A Guide To The

Education Funding Planner

By Denver Tax Software, Inc.

For more information see:
http://denvertax.com/edu

Denver Tax Software, Inc.
P.O. Box 5308
Denver, CO 80217-5308

Telephone (voice):
  Toll-Free: 1(800)326-6686
  Denver Metro: (303)796-7780

email: info@denvertax.com
Web sites
Information: http://denvertax.com
Order Online: http://denvertax.com

FAX:
  Toll-Free: 1 (888) 326-6686
  Denver Metro: (303)796-7768

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For more information see:
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Overview

Why Use This Program

Purpose

- To determine whether the student is better using an Education IRA or 529 Plan vs. Traditional Gift Giving vs. Waiting Until The Last Minute.

- To determine how much per month needs to be saved using the Education IRA – 529 Plan and using Traditional Gift Giving.

Getting The Most Out Of This Program

Quick Start

Go to the section "Installing and Running" on page 3. We have tried to design the program so that you don't have to refer to this manual! When you are entering inputs, there will be a section of the input screen that discusses what you should be inputting. If you have any questions, please go first to the Tutorial – Example section. See "Tutorial -- Examples" on page 17.

The help file is identical to this manual. The help file, accessed by clicking on the **Help** menu choice, has the same Table Of Contents (Contents) and index that this printed manual does. However, the help file has word search features which are not possible with the written manual.

When the program installs, it also installs a copy of this manual in Adobe's Acrobat (.pdf) format. If you want a hard copy of the manual, click on the manual icon in the Denver Tax Software Group (**Start** - **Programs** - **Denver Tax Software Group**). That will bring up the manual in the Acrobat Reader. The manual can be printed from the Acrobat program.

How To Get A Complete Understanding Of This Program

Read the complete manual. The Analyzing Education Funding Alternatives chapter discusses the law that made this computation mandatory. See "Analyzing Education Funding Alternatives" on page 5. This manual discusses each input in depth in the Inputs section.

Installing and Running

System Requirements:

Operating System: Microsoft® Windows® versions 95, 98, ME, NT 4 or Windows 2000. Please refer to the readme.txt file to see if service packs might be required.

Limitations

This program is comprehensive, but it does have limitations as follows:

- The program's computations assume that the provisions of Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Tax Act") will continue after 2010. Without action to extend those provisions after 2010, many of the provisions changed by the 2001 Tax Act will revert to their pre 2001 Tax Act form.

- The program's computations assume that inflation rates, rates of return, discount rates and tax rates will stay at one level throughout the time frame of a scenario. Thus, if the computations runs from 2001 through 2025 and if the user enters a rate of return of 5%, the program will assume that the rate of return is 5% in 2001 through 2025. In real life, such amounts will fluctuate.

- Various gift tax limitations are not considered. In most cases, educational funding requirements will be below various gift tax limitations.

- Phase out of Education IRAs is ignored. If the contributor to an Education IRA has a sufficiently high Adjusted Gross Income, the maximum Education IRA contribution may be reduced. Since there is no similar phase out for 529 Plans and 529 Plans have cashflow characteristics similar to Education IRAs, the contributor can contribute to a 529 Plan instead of an Education IRA. The primary problem with this limitation happens when the Education IRA is meant to fund Kindergarten through High Schools (K – 12). 529 Plans are limited to funding higher education.

Installation

All commands you need to enter will be typed in **bold** type.

Installing To A Single Machine

For the purpose of these instructions, we are assuming that your CD drive is drive D, if it is not, please make the appropriate changes. To install the program to a single machine, use the following steps:

1. Click on the **Start** button.

2. Click on the **Run** menu item.

3. Type **D:SETUP** and press the **ENTER** key.

4. Follow the instructions in the installation program.

Network Installation

Network installations instructions are provided in a separate document to customers that have purchased rights to use this program on additional desktops.

Starting the DTS Education Funding Planner

The Installation program will create a "Denver Tax Software" Start Group, if it doesn't already exist. The DTS Education Funding Planner will be placed within this group.

To start the Education Funding Planner, click on the **Start** button, click on the **Programs** button, click on the **Denver Tax Software** program group, then click on the **Education Funding Planner** icon.

