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Talking to Your Child about College Expectations



If you're the parent of a high school student who's looking ahead to college, it's important to have a grown-up conversation with your child about college expectations. A frank discussion can help everyone get on the same page. Here are some talking points.

Costs

For many families, the cost of college is the elephant in the room. You may want to start off by saying something like "we will have saved x by the time you start college, and after that, we should be able to contribute y each year." Financial professionals typically recommend that parents avoid promising to pay 100% of college costs, in case they experience an unforeseeable financial setback.

If your child is interested in schools that have significant price differences, you may say something like "we can come up with x each year from savings and income that should cover most of State U, but if you want to attend Private U, then you'll have to borrow the difference, which is z ." Then use an online calculator to show your child exactly what " z " will cost each month over a standard 10-year repayment term. You're borrowing \$27,000 at 6.8%? That will cost you \$311 each month. The loan is \$45,000 at 8.5%? That will cost you \$558 each month. And so on. The idea is to take a big, abstract loan amount and translate it into a month-to-month reality.

Next, print out an amortization table showing the breakdown of principal and interest payments that will be due each year. Review the basic deferment and forbearance rules that govern under what circumstances borrowers can temporarily postpone their federal student loan payments. Finally, make sure to put that student loan payment into a larger financial context--there will be other items competing for your child's financial resources after college, like rent, food, utility bills, a car payment, etc. The goal is to help your child understand the

long-term financial impact of choosing the more expensive college. Even then, many 16, 17, or 18 year olds may be unable to fully grasp the seriousness of such an endeavor.

Ultimately, it's up to parents to help their child avoid going into too much debt. According to the *New York Times*, for the first time ever last year, student loan debt outpaced credit card debt in the United States, and this year it's expected to surpass a trillion dollars. Unlike most other types of debt, student loan debt generally cannot be discharged in bankruptcy, and in the case of default, the federal government can garnish your child's wages or intercept tax refunds to recover the money.

If there's any silver lining here, it's that many parents believe that kids get more out of college when they are at least partly responsible for its costs, as compared to having a "blank check" mentality. Being on a financial hook, even a small one, may encourage your child to live more frugally, choose courses carefully, and hit the books sufficiently. Later, if you have the resources, you can always help your child repay his or her student loans.

Grades

Many parents consider going to college their child's first real job. But some students don't take academics as seriously as they should. You might say something like "we expect you to maintain a GPA of x , and if you don't, we may have to reconsider paying the tuition bill for the following year." Though you'll probably want to build in some wiggle room for the adjustment period that freshmen typically require, after a certain period of time your child needs to be serious enough about academics to make the college cost burden worthwhile.

Course of study

Even if your child has no idea what career path to choose (and most high schoolers don't), ask about your child's likes and dislikes, strengths and interests. At a minimum, this information will help start the wheels spinning, and when coupled with new revelations and experiences later on, it can lead to potential career pathways.

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Medicare and Medicaid: Do You Know the Difference?

Life Insurance Policy Loans: Tax and Other Implications

I'm a stepparent. Is my financial information listed on the FAFSA?

Medicare and Medicaid: Do You Know the Difference?



Medicaid, not Medicare, is the primary payer of nursing home care in the United States. Although Medicare pays for short-term skilled nursing or rehabilitative care in a skilled nursing facility, it does not pay for extended care in a nursing home or for other custodial long-term care. Custodial care is help with daily activities such as eating, bathing, dressing, and using the bathroom. Some individuals need both short-term and long-term care; for example, someone who has suffered a stroke may receive rehabilitation services in a skilled nursing facility, but may later be admitted to a nursing home in order to receive custodial long-term care services.

For more information, visit the Centers for Medicare & Medicaid Services website at www.cms.gov.

Medicare and Medicaid were signed into law 36 years ago to protect older and poorer Americans against the high cost of health care. Ironically, it's the high cost of providing health care through these programs that now threatens federal and state budgets, leading to calls for Medicare and Medicaid reform. Although these programs are often lumped together, they function quite differently. Here's a look at the coverage each provides.

What is Medicare?

Medicare is a health insurance program funded and run by the federal government that guarantees health coverage to older Americans. Medicare is not income-based. People who have paid Medicare taxes on their earnings are automatically eligible at age 65, but some people with disabilities qualify for Medicare coverage earlier than age 65, and people with end-stage renal disease qualify at any age.

Medicare offers three main types of coverage. Part A covers inpatient hospital care, as well as short-term skilled nursing care, hospice care, and home health care under certain conditions. Part B covers medical services such as doctor's visits, outpatient care, and laboratory tests. Part D covers prescription drugs. If you or your spouse has paid Medicare taxes while working, you generally won't pay a premium for Medicare Part A coverage, but you'll pay a premium if you want to enroll in Part B or in some (but not all) Part D plans. You'll also need to pay certain out-of-pocket costs such as deductibles, co-payments, or coinsurance costs, depending on the types of coverage you have.

What is Medicaid?

Medicaid is a health insurance program funded by both the federal government and state governments to provide coverage to Americans of all ages who have low incomes and no health insurance. States administer their own Medicaid programs under federal guidelines. They must cover individuals on public assistance, but they may also opt to cover other groups and establish eligibility requirements. Children, families, people with disabilities, and older individuals may all receive Medicaid.

If you're eligible for Medicaid, you may have to pay a small co-payment when receiving medical services, but most of your health-care costs will be covered.

Can you be eligible for both Medicare and Medicaid?

Yes--if you're eligible for both programs, you're

known as a "dual eligible" beneficiary. Generally, individuals who are eligible for both programs are older or disabled (or both) and need help paying their Medicare costs because they have very low incomes. Medicaid covers premiums, deductibles, co-payments, coinsurance, and other Medicare costs and provides some health benefits that Medicare does not. Individuals in nursing homes are often dual eligible beneficiaries, and that's partly behind the misconception that Medicare pays for nursing home or other long-term care (it does not--see sidebar); instead, Medicaid is the primary payer of nursing home bills. Because many older individuals cannot afford the high cost of nursing home care and exhaust their savings, they eventually become eligible for Medicaid.

Medicare	Medicaid
Primarily age-based; individuals age 65 and older qualify, along with some individuals with disabilities	Primarily means-based; individuals of any age with low incomes who meet eligibility requirements may qualify
The federal government runs Medicare, and the program is the same for all Americans	State governments run programs under federal guidelines, so programs vary from state to state
Financing comes from federal funds; partly financed through payroll taxes and premiums	Financing comes from federal, state, and local revenue
Medicare Part A provides coverage for hospital stays; Medicare Part B covers the cost of doctor's bills, laboratory costs, and some outpatient costs; Medicare Part D covers some prescription drug costs	Broader coverage of health costs than Medicare, including inpatient and outpatient care, prescription drugs, laboratory costs, family planning, and nursing home care (types of coverage may vary from state to state)
Medicare beneficiaries may pay deductibles, co-payments, coinsurance costs, and premiums	Medicaid generally pays all approved charges, though a small deductible or co-payment may be required



What is a MEC?

A life insurance policy purchased after June 20, 1988, is a modified endowment contract if the accumulated premiums paid at any time during the first seven years exceed the sum of the net level premiums for a policy that would be paid up after seven years. A single premium policy is one example of a modified endowment contract. (Your life insurance company or life insurance agent can tell you if a policy is a modified endowment contract.)

Life Insurance Policy Loans: Tax and Other Implications

As the owner of a life insurance policy, you can generally borrow the policy's cash surrender value and use the proceeds for any purpose. Before you take a policy loan, be sure you understand the implications of the loan on the policy itself as well as any tax implications, now and in the future.

Effect of policy loan on policy

You can generally borrow an amount up to the policy's cash surrender value (less an adjustment for interest) from the insurer. The insurer will charge you interest on the loan. Generally, interest is not actually paid, but is added to the amount of the loan. Interest charged on a policy loan is not generally deductible for income tax purposes. There could be other adjustments as well under the contract; for example, a participating policy may restrict the payment of dividends to you while a loan is outstanding.

You are not required to repay a life insurance policy loan. But you can generally repay a life insurance policy loan at any time while the insured is alive. If you do not repay the loan, the cash surrender value paid to you or the policy proceeds at death will be reduced by the amount of the loan (plus interest). Thus, a loan generally reduces life insurance protection.

If the amount borrowed plus interest ever equals or exceeds the cash surrender value, the policy can terminate if additional amounts are not paid into the life insurance policy. Life insurance protection could be lost.

If you have any incidents of ownership in a life insurance policy on your life, proceeds paid at death are includable in your gross estate for federal estate tax purposes. The right to obtain a policy loan is an incident of ownership. Generally, life insurance proceeds received at death by your beneficiary are received income tax free.

