John Hancock INSURANCE

SUCCESS STRATEGY

INDIVIDUAL NEEDS | Advanced Markets

Life Insurance and College Funding

Using Life Insurance as a College Funding Supplement

College costs are considered a major expense for most individuals. As a parent, it is important to take a proactive approach when investing for your children's college goals. While there are a variety of products and accounts in the marketplace, you may want a plan that will give you flexibility, as well as coverage for your family should something happen to you.

Understanding the Options

What are some of the options to save for your children's education?

1) **529 Plans:** These plans are very popular. Individuals select these accounts because they offer a way to save for college *and* they have tax benefits associated with them.[1] These plans grow tax-deferred and the money can come out tax-free if utilized for qualifying higher education expenses. However, many individuals have concerns over flexibility as it pertains to these types of accounts. For instance, if a 529 plan is not used for qualified education expenses, a 10% penalty and taxes are issued on the gain within the plan. While there are some ways to transfer the beneficiary designations to a family member (e.g., you can transfer from one sibling to another in most plans), what if that option is not available/applicable for your family? You will also need to consider limits — most 529 plans have restrictions to how much money can be invested, and while these limits are high, there is a ceiling.
2) **UTMA/UGMA Accounts:** For practical purposes, these accounts are for the exclusive benefit of a minor, but name a custodian to manage the account until that child reaches the age of majority (anywhere between 18–21 years, depending on the state). These types of accounts do not necessarily have to be used for higher education, but they **do** transfer to the minor as soon as he or she reaches age of majority. If that child does not go to college, they can use that money for whatever they wish.
3) **Coverdell Education Savings Plan:** These accounts have income limitations, and annual contributions cannot exceed $2,000 per student per calendar year. These accounts grow tax-deferred and the money is tax-free if used for qualifying education expenses. You can also use these accounts for education expenses prior to college, so a private high school may qualify, for example.
4) **Mutual Funds and Retirement Accounts:** Mutual funds can offer the most flexibility because money can be invested and withdrawn without any additional tax penalty. Money in the account belongs to the owner, and as such, the owner can control who receives distributions, if there are any. Mutual funds have taxes associated with them, such as capital gains and dividends. Although retirement accounts, including 401(k)s and IRAs are typically reserved for retirement spending, some people will earmark a portion of money in these accounts to fund a college education. While money in a retirement account grows tax-deferred, most individuals should be aware that access to this money prior to 59½ may result in a 10% penalty and tax will be associated with the withdrawal. (IRAs may be accessed for higher qualified expenses, without the 10%

penalty. Please consult your tax advisor for more information.)

5) **Permanent Life Insurance:** Life insurance provides a death benefit should something happen to you. Part of the tax-free death benefit can be used to fund children's education goals. In addition, the cash value build up in a life insurance policy can be accessed for college education purposes. The cash value is tax-deferred and comes out tax-free if the contract is structured properly. If your child does not need money for college expenses, the cash value can continue to build for your future goals, such as retirement.

Financial Aid

Financial aid packages that are generated for most students consist of loans, while grants and scholarships are often secondary. Some institutions may have additional requirements for determining aid, although most require federal forms. In estimating a family's ability to contribute funding for college, federal financial aid will consider the parents' income and assets as well as assets and income in the child's name. Other factors, such as whether or not the child has other siblings currently enrolled in college, will also factor into the family's ability to contribute.

Some assets are not considered when determing aid, such as 401(k)s and IRAs. (Note: if you take out money from an IRA, this will count as income for the following year, as financial aid is determined on an annual basis.) Life insurance cash value is not currently factored on the federal level, but certain institutions may require it at their level. (If a policy is surrendered, though, it would count towards the family contribution.) It is important to note that UTMA/UGMA accounts are heavily factored when determining financial aid benefit. These accounts tend to have a higher negative impact on whether or not aid is granted.

Benefits of Life Insurance

Life insurance can offer peace of mind in knowing that your children would be protected should something happen to you. In addition, life insurance is a uniquely flexible asset to own. For example, if your children decide to go to school, the potential policy cash value is there for you to access in a way that is tax-free. If your children change their mind and delay going to school, you can use the cash value toward your own goals. As an additional benefit, life insurance cash value can be used for a myriad of expenses associated with higher education — travel expenses, and spending money for instance — and it is not limited or restricted to qualified higher education costs.

Considerations

- Life insurance has costs and fees associated with it. Policies should be structured so they are not classified as a Modified Endowment Contract (MEC).
- Policies classified as MECs may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.
- Life insurance eligibility will be based on financial and medical underwriting.
- Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income.
- Cash value available for loans and withdrawals may be more or less than originally invested.
- Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions, such as when a life insurance policy has been transferred for valuable consideration.

1. The Tax Cuts and Jobs Act of 2017 expanded 529 plans by allowing tax-free qualified withdrawals for primary and secondary education expenses at the federal level. Consult a local attorney to determine if withdrawals for K-12 expenses will be tax-free at the state level. State laws may vary.

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