Analyzing Education Funding Alternatives

Why Bother With This?

- Many parents, grand parents and other relatives want their next generation to go to college. Historically, those with better educations, in general, earn better livings. There are notable exceptions, for instance, Bill Gates does not have a college degree.

- For most families, paying for a child's education is a huge financial burden. For those families, this program helps to reduce the burden by demonstrating how much should be set aside each month.

- There are various methods to help save for education. One method might be better than the others depending on the needs and circumstances of the student.

- With the growth of private schools for Kindergarten through High School (K – 12), the requirements for funding education are expanded for those attending private school. Are those attending private K – 12 schools going to have sufficient funds for college?

Important Factors

The Cost Of One Year Of School

This is a tough number to figure out. The numbers will vary depending on the school. Elite private schools like Harvard or Stanford will be significantly higher in costs than community colleges. One of the best ways to determine what a year of college might cost is to go the school's Web site. To locate Web sites for various schools look at http://dir.yahoo.com/Education/Higher_Education/Colleges_and_Universities/ (This is subject to change.)

In addition to the current cost at a school, the program will need to adjust that cost for inflation.

Tax Rates

The tax rates for the parent or donor and the student are important. Tax can eat up almost half (including state taxes) of the annual income in the education fund. Up to a certain age the "Kiddie Tax" will apply. In those cases, the child's income will be taxed at the parent's tax rate. The program considers the Kiddie Tax when appropriate.

Since this type of economic analysis looks at alternative costs for funding methods with different tax characterizations, we recommend using marginal tax rates rather than average tax rates. The marginal tax rate is the tax rate on the last dollar of income.

Rate Of Return On Education Funds

The rate of return on education funds is the percent of annual earnings on the funds. This should be a pre – tax number, since the program will compute the tax, if appropriate.

For this program, you would enter a rate of return that would be an average of the expected rates of returns for all the years involved in this analysis. In reality, the rate of return would fluctuate depending on risk, quality of investments, the condition of the economy, the skill and luck of the person managing the investments.

One school of thought is to move from higher risk and higher return investments while the student is very young to lower risk and lower return investments as the date of starting school approaches. This consideration is not built into the program, but it is something that the investor should consider.

Discount Rate

Since a very important part of this program's analysis is to compute the present value of each method's cashflows, a discount rate is used to discount or reduce each year's cashflow to a current year equivalent. The discount rate is the opportunity cost of money. What else could you do with the funds other than invest them for the student? To go a step farther, what is the highest rate of return that you are likely to get if you did not invest the funds for the student? That is your discount rate.

If your only investment is a money market account earning 3.5%. Your discount rate is 3.5%.

If you own your own business that will generate a 20% pre – tax rate of return, your discount rate might be 20%.

If you have invested in a 3.5% money market account and are paying down 18% credit card debt, your discount rate is 18%.

If you have no debt and your only asset is money stuffed into your mattress, your discount rate is zero.

Since this program discounts after – tax cashflows, you will want to use an after – tax discount rate. To convert a pre – tax discount rate to an after – tax discount rate, reduce the pre – tax discount rate by the pre – tax discount rate multiplied by the tax rate. For example, if the pre – tax discount rate is 8% and the tax rate is 30%, the after – tax discount rate is 5.6% [8% - (8% x .30)].

Present Value Analysis

The primary tool used to compare education funding methods is the present value computation. That is because there is a time value of money. A dollar today is much more valuable than a dollar twenty years form now. Since determining cashflows is the starting point for a present value calculation, we also present the annual cashflows. The Detailed Report and Summary Report presents what the total cashflow amounts are. Don't be fooled. The present value amounts, not the cashflow amounts, are what you should base your decisions on. Looking at the total cashflow instead of the net present value could easily cause one to make the wrong decision.

If the program's present value analysis in the Summary Report shows that one method is better by $5,000 with a 5% discount rate than the other method, that means that the parents could invest $5,000 less today with the better method, if they were going to fund the entire college education today expecting a 5% after – tax rate of return on today's investments.

Methods To Fund Education

No Plan – Wait Until Last Minute

This is the "Do Nothing Until It Is Too Late" method. The student's relatives may have invested prudently, though not for education purposes, or blown their income on lottery tickets. With the No Plan method the student or the student's relatives need to come up with the education funds when the student needs the funds. The funds might come from sources of income, from reduced personal spending by the parents, from selling personal assets or from investments that were not ear marked for education.

