is the case, you can exclude your debt cancellation income by reporting your financial condition and filing IRS Form 982 with your tax return.

* Primary home. If your home is "short" sold or foreclosed and the lender receives less than the total amount of the outstanding loan, you can also expect that amount of debt cancellation to be reported to you and the IRS. But special rules allow you to exclude up to $2 million in cancellation income in many circumstances. You will again need to complete IRS Form 982, but the exclusion from taxable income brought about by the debt cancellation on your primary residence is incredibly liberal. So make sure to take advantage of these rules should they apply to you.

* Second home, rental property, investment property, business property. The rules for debt cancellation on second homes, rental property, and investment or business property can be extremely complicated. Generally speaking, the new laws that cover debt cancellation don't apply to these properties, and the IRS considers any debt cancellation income taxable. Nevertheless, given your cost of these properties, your financial condition, and the amount of debt cancelled, it's still possible to have this debt cancellation income taxed at a preferred capital gains rate, or even considered not taxable at all.

Be aware that many of the special debt cancellation provisions are set to expire at the end of 2012. If you're unsure as to how debt cancellation affects you, contact our office to review your situation and determine how much, if any, cancelled debt will be taxable income to you.

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