Tax Tips to Remind Your Clients that You are the Center of Their Financial Universe

**Consider Using Roth IRAs as a College Funding Vehicle as well as 529s**

My first choice for college savings planning is not always 529 plans. Sometimes it is Roth IRAs. Here’s why:

Many of my clients own their own businesses. As such, we are constantly seeking legal ways to convert what would have otherwise been a personal expense into a business deduction. Understanding that, wouldn’t it be great to be able to write off your kids’ college education against business income? I have a dental client specializing in children’s dentistry who has two children of her own, ages 3 and 1. Both kids have been hired by the business as models, and their pictures appear in the practice’s marketing materials showing the kids sitting in dental chairs with big smiles on their faces. Under the picture are comments about how painless the practice makes dentistry for children. The practice currently pays the kids $1,500 a year as a modeling fee and issues them a W-2. The dentist gets a tax deduction for the $3,000 in wages. We opened up Roth IRAs for the two kids. The $3,000 will now grow tax-free until college time. As the kids get older, we will increase their duties at the practice: after-school office admin chores, office grounds maintenance on the weekends, etc. And we will also quickly increase those W-2s getting them up to the $6,000 max. The dentist continues to get tax deductions, but since the kids’ income will never exceed their standard deduction, their income tax bill is always zero. Once they reach college age, the Roths will be cashed in and used for higher education. As such, there will be no 10% early distribution penalty because the funds were used for qualified education expenses. There will likely be minimal income taxes because of the Roth distribution rules. I call the free growth in the Roths, plus the tax savings for the parents via the wage deduction, a “Tax Scholarship”. And it is huge!! Obviously, the younger the child, the better this strategy works.

What if your client is just a wage earner and does not have their own business? Hire the kids to work around the home. Who says you cannot pay them as household help? Have the parents apply to the IRS for an EIN, get the kids on payroll for a reasonable wage for cutting the grass, doing household chores, etc., then issue them a W-2. And with the W-2, now they can contribute to a Roth. Although there will not be a tax deduction for the work (as in the example above), there will still be many years of tax-free growth in the Roth, all to be used for college funding. Another Tax Scholarship.

Here are two other benefits:

What happens if the kids do not go to college? Or they get a free ride due to merit and/or athletic aid of some kind? With 529s, you have a problem if the money is not spent on qualified education expenses. But with the Roths, no problem. The kids let it ride, and it becomes a leg up on their retirement savings.

529s are includable assets when filling out college financial aid forms. IRAs are not. And less includable assets could translate into greater need-based financial aid.

As said in my prior articles, this is another example of how your client will see you are reaching out to help them, and there is no “sale” involved as it is the same money whether it is in a 529 or a Roth. Which, in turn, will make them realize, once again, that you are that go-to person, The Center of Their Financial Universe.