The No Plan method may cause severe financial stress on the family, burdensome school loans or a decisions to drop out of college, put off going to college or choosing to not go to college.

For some students with relatively wealthy relatives, the No Plan method may not cause financial disruption, but No Plan may be the wrong decision. Using No Plan, excludes the possibility of tax – free income.

<u>"No Plan" may be the best plan if the relatives have a sufficiently high rate of return on their investments.</u> They may be very good at investing in assets that would not normally be used for educational purposes. They might have a business that brings in a very high rate of return.

Naturally, funds better be available when needed for the "No Plan" method to work. That is a significant assumption.

Traditional Gifting

With Traditional Gifting, the relative makes gifts that are gifted in the student's name. Once the student is not subject to the Kiddie Tax, any income is taxed at the student's tax rate. The student's tax rate is usually lower than the relative's tax rate. Thus, less of the funds are lost to taxes than if the accounts were in the relative's name.

With Traditional Gifting any taxable income is taxed each year. However, Education IRA and 529 Plan's annual income is not taxed.

With Traditional Gifting the student gains control of the funds once he or she is no longer a minor. There is no guarantee that gifts for education will be used for education.

529 Plan Or Education IRA

After 2001, 529 Plans and Education IRAs have almost identical cashflow patterns. The cashflow patterns for both of these types of accounts has income accumulating tax – free and distributions for qualified educational purposes are also tax – free. Since 529 Plans and Education IRAs have the same cashflow pattern, for computational purposes they are identical. Within the program's inputs and printouts you can almost always replace the words "529 Plan" with "Education IRA." There are some differences that should be noted as follows:

- The contributor to an Education IRA has much more control over how the funds are invested than if the funds were contributed to a 529 Plan. 529 Plan assets are typically managed by professional financial managers or a brokerage house. A state typically chooses who the 529 Plan managers will be. Thus, 529 Plans are usually managed by professionals. The point is that the contributor does not have much say in the matter. This may make 529 Plans less desirable. It is possible for the 529 Plan manager to manage 529 Plan assets better than the contributor might manage an Education IRA.

- Education IRAs can be used for certain K – 12 private school costs. 529 Plans are limited to higher education costs.

- Education IRAs will be limited to $2,000 per year after 2001. If the contributor's Adjusted Gross Income (AGI) is over certain limits, that $2,000 limit can be further reduced. If the AGI is high enough, no Education IRA would be allowed.

- With the Educational IRA the student gains control of the funds once he or she is no longer a minor. With 529 Plans the donor controls payments from the fund, even when the student is no longer a minor.

- There is a possibility that the 2001 tax act will not be extended after 2010. If the 2001 tax act is not extended past 2010, after 2010 portions of the 529 Plan qualified distributions will be partially taxable but Education IRA distributions to pay for the same costs will be tax free. If the 2001 tax act is not extended after 2010, the maximum annual contribution to Education IRAs will drop from $2,000 to $500 per year.

A word about 529 Plans. They are set up by states. They do not have to be (but may be) limited to state colleges. Usually non residents may participate in a plan. For example, a Montana resident may choose to participate in Colorado's plan to pay for tuition to Harvard.

A big plus for 529 Plans is that the contributor has control over how the funds are spent. With Traditional Gifting there is nothing to stop a student from using education ear marked assets for things that the donor would frown upon.

If either Education IRA or 529 Plan funds are used for non qualifying purposes, the portion of the distribution that is related to income will be subject to tax and there will be a 10% penalty.

What is better – an Education IRA or a 529 Plan? This program compares No Plan, Traditional Gifting and 529 Plans? From the cashflow and present value point of view, if a 529 Plan is better than No Plan and Traditional Gifting, so is an Education IRA.

If the program indicates that the 529 Plan is better than Traditional Gifting and No Plan, we recommend:

1. Assuming the contribution to the Education IRA is not eliminated by the AGI limitation, use Education IRAs instead of 529 Plans to the contribution limit of the Education IRA. Once the Education IRA contribution limit is reached, use a 529 Plan to cover the difference between what needs to be funded and what can be funded with an Education IRA. This recommendation is subject to the consideration of the points that follow.

