Q.

My parents are in a position to really help me financially in medical school. What should be considered in deciding our best moves?

A.

I have written before about how multiple generations working together financially can be highly advantageous compared to a family where every generation attempts to optimize their own financial outcome. This post will be specific to this one issue.

Best For You Or Best For The Entire Family?

The first consideration when deciding the best way to proceed is to decide if you are trying to optimize the outcome just for the student, or if you wish to optimize the total financial benefit and expense to the family. This is primarily a value judgment, but if you decide the goal is to optimize the benefit to you, then you simply try to get as much as you can from your parents at the best possible terms and then go
with it. It’s not particularly complicated- you simply take what they are willing to give. They get to feel good about their contribution and you’ve maximized your outcome. However, where it really becomes complicated is when the goal is to optimize the overall outcome for the entire family.

**Dependent Status**

For many parents, being able to claim their student as their dependent can be fairly beneficial. In 2015, the personal exemption is $4K per dependent. If you’re willing to be your parent’s dependent, and they’re in a 40% marginal tax bracket, then it is worth $1600 a year to them for you to be a dependent. What’s the downside? Well, your standard deduction drops from $6200 to $1000 (technically the greater of $1000 or $350 + your earned income up to $6200.) Plus you don’t get to claim yourself as an exemption. This could increase your taxes if you have significant earned income. If you don’t have significant earned income, then great, let your parents claim you if they possibly can. As a general rule, the taxpayer with the higher marginal tax rate should claim the dependent, assuming their income is not so high that the exemption is phased out. (AGI of $432K+ for MFJ.) [Update: If the parents are paying under AMT, their income doesn’t even have to be that high.]

There are rules for claiming dependents, of course. Your dependent must be a US Citizen, US National, US Resident, or a resident of Mexico or Canada. A dependent also cannot be claimed on anyone else’s taxes, including their own. You also cannot claim someone who filed a joint return with someone else. In addition to those rules, your dependent must fit into one of two categories.

The first category is a qualifying child. This person must pass five tests.

1. **Relationship test-** Son, daughter, step-child,
grandchild, brother, sister, niece, nephew, adopted child, foster child etc.

2. Age test- Under 19 or under 24 if a full-time student (and younger than you and your spouse), or permanently disabled. Unfortunately, this test alone will rule out many medical students, at least in their last couple of years.

3. Residency test- Must live with you more than half the year. Education and military service are valid excuses however.

4. Support test- The child cannot have provided more than half of his support for the year.

5. Joint return test- The child cannot have filed a joint return with anyone (except to get withheld taxes back.)

The second category is a qualifying relative. This person must pass four tests.

1. Not be a qualifying child (see above)
2. Related to you (in pretty much anyway) or a member of your household for the entire year
3. Gross income test- Make less than $3,950
4. Support test- You provided more than half his support (slightly different from the child rule). If no one provided more than half his support, however, it can be mutually agreed upon as to who gets the exemption.

Educational Tax Benefits

There are tax benefits for the person who actually pays for education. There are two tax credits, the American Opportunity Credit (basically undergrads only) and the Lifetime Learning Credit (only available to people with a MAGI of < $62K [$124K married]). The LLC is 20% of up to $10K spent on qualified educational expenses. Many parents capable of providing significant help to their medical student children aren’t going to be able to use either of these credits.
Beyond the credits, you are also allowed to deduct up to $4K in tuition and fees for your child. However, this requires an income (MAGI) of < $80K ($160K married) in order to be claimed. Again, well-to-do parents are going to be excluded.

The student loan interest deduction of up to $2500 of interest paid may also be useful, but high-income parents are again excluded by the income limit of $75K ($150K married.)

