

Education Funding Ideas By Gary Case

Imagine receiving this letter from your grandchild's school or college: "Did you know grandparents and others who would like to legally avoid the federal gift tax on their money can do so by prepaying tuition for their grandchild, or any other child, for that matter?" You may actually see educational entities use such a letter as an alternative and tax-efficient way for students' family members or friends to pay school costs.

A recent private letter ruling from the IRS confirms the gist of an IRS technical advice memorandum issued in 1999, specifically allowing for the taxpayer involved to prepay family members' tuition bills for multiple years without the payment being considered a gift for tax purposes. Such payments don't have to be reported to the IRS. The institutions involved may or may not offer a tuition discount for multi-year prepayment, but if you consider such a strategy, you may wish to negotiate for one.

Some tax advisors say this technique could be a smart move for people with large estates who want to pay for a student's tuition in order to help their families deal with soaring education costs and skirt hefty estate and gift taxes. You should check with your tax advisor as to specifics of using this strategy in your particular situation. Younger individuals may also wish to take advantage of this technique as a way to assist family or friends. However, the technique is best suited for those who are concerned that they might not live long enough to pay each year's tuition as it comes up, could afford to part with the money permanently, are comfortable the child will complete education at the school where tuition has been paid and are willing to let the school keep the money in any event.

One of the advantages of the multiple year prepayment strategy is its simplicity. There's no need to hire a lawyer to draft complex trusts or other sophisticated wealth transfer techniques. There are alternatives to the direct prepayment method. 529 college-savings plans, setting up Health and Education Exclusion Trusts, and Coverdell Education Savings Accounts may have application to your particular situation. Although not specifically designed as such, using distributions of cost basis from a Roth IRA to pay education costs is one of my favorite ways to address the competing family needs of concurrently saving for retirement and education. Your Financial Planner should be able to help you evaluate which, if any, of these options fit your needs.

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