2. If the contributor is not capable of proper management of the fund assets, either make sure the Education IRA is being professionally managed, or use a 529 Plan which will be professionally managed.

3. Since the beneficiary of an Education IRA gains control of the education funds when he or she is no longer a minor, if the donor has concerns how the education funds might be spent, the 529 Plan offers more control to the donor.

4. If the law changes, so might our recommendations.

Using The Education Funding Planner

The Startup Options Screen

The first screen to appear when starting the program is the About Screen. This is where you will find the program's version. It also has a button that will help you locate information about your system. That information might come in handy if technical support is needed, or if you are simply curious.

The next screen is the Startup Options Screen.
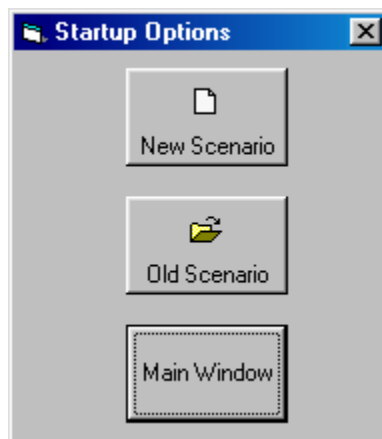
If this is going to be a new scenario, **click** on the **New Scenario** button. If you are going to use a previously saved file, **click** on the **Old Scenario** button.

The next screen that will appear is the Input Screen. The Input Screen is discussed in detail in a separate section. See "Inputs" on page 13.

The Main Window
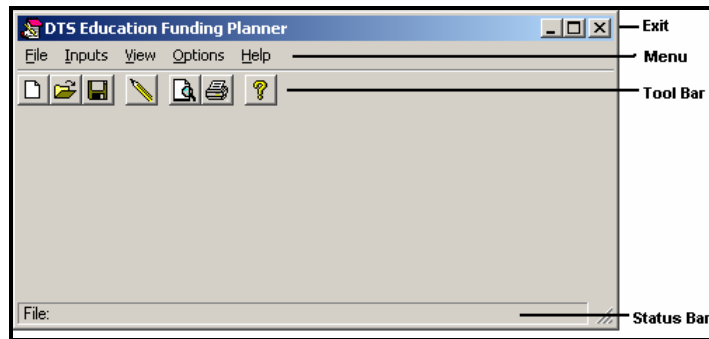
Basic Parts Of The Main Window

Minimize, Maximize – Restore Size, and Exit Buttons

The upper right portion of the Main Window has the standard buttons to minimize, maximize – restore size and exit. If you have used any other programs designed for 32 bit Windows systems, you are already familiar with those buttons.

Menu File Inputs View Options Help

This is where you can pick menu choices. See "Menu", below.

Tool Bar

Using the Tool Bar is typically the fastest and easiest way to use the program. Tool Bar choices are described with the Menu selections. See "Menu", below.

Status Bar File:

This displays what file or scenario is active.

Menu

File

New . This brings up a blank input screen.

Open . This brings up a screen where you can choose a previously saved file. Once the file has been selected, the input screen will appear with that file's information.

*When you **click** on the Input Screen's **OK** button, the scenario will be automatically saved.*

Save . This saves the current scenario to the file shown in the Status Bar.

Save As…. This is where you can choose a filename.

*This is the Menu choice
where you can rename a file.
Use this a lot if you are
running a "what if" analysis.*

Print Preview… . Use this to display the reports to the screen. You
can display any combination of Input Report, Detailed Analysis Report
or Summary Report.

Print… . Print the reports. You can print any combination of Input
Report, Detailed Analysis Report or Summary Report.

Exit. Exit the program.

Inputs

Inputs . Enter information into the program. This will bring up The
Input Screen. See "Inputs" on page 13.

View

Reports… . Display the reports on the screen. You can display any
combination of Input Report, Detailed Analysis Report or Summary
Report.

Options

Fonts…. You can change the fonts to make the reports appear differently.
We recommend staying with Courier or Courier New.

Help

Contents . Displays the table of contents for the help file.