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Gifting Laws

In a situation like this is it also useful to be aware of the gifting laws. Essentially, any person can give $14K a year to any other person without having to file any kind of paperwork or pay any kind of taxes. The gift tax actually isn’t a tax most of the time. On a federal level, if you give more than $14K a year, it simply comes out of your estate tax exemption, which at over $5 Million ($10 Million married and indexed to inflation), is probably enough and to spare for all estate and gift tax considerations for most docs. But just in case, it might be wise to preserve it. Also, be sure to look into whether your estate has an estate tax/gift tax with a much lower exemption level. You can preserve the exemption by only giving $14K a year. But keep in mind that is $14K from each
person to each other person. So you can give your child $14K a year, your spouse can give your daughter $14K a year, you can give your inlaw $14K a year, and your spouse can give your inlaw $14K a year. $56K a year all without using up a bit of that exemption!

In addition to the $14K a year, the parents can pay tuition directly to the school without using up that exemption.

Once you hit $14K a year, you’re required to file this form with the IRS. But if you’re like most, you can just work the laws to avoid having to file it.

**Loan Laws**

The parents may prefer not to give the money to the child, but rather to loan it. This can be done informally, especially if under the gift tax limit- “I’ll ‘loan’ you $14K a year, and you can pay me back when you’re an attending,” but if you want to formalize it, the IRS technically requires you to charge a market rate for interest (currently about 2.7% for long-term loans.) If you do not, the “forgiven” interest is considered a gift and is subject to gift taxes (again, $14K a year will cover a lot of forgiven interest.) There are special rules if the loan is less than $10K and if it is between $10K and $100K, so be sure to read those if you’re going to do this.

**Mortgage or Margin Loans**

Sometimes parents don’t have the money, but have access to credit at rates and terms that are much better than what is available to the student, especially a grad student relying on private lenders. As a general rule, I think if someone is going to borrow for school, that it ought to be the student. Prior to borrowing money, the parents should be aware of several things:

1. There is no PAYE/IBR, or PSLF for parental loans. While getting a loan at 4% instead of 6% seems great, it could
end up costing hundreds of thousands more if those 6% loans could have been forgiven.

2. If the student can’t or doesn’t finish school, doesn’t match, and/or can’t pay back the loans, the parent is still on the hook. The unmatched rate is 5% for US MD students in the MD match, 20% for US DO students in the MD match, and 50% for US citizen FMGs in the MD match. There’s real risk there.

3. If the student dies, the parent will still owe the money. This can be worked around by purchasing inexpensive term life insurance on the student’s life, of course. The interest savings will generally more than cover the insurance costs.

However, a deductible HELOC or mortgage at 3%, or even a low-cost margin loan, is obviously far better than an unsubsidized, undeductible 6 or 8% loan.

**Outside the Box**

There are other, outside the box, ways to assist a child. We had a post a few months back about a medical student who used 0% credit cards to dramatically reduce the interest costs of her student loans while in medical school. Parents, especially well-to-do parents, often have access to far more credit than a medical student and can use similar techniques.

If the student has some income, the parents can do the “mommy match” and help the student max out Roth IRAs or do Roth conversions. For example, if the student earns $5K in the summer, but needs that $5K to pay expenses, the parent can give the student $5K for expenses while the student puts her $5K into a Roth IRA, never to be taxed again.

At some universities, children of employees receive dramatic tuition reductions, often 50% or more. When it comes to medical, dental, or law school tuition, this may be the
equivalent of a large raise, so serious consider should be
given to working for the school your child attends if this is
an option.

Parents are often savvier financially than medical students.
Of course, that’s not saying much since medical students may
be the financially dumbest people on the planet. At any rate,
a little financial advice from the parent may go a long way.
Here are some examples:

- “Don’t take out your loan money until you actually need
  it.”
- “Use a high-interest savings or checking account.”
- “Don’t use that loan money to buy a new car.”
- “You did apply for the food stamps/Medicaid etc that
  you’re eligible for, right?”
- “If you love Pediatrics and Orthopedics equally, choose
  orthopedics.”
- “Get a roommate.”
- “Quit drinking expensive beer.”

In summary, there are many ways that parents COULD help out a
medical student. Whether they are able to do so or should do
so are separate questions. But there is no doubt that when
multiple generations work together toward common goals, real
synergy can happen.

What do you think? Did your parents help you out financially
in medical school? How did they do so? Would you help your
child get through professional or grad school? How do you plan
to do so? Comment below!