

Financing Private School

»» As a parent, you want nothing more than to provide your children with the best possible education. Still, a private school education can be difficult to work into an already strained family budget. **By John Heckathorn**

Here are a number of tips to help you (and other family members) finance the right school for your child.

1. Look into financial aid.

Most schools consider applications for admission and financial aid separately. That means asking for aid won't hurt your child's chances of getting in.

If you're going to ask for aid, do so early. Missing deadlines will hurt your chances.

And remember, not all private schools charge five-figure tuitions. More than half of Hawai'i's private schools have tuitions of less than \$5,000 a year.

2. Look into lines of credit.

When tuition comes due, you can find yourself in a short-term cash

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crunch. There are a number of alternatives: Some schools will allow you to put tuition and fees on a credit card. This may have some side benefits—many cards offer airline miles or other rewards.

The downside: credit-card interest can be 18 percent or more. Watch which card you use for your tuition payments.

You can get a loan. Some banks will give you a favorable rate on a tuition loan. For instance, First Hawaiian Bank offers what it calls "prep loans." These are usually offered through the school, but you can call 643-5626 and mention "prep loan."

If you are thinking of financing long term, your best bet may be a home equity line of credit. If you own a home, your equity has likely soared over the past few years. There may be certain tax advantages to borrowing against your home, and you may have the ability to make interest-only payments for an extended term. Most financial institutions offer home

equity lines of credit, and interest rates remain low. The downside, of course: Any money borrowed against equity puts your home at risk, should you face financial reversals.

3. Set up a Coverdell Education Savings Account.

Coverdell ESAs replace what used to be called Education IRAs. In 2002, the law was changed to make the accounts more attractive. As with anything tied to the IRS code, the rules for a Coverdell ESA can get a bit complex.

Unlike an IRA, you can't use a Coverdell ESA to defer taxes on your income. However, you can contribute up to \$2,000 per child to an account per year. Any earnings on the money are tax-free when they are used for educational expenses.

Coverdell accounts aren't just for college. You can use a Coverdell account to pay the costs of elementary or secondary education, in public, private or religious institutions. These costs are fairly broadly defined and include uniforms, supplies and computers.

You don't have to be parent to establish a Coverdell ESA. You can contribute to the education of a niece, a cousin, a grandchild, even a neighbor's or friend's child. The only sticky point: No single child can receive more than \$2,000 in contributions in a year, no matter who makes them.

There are income limitations. If you make more than \$190,000 a year as a couple (or \$95,000 as a single filer), the amount you can contribute is reduced. If you make more than \$220,000 a year as a couple (or \$110,000 as a single filer), you can't contribute at all.

However, in one of those weird quirks of the tax laws, you can—even if you're over the income limits—give the child the \$2,000. The child can then make the contribution to the account, presuming, of course, that he or she doesn't have \$95,000 a year in other income. You're right: This makes no sense. It does, however, follow the letter of the law. There may be gift tax restrictions if you give other money to the child.

Your contributions have to be in cash, and you must set up the account specifically as a Coverdell ESA, at any bank or IRS-approved financial institution.

You lose control of the account when the child turns 18. All funds have to be spent by the time the child turns 30. However, the account can be transferred to another family member under age 30, and family is fairly broadly defined.

4. You're stretched tight already, but you're probably looking ahead to college. Set up a 529 account now.

A 529 college savings plan allows you to put away money and spend it

on higher education without paying taxes on the earnings. It's named after Section 529 of the IRS code.

There are two types of 529 plans. Prepaid plans allow you to prepay tuition, at today's rate, at a certain school or group of schools. Savings plans allow you to invest the money and use it at any accredited college or university.

Every state, and the District of Columbia, has its own 529 plan, sometimes one of each type. You can invest in any state's plan. For a quick guide, go to www.401Kid.com or www.savingforcollege.com.

While the earnings on any 529 plan are exempt from federal taxes as long as you spend them on higher education, you'll want to look into Hawai'i's TuitionEdge savings plan, www.tuitionedge.com or www.hawaii.gov/budget/college. TuitionEdge also exempts you from state income taxes.

As in a Coverdell account, the money in a 529 plan grows tax-free and you don't pay taxes on earnings spent on education. Unlike a Coverdell, your child doesn't own the account; you do, so you maintain control.

Anyone can contribute to the account, and there are no income limitations. You can contribute up to \$297,000 in a Hawai'i account.

If you can afford it, you can contribute up to \$11,000 a year per child. Parents or grandparents with estate tax considerations can contribute up to \$55,000 the first year. If they do, they can't contribute again for five years, but they have transferred a nifty bit of wealth down a generation.

Investments in the Hawai'i TuitionEdge plan are handled by Delaware Investments, which charges a yearly fee of 0.95 percent for its services. (For accounts under \$10,000, there may be an additional \$25 annual fee.) Delaware Investments offers five investment options, keyed to the age of the child or your risk tolerance.

If you're too risk-averse for stocks,

you can put the money into an FDIC-insured savings account at First Hawaiian Bank, the plan's local sales agent.

You can start a TuitionEdge account directly with Delaware Investments (866-529-EDGE), at First Hawaiian Bank or through your broker or investment advisor. Be cautious, however; an investment advisor may charge you a front-end fee, called a "load." Both Delaware Investments and First Hawaiian Bank will set up plans on a "no-load" basis.

Caution No. 1: If you have to withdraw the money for some reason other than to pay for higher education, then you pay tax on the earnings (at your rate) and a 10 percent penalty.

Caution No. 2: Some tax advantages of the 529 plan are set to expire in 2010. After that, earnings will be taxed at the student's rate. Congress may vote to extend benefits, but it doesn't have to. Once you start a 529, start writing your congressional representatives about extending the law.

5. Look into your tax situation.

In addition to Coverdell accounts and 529 plans, there are other education tax breaks. A number have income restrictions and most apply to higher education, but some may be relevant to you if you're paying for private school.

The best overview is IRS Publication 970, "Tax Benefits for Education." You can download a copy at <http://www.irs.gov/pub/irs-pdf/p970.pdf>.

Fair warning: "Tax Benefits for Education" is 83 pages long and less fun to read than a Harry Potter book. If IRS publications give you a headache, you might just ask a tax advisor.