Search For Help On…. This gives you the choice to search the help file
using either the index or a keyword search.

*This is identical to the very
first screen that the program
displays.*

About. This displays the information about the DTS Education Funding
Planner. This is where you can find the program's version number and
ways to contact DTS.

Inputs

Entering Information

Data Entry

The Education Funding Planner uses the normal input procedures that most Windows programs use. To move from one input to another you can either use the mouse to select the input item you want, or press the **TAB** key to move through them. To exit an input screen you can use the mouse to click on the appropriate button.

You may find it easier to enter numeric information using the numeric keypad. If so, make sure the **Num Lock** key is on.

How To Move Around The Input Screens
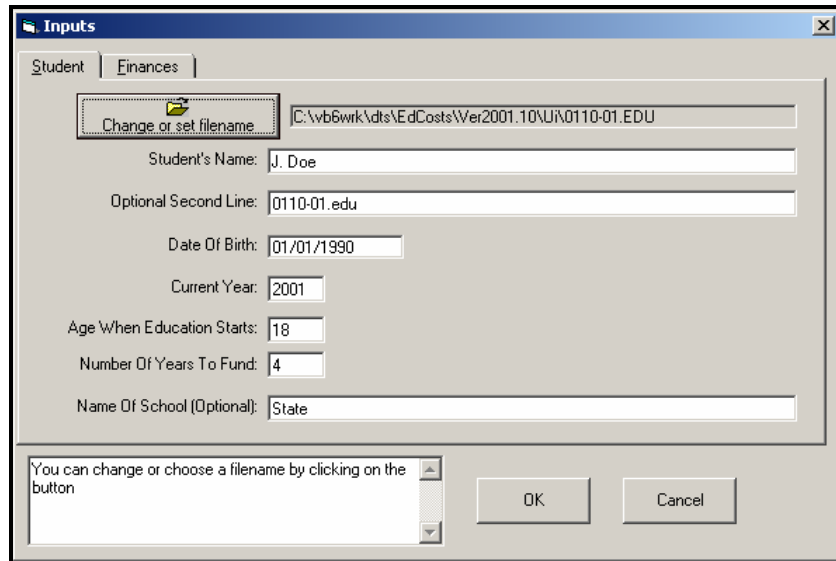
The input screen is broken down into tabbed dividers similar to a tabbed notebook. To move to a different tab simply click on the tab you want to move to. The input screen's tabs are Student and Finances.

How To Exit The Input Screens

When working with an input form, the **OK** button or **ENTER** key will exit the form and save the information you entered to a file. **Cancel** button is used to exit the screen without saving the information you entered.

Input Screens

Student Screen Inputs

Change or set filename

This is an improvement on the Windows interface. With most Windows programs, when you click on a form's OK button you just move to the next screen. When you click on the OK button in this program, it actually saves your data for you.

Click on the [Change or set filename] button to choose or change a filename.

Student's Name

Enter the student's name.

Optional Second Line

Enter information that you would want to appear as the second line on the reports.

Date Of Birth

Enter the student's date of birth. The year is more important than the day and month. If the date of birth is not known, but the year of birth is known, enter 6/30/yyyy, where yyyy is the year of birth. *Always enter the year as four digits!*

Current Year

Enter the current year.

Age When Education Starts

Enter the age when the student will start needing to pay for education. E.g., if the student is expected to start at age 18, enter 18.

Number Of Years To Fund

Enter number of years of education that will be expected to be paid for. E.g., if the student is going to have four years for undergraduate school and three years for law school, enter 7.

Name Of School

Optional. Enter the name of the school(s) that the student will attend.

Finances Input Screen

Annual Education Costs Now

Enter the current annual cost for 1 year of education. If you are only planning to fund a portion of the education, reduce the current annual cost accordingly. For example, if the current annual cost is $10,000 and you are planning to fund 75% of the education, enter 7500, not 10000.

To determine what the current annual cost might be, you could go to the school's Web site. Most schools Web sites can be found at: http://dir.yahoo.com/Education/Higher_Education/Colleges_and_Universities/ (subject to change).

Amount Of Funds Already Accumulated

Enter the amount that is already saved up. For example, if $5,000 has been saved to date, enter 5000 at this input. This number will be used for the Traditional Plan (Gