Financing college education despite tax law reform

By Sid Mittra
special writer

Part I

Thanks to the passage of the new tax law, most of the traditional strategies for financing college education have been rendered obsolete. Here are the key changes:

1. Interest on money borrowed for college education will not be deductible.
2. Scholarship money not used for tuition will become taxable.
3. Money put in a Clifford Trust (10-year trust) will be taxed at your tax bracket.
4. For children under 14, just $1,000 income generated by the money given under the Uniform Gifts to Minors Act will be taxed at the child's tax bracket.

Now that the new tax law erases most of the tax benefits of traditional planning tools, here are some strategies still offering tax advantages that you can use to prepare for meeting the mounting college costs.

Taxation

Table 1 presents a taxation policy for a 55-year-old male who invests $25,000 in this policy. He will not only be able to withdraw $1,825 tax free every year for an indefinite period but also will enjoy a sizable life insurance coverage as an added bonus.

The investor can never lose his principal, will never pay federal taxes on either the annual loans or the death benefit, and can take cash distribution any time by liquidating the policy.

But the biggest advantage of taxation is that the investment belongs to the father and the child cannot use it for any purpose he chooses. In short, it is an excellent educational planning tool.

Auto 7

A relatively new concept in educational financing is Auto 7, an alternative to the venerable Clifford Trust, which is now obselete.

Basically, you buy two annuities from an insurance company. A little less than half of your money goes into an immediate annuity. This portion is used to generate a monthly income.

The balance is investing in a deferred annuity. This portion grows at a predetermined rate of, say, 7.7 percent so that you recoup the cost of both annuities in seven years.

Table 2 presents an Auto 7 policy for a 55-year-old who invests $25,000 in this policy. He will receive the principal back in seven years.

In addition, for the next seven years he will receive a monthly income of $156. Of that, 77.4 percent ($121) is completely tax free.

Auto 7, or *split annuities as* they are sometimes called, has an advantage over another popular college-funding investment, single-premium variable life insurance.

Such policies let you borrow at very low cost after cash value builds up for a year or so. With a split annuity, however, cash starts flowing during the first month.

Table 1 — taxation

male, 55 — investment $25,000

Age	annual loan	net death benefit
56	$1,825	$68,476
57	1,825	66,553
58	1,825	64,521
59	1,825	62,379
60	1,825	60,118
65	1,825	46,806
70	1,825	38,858
75	1,825	34,198
80	1,825	32,753

Table 2 — auto 7

male, 55 — investment: $25,000

year	monthly income	tax free (77.4%)	deferred annuity
1	$156	$121	$15,058
2	156	121	16,390
3	156	121	17,838
4	156	121	19,412
5	156	121	21,122
6	156	121	22,981
7	156	121	25,000

Refinance mortgage

You can refinance your mortgage, use the money to pay for college costs and still deduct the mortgage loan interest.

If you borrowed money directly to pay for school, the new tax law would not allow a deduction for consumer loan interest.

Educatonal Seminar: Main Topic "Impact of New Tax Law on Your 1986 Investment, Tax and Retirement Planning." The seminar, sponsored by Observer & Eccentric Newspapers and Coordinated Financial Planning Inc., will be held 7-9:30 p.m. Tuesday, Nov. 18, at the Kingsley Inn, 1475 N. Woodward, Bloomfield Hills.

For information or reservations, call 643-8888.

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Try for a high growth-rate

By Thomas O'Hara
special writer

I know getting a high compounded annual rate of growth is a very important part of having a top grade investment performance. However, it seems to me that the average individual has a hard time picking a fast-growing stock and that the risk is so great you aren't likely to win very much.

Would you advise me to try for a high rate of growth?

If, by a high rate of growth, you mean an annual compounded rate of 12-15 percent, the answer is yes. I would urge every investor to set such a goal.

You may not reach it, but setting your goal high and working toward it should give you better results.

It is important to recognize that a good rate of compounded growth can be achieved in several ways, and some of them are really quite safe.

FOR INSTANCE, there are a number of electric utilities whose dividend represents a 10-percent return on the current price of their stock.

Detroit Edison yields 11 percent, Commonwealth Edison pays 10 percent, Utah Power & Light returns 11 percent, to name a few. In addition you will find modest growth in these companies that, over four or five years, will average 2-5 percent.

If you add the dividend yield and growth rate together, you have as good a total return as you have with a stock that has a 12-15 percent rate of growth but no dividend.

You do have a problem of reinvesting the dividends as you receive them so that you can compound your income. Most utilities make that easy by having a dividend reinvestment plan.

YOU CAN sign up for the company's plan, and your dividends will be atuomatically reinvested and thus you will be compounding your income in the company's stock. Most companies pay the commission for you or subsidize it.

Some even give you a discount on the stock your dividends buy.

If you try for growth in growth stocks, you want to be sure the company has at least a five-year — and preferably a 10-year — record of increased sales and earnings-per-share of 12-15 percent or more each year.

Expense account ethics in spotlight

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STODDARD SHED some light on his personal feelings when he told me, "Few in the comptrollers' office have served 30 years. I've served banking 30 years."

(The two government lawyers prosecuting him are in their 30s.)

He recited the history of maverick policies he learned at his father's knee: Saturday banking . . . consumer banking "for the man on the street vs. the chosen few" . . . high interest on savings . . . statewide banking . . . .

The last opinion wasn't shared by the Michigan Bankers Association, which for decades vehemently and repeatedly opposed statewide banking. Stoddard wouldn't belong to that association. His viewpoint was vindicated last year when Gov. James J. Blanchard signed the statewide and interstate banking law sponsored by Rep. William Keith of Garden City.

An executive friend shed some light on the Stoddard personality. He said federal regulators are jealous of their authority and like to be treated with deference. The unorthodox Stoddard probably rubbed them the wrong way, he said, and the banker figures he's being picked on.

I PAID the lunch bill in the German restaurant.

My share of it I charged to Observer & Eccentric Newspapers. I bought my canoein' buddy's lunch myself.

We spent only about 10 percent of our time — 49 cents worth of his *kassler ripchen* — discussing the Stoddard case, and I used him as a sounding board for this column. But charging the O&E for his lunch doesn't seem right.

But that's a working newsman's viewpoint, not a banking executive's.