# THE SHERIDAN ROAD MAP

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## 529s Shouldn't Be Parents' First Financial Step

### College savings plans are useful, but other moves might be more important or effective.

**529** college savings plans are the best method most families have to save money for higher education expenses, delay or eliminate taxation on future earnings, and still maintain control over the assets.

But the relatively short investment time frame college savers usually have, combined with the possibility of lower net returns during the "accumulation" period, means that families hoping to outrun rising college costs may be disappointed.

So before you start putting parents' money into 529 college savings plans, you should discuss several steps that address more urgent issues, and may offer greater advantages.

**1. Prepare For the Worst**

The untimely death of one or both family breadwinners can leave the survivors with a lack of enough money to cover basic living expenses, much less a five- or six-figure future college bill.

The most cost-effective way to address this deficit is using term life insurance policies that last at least until the children are (hopefully) old enough to care for themselves.

The amount of the death benefit should be enough to allow the remaining family members to be financially independent, and policies should be obtained on both working and stay-at-home parents.

Of course, the parents wouldn't want a sum of money this large to be inherited directly by their orphaned children, especially when the kids are "adults" in name only.

So the parents should consider adding a trust to the will, with guardians and powers of attorney they have established with the help of a qualified estate planning lawyer.

**2. Ramp Up Retirement Savings**

Many well-meaning families put near-term college expenses ahead of the farther-out goal of retiring comfortably. But this is usually a short-sighted mistake for several reasons.

First, it's possible to borrow money to pay for college, and often at favorable terms. But no lender is ever going to offer a "retirement loan."

The immediate tax benefits of saving in a 401(k) or IRA are also much larger than anything provided by depositing money into a 529 college savings plan.

Also, assets accumulated in retirement plans don't measurably reduce the need-based financial aid packages awarded by most schools, especially when compared to other types of savings vehicles.

But parents who attempt to save for retirement while their children are in school (and applying for financial aid) will likely have the amount they're trying to set aside in retirement accounts added back into the "expected family contribution."

If the parents do eventually end up with extra money in retirement, they can use any surplus to make payments on (or pay off) any higher education loans the children have obtained.

**3. Pay Off "Bad" Debt**

According to *CreditCards.com*, in September 2011, the average interest rate charged by credit card companies was 14.94%, the highest figure charted by the site since it first began

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## 529s Shouldn't Be Parents' First Step (continued from page 1)

tracking the number in 2007.

If parents have any of this high-interest debt outstanding, paying it off saves them a cost that will likely exceed anything they could expect to earn in a 529 savings plan sub-account.

The resulting reduction in savings may also increase the family's eventual need-based financial aid package, as well as bump up the parents' credit score.

Which will come in handy when the parents go to …

**4. Fund the Kid's Roth IRA**

Since the parents of high schoolers have only a couple of years left to save and invest before their child starts college, it's difficult to see how money put into a 529 plan at this point can grow substantially, especially if it's invested conservatively.

**If parents have any of this high-interest debt outstanding, paying it off saves them a cost that will likely exceed anything they could expect to earn in a 529 savings plan sub-account.**

Therefore, parents of working teenagers may be able to get more bang for their bucks and their kids by instead setting money aside in Roth IRAs for their children.

The child has to have legitimately-earned income to be eligible for the Roth IRA. But she doesn't have to put her own money into the account — her parents (or anybody else) can make the deposit, as long as the benevolent depositors recognize it's an irrevocable gift to her.

Of course, the contributions can be withdrawn at any time for any reason with no taxes whatsoever. So if she needs the money for college, or a down payment on her first house, or just to cover living expenses, only the "earnings" portion of the account will be subject to taxes and penalties.

But if she can leave the account alone, the payoff in retirement could be astounding. Say a 15-year-old makes $5,000 each year for the next three years, and ends up with $15,000 deposited into her Roth IRA.

If that money grows at a hypothetical annual return of, say, 7%, by the time she's 65 the $15,000 would be worth about $413,000 — tax free.

Trying to reach that same figure by saving later in life would require her to make $5,000 annual contributions to a Roth IRA from age 38 to 65 — a total of $135,000.

And if you can make that point clear to the teenager, you will not only earn the gratitude of the parents, but provide the most valuable education she may ever receive.

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*The Roth IRA offers tax deferral on any earnings in the account. Withdrawals from the account may be tax free, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59 ½ may result in a 10% IRS penalty tax. Future tax laws can change at any time and may impact the benefits of Roth IRAs. Their tax treatment many change.*

*The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing.*

*By Kevin McKinley • Registered Rep, October 2011*

## 2012 Retirement Plan Limits

***The Internal Revenue Service has announced its inflation-adjusted retirement plan contribution limits for 2012.***

| Deferral Limits | | 2012 | 2011 |
|---|---|---|---|
| Elective Deferral Limit for 401(k), 403(b) and 457(b) Plans IRC 402(g) | | $17,000 | $16,500 |
| Catch-up Contribution Limit IRC 414(v) | (*no change*) | $5,500 | $5,500 |
| **Benefits and Compensation** | | | |
| Annual Additions Limit for Defined Contribution Plans IRC 415(c) | | $50,000 | $49,000 |
| Limit on Annual Benefits for Defined Benefit Plans IRC 415(b) | | $200,000 | $195,000 |
| Annual Compensation Limit IRC 401(a)(17) | | $250,000 | $245,000 |
| Highly Compensated Employee Limit IRC 414(g) | | $115,000 | $110,000 |
| Key Employee Determination Limit IRC 416(i) | | $165,000 | $160,000 |
| SIMPLE Retirement Plan Contribution Limit IRC 408(p) | (*no change*) | $11,500 | $11,500 |
| **Social Security/Medicare** | | | |
| Social Security Wage Base (Old Age, Survivors) | | $110,000 | $106,800 |
| Medicare Wage Base | | No Limit | No Limit |

*LPL Financial does not provide tax advice. Please consult a qualified tax advisor.*

# Where to Find the Biggest College Scholarships

## Your clients can strike gold by seeking aid from the country's private colleges directly. Some dole out merit awards worth up to half of tuition.

When teenagers start searching for college scholarships, they usually look in the absolute worst place.

Typical teenagers and their parents assume that the best way to cut their college costs is to win private scholarships. I'm talking about modest scholarships from nonprofits like the Rotary and Kiwanis clubs and major prizes from the likes of AXA Equitable, Coca-Cola and The Bill & Melinda Gates Foundation. And then there are the oddball scholarships awarded to students who design duck tape prom outfits or kids who happen to be left-handed flutists from Wisconsin. I exaggerate, but you get the idea.

It's frustrating that teenagers devote so much energy to chasing these private awards because so many of them are puny. The average private scholarship is about $2,500. What's more, these scholarships represent only 4% of all the money each year that's available through college grants.

**So where is the big money?**

The federal government is sitting on the largest stockpile (44%) of college grants. The biggest federal award is the Pell Grant, which provides a maximum award of $5,550 to eligible students. It's highly unlikely, however, that your clients will qualify for a Pell Grant or any of the smaller federal grants. You typically must have an income of less than $30,000 to capture the full Pell Grant and families with incomes approaching $50,000 have little chance of pocketing anything. The only federal assistance your clients will probably qualify for will be government loans.

Your clients, however, can strike gold by focusing on the nation's second largest source of scholarships, which you can trace right up to the front doors of colleges and universities across the country. It's these institutional awards from the colleges themselves that families should aggressively pursue.

You might be shocked at how much is available. Private colleges and universities dole out merit awards that typically slash 49% off their published tuition, according to the latest annual statistics from the National Association of College and University Business Officers. A student who captures the average grant from a school that charges $38,000 in tuition, for instance, would save more than $18,600 a year. That's a heck of a lot better than a one-time check of $250 from your local Lions Club.

**Why Do Colleges Award Scholarships?**

Why are private institutions discounting so heavily? Here are three reasons:

1. They must compete with less expensive state schools, and their scholarships help them remain competitive.
2. Schools use the awards to compete among themselves for promising prospects, regardless of their financial need, because, contrary to conventional wisdom, it's a buyer's market. Most private schools worry every year about filling all their freshmen slots. The exceptions are the Ivies and a few dozen ultra elite schools, which turn away the vast majority of their applicants. All the other schools must offer discounts to improve their curb appeal.
3. Schools use merit scholarships to attract solid students, which they hope will help them improve their *U.S. News & World Report's* college rankings or at least allow them not to lose any ground.

This is going to sound perverse, but the widespread use of scholarships — 88% of students at private colleges and universities receive some type of award — are one reason why prices at private institutions are so outrageous. Schools use some of the extra revenue that's generated from their higher prices to bestow scholarships on the teens they covet.

**State University Scholarships**

It's not just private schools, by the way, which are dispensing institutional scholarships. Public universities are also luring attractive teenagers to their campuses with scholarships. Just like their private counterparts, state schools are dispensing awards not just to needy students, but to wealthy teens too. According to the Education Trust, flagship universities in the 50 states were recently awarding an average scholarship of nearly $4,200 to students in the top income quintile. Keep in mind that the state awards aren't going to be as high as those offered by private schools because the price tags are considerably lower.

State universities dispense money to wealthy students for the same reason that private schools do. Affluent students are more likely to have attended top public and private high schools that have prepared them well for college, and they also tend to have higher GPAs and standardized test scores. State schools attracting these students also hope it will help them inch up *U.S. News & World Report's* rankings.

Top students, who hope to win merit scholarships from flagship universities outside their own states, need to be aware that it's often going to be tougher pocketing awards than from private institutions.

Why? Flagships are often the most prominent schools in their respective states so they rarely have a problem attracting enough applicants. Flagships typically reserve their awards for a smaller percentage of students, who have earned high grade point averages and standardized test scores.

Smart nonresidents may actually end up overpaying to attend flagships because these schools need the extra revenue generated by out-of-state tuition as support from their state governments continues to decline.

Some prestigious state universities, such as UCLA, University of California, Berkeley, University of Michigan and University of Virginia, are now charging in the $50,000 range or higher for outsiders. Buyers beware.

*By Lynn O'Shaughnessy • Registered Rep, October 2011*

# CFOs Prefer a Simpler Tax Code, Even If They Don't Save

## New Duke University/*CFO* Magazine Global Business Outlook Survey finds finance executives united in their desire for tax reform.

There are many points on which most finance chiefs disagree with the country's chief executive, President Obama. But they are united in their desire to change the corporate tax code, whose statutory rate of 35% ranks as one of the world's highest.

> *"Our system actually hinders success. It was designed when the U.S. was the dominant economy, and before globalization became an unmistakable market reality."*
>
> **Greg Hayes,** CFO of United Technologies

The President called for a reduction of the corporate tax rate and the elimination of a variety of deductions in his September jobs speech. From the results of the most recent Duke University/ *CFO* Magazine Global Business Outlook Survey, it would seem that most finance executives agree with the idea, at least in theory.

Nearly half of the 494 U.S. finance chiefs surveyed say the corporate tax system in the U.S. is seriously flawed and needs a complete overhaul (see charts; for full survey results). Another 47% take a more moderate view, saying the system "has some flaws and needs some reforms." Just 6% say the system works reasonably well.

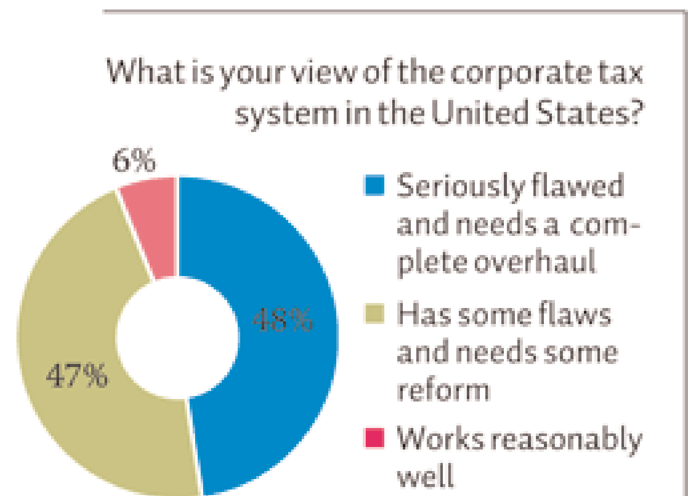
The number calling for major reform has jumped since *CFO* last polled finance executives on the topic in June, when there were more in the moderate camp and a substantial but smaller number — 39% — calling for a total overhaul. Since then, tax reform has become an even more prominent part of the national conversation, as lawmakers struggled through the debt ceiling negotiations and as the congressional committee that emerged from that debacle now works on identifying other ways to cut the national debt.

Showing their frustration with the complexity of the tax code and the time and money they spend to comply, 71% of CFOs say they'd be willing to give up all existing exemptions and credits in return for a reduction in the overall corporate rate — even though they might not come out ahead on their tax bill. Another 17% say they'd forgo exemptions for a lower rate because they believe their companies would end up paying less in taxes than they do today.

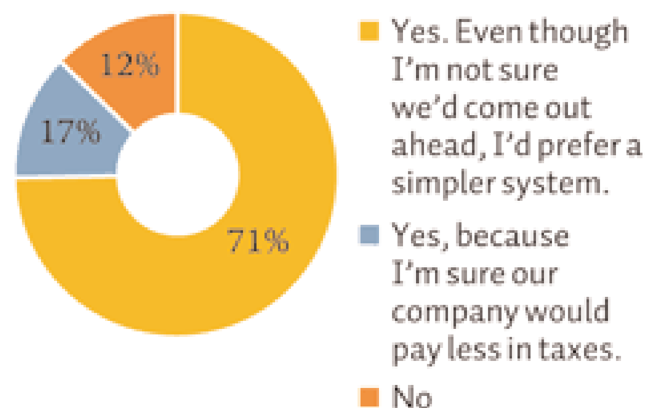
The results echo calls made by finance chiefs on Capitol Hill in May, when the CFOs of Kimberly-Clark, United Technologies, Zimmer Holdings, and Caterpillar testified before Congress that they were not interested in a holiday on the taxation of overseas profits. Instead, they said, they would prefer a uniformly simpler code. "Our system actually hinders success," said Greg Hayes, CFO of United Technologies, at the hearing. "It was designed when the U.S. was the dominant economy, and before globalization became an unmistakable market reality."

But if the elimination of all deductions were to become a reality, would all CFOs regard that as a victory? Particularly in industries like biotech and alternative energy, tax credits are hugely popular. Meanwhile, large companies have the resources to drive down effective tax rates, sometimes to zero, while smaller firms do not. The united front that CFOs appear to manifest on reform may crumble when proposals become more specific.

What is your view of the corporate tax system in the United States?




Would you be willing to give up all existing exemptions and credits for a reduction in the overall corporate tax rate, for example, up to 25%?




Note: Percentages may not add to 100%, due to rounding.
Source: Duke University/CFO Magazine Global Business Outlook Survey, September 2011

# Did You Know? Retirement Plans by the Numbers

**69%** of participants admit that they don't read the plan information they receive today.

**47%** of participants said they would just figure out how to live off what they've saved for retirement.

**2/3** of participants are counting on their 401(k) balances as the **primary source** of retirement income.

**FOUR IN 10** PARTICIPANTS DON'T KNOW AT WHAT AGE THEY'LL RETIRE.

Paying the monthly bills is a **TOP FINANCIAL PRIORITY FOR 49%** of participants; retirement comes in a distant second with **17%** of participants.

**4 in 10**

*participants think their savings will last less than 20 years.*

**91%** **of participants agree that they are personally responsible for their financial future.**

**30%** of participants think they are on track to receive less than **50%** of their current income in retirement.

*Journey, Fall 2011*

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