Taxation of policy loan

You can borrow against your life insurance policy, and the loan proceeds are generally not taxable to you (unless the policy is a modified endowment contract (MEC), see sidebar).

A loan from a MEC is treated as a distribution from the MEC. A distribution from a MEC is subject to the income-out-first rule. As amounts are distributed, they are treated as consisting of taxable income to the extent that they do not exceed the excess of the cash surrender value of the policy over the investment in the contract (generally, premiums paid less tax-free distributions). The taxable income will also be subject to a 10% penalty tax unless the distribution is made after age 59½, on account

of disability, or as part of a series of substantially equal periodic payments.

Example(s): *You have a MEC with a cash surrender value of \$100,000. You have paid premiums of \$50,000. You take a policy loan for \$60,000. The first \$50,000 (\$100,000 cash surrender value - \$50,000 investment in the contract) of the loan is taxable income to you.*

Lapse or surrender of policy

An outstanding loan is generally treated as an amount received if a policy lapses or is surrendered and may result in taxable income. A policy can lapse if premiums are not paid and the policy terminates when any policy benefits are exhausted as a result. Also, as noted above, if the amount borrowed plus interest ever equals or exceeds the cash surrender value, the policy can terminate if additional amounts are not paid into the life insurance policy. You can cash in a policy by surrendering the policy to the insurer in return for the policy's cash surrender value (as reduced by the amount of the loan plus interest).

If you surrender your policy to the life insurance company or the policy lapses, any gain realized is taxable at ordinary income tax rates. The gain is the excess of the amount you receive over the net premium cost. The net premium cost is the total premiums you paid less any tax-free distributions received. An outstanding loan is generally treated as an amount received if a policy is surrendered or lapsed and may result in taxable income.

Example(s): *You have a life insurance policy with a cash surrender value of \$200,000. You have paid premiums of \$75,000. You also have an outstanding policy loan of \$175,000. There have been no distributions from the policy. You surrender the policy to the insurer for \$25,000 cash. You have taxable ordinary income of \$125,000 (\$25,000 cash + \$175,000 loan - \$75,000 premiums). If you have not prepared for it, it may come as quite a shock.*

Example(s): *You have a life insurance policy with a cash surrender value of \$200,000. You have paid premiums of \$75,000. You also have an outstanding policy loan of \$200,000. There have been no distributions from the policy. The policy lapses. You have taxable ordinary income of \$125,000 (\$200,000 loan - \$75,000 premiums). Once again, if you have not prepared for it, it may come as quite a shock.*

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Ask the Experts



I'm a stepparent. Is my financial information listed on the FAFSA?

If you're a stepparent and your spouse is the one filling out the FAFSA (i.e., your spouse is the custodial parent of the college-bound child), then your income and assets will need to be reported on the FAFSA. This rule applies as long as you are married on the date the custodial parent fills out the FAFSA. So even if you weren't married the previous year--the year for which the FAFSA wants financial information--you will still need to list your income and assets if you are married on the date the custodial parent fills out the FAFSA.

What if you have a prenuptial agreement that absolves you from having to contribute to your stepchild's college costs? It doesn't matter. In its financial aid determination, the federal government ignores prenuptial agreements and considers a stepparent a financial resource, even if the stepparent is unwilling to provide financial support for college. The government is not bound by a private prenuptial agreement.

Bottom line: a stepparent's financial resources are counted on the FAFSA if the stepparent is married to the custodial parent on the date the

FAFSA is completed, and a noncustodial parent's financial resources are not counted (except to the extent they are reported as child support and/or alimony by the custodial parent).

However, the custodial parent/stepparent household may be eligible for some tax relief. If the custodial parent claims the child as a dependent on his or her tax return and files a joint return, then the custodial parent may be able to take advantage of the American Opportunity tax credit.

The American Opportunity credit (formerly the Hope credit) is worth up to \$2,500 per year for the qualified tuition and related expenses paid during the first four years of an undergraduate student's college education, provided the student is attending school on at least a half-time basis. To qualify for the full \$2,500 credit in 2011, your modified adjusted gross income (MAGI) must be below \$160,000 (the threshold for married taxpayers filing jointly; the credit is not available for married taxpayers filing separately). A partial credit is available if your MAGI is between \$160,000 and \$180,000.