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Paying Your Kids' Tuition

Some personal-financial experts offer strategies for business owners to pay for college for their kids.

By: Jill Andresky Fraser Published February 1997

Personal Portfolio

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If business owners start planning early, several strategies can work

Does the thought of facing those six-figure college-tuition bills scare you even more than a surprise visit from your banker?

If so, there's only one lesson you need to learn. To plan successfully for your children's education costs, start early and make use of some strategies that can work particularly well for business owners.

Starting to save early is critical, advises Jody Tallal, a personal financial manager with Life-Plan, in Dallas. When he ran the numbers for one client, Tallal calculated that putting away money early would result in significant savings: "By starting when his two children were infants and setting aside about $6,500 a year for each child, the business owner would wind up spending nearly $400,000 *less*."

Another basic rule of thumb: "Look for ways to shift income between tax brackets," advises Brian Whitlock, a partner at Blackman Kallick Bartelstein LLP, a Chicago accounting firm. Children's tax rates vary. If your child is under 14, his or her first $650 of income is tax free. The next $650 is taxed at 15%. Any income over that is taxed at your rate. (After age 14, rates vary, from 15% to 39%, depending on your child's income level.)

All but the most cash-strapped business owners should be able to take advantage of the tax benefits available to kids under 14. "One way to do that is with passive earnings, maybe from interest income, investment dividends, or rent," says Whitlock. The advantage: if your child, not you, owns the investment and receives the income, you might be able to save as much as 25% of the tax bite you would otherwise incur. Meanwhile, that $1,300 yearly, if reinvested well, might grow to $50,000 or so by the time college rolls around.

You might consider hiring your children for filing, copying, or other simple tasks--for earned income, up to a limit of $28,000, the 15% tax level holds. But be warned: although that strategy will divert money out of the company coffers and into a college fund, little Janey's salary will still be liable for FICA and Medicare taxes, which add up to about 15%. Also, child-labor laws vary from state to state. To be sure you're in compliance, check with your lawyer.

Or, next time your company purchases a piece of large equipment or real estate, do it through a limited partnership that you set up with your children. "You can structure a limited partnership so that you are the managing partner and your children have no vote. But they receive the rental or lease income from your business," advises Whitlock, and you avoid the payroll taxes that would be due if they were working for you. The payoff comes after the financing is paid off, presumably in five to seven years, when cash flow from the rental will be positive enough to cover some or all of college-tuition costs.

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If your company is an S corporation, you should consider awarding your child a small equity stake. "If your company is profitable, dividends can pass directly to the child, to be taxed at his or her rate, without incurring any payroll taxes," Whitlock says. The ideal time to do that is when your company is young and not too profitable. At that stage your stock will be worth less, so you can give away more. Structure the stock transfer to fit within the IRS's tax-free gift limit of $10,000 a year per child.

One caveat: if you've given little Janey some company stock, you should know that financial-aid officers treat that as an asset. (Colleges expect parents to spend up to 6% of their assets each year and children up to 35% of their assets a year before they'll provide financial aid.) Says Doug Mollin, a financial planner with ProPlan, in Elmhurst, N.Y., "You could wind up in a situation where the school expects your child to sell off your company's stock in order to pay the tuition bill--not exactly what you had in mind."

How to Pay for School

- The earlier you start saving, the less money you'll have to sock away overall--your savings will appreciate through investments.
- Take advantage of varying tax rates by shifting funds to your children. Up to age 14, your children get a tax advantage on investment earnings of up to $1,300 a year and on earned income of up to $28,000 a year.

Jill Andresky Fraser is Inc. *'s finance editor.*

Resources: Ready to tackle those college costs? There may be no better way to begin than by visiting the Financial Aid Information Page, a Web site. It's full of useful information, including a large index of related Web pages on topics that include scholarship scams and various financial-aid databases. You can even download a valuable free government guide, *Preparing Your Child for College: A Resource Book for Parents,* or visit a question-and-answer site staffed by 60 volunteer financial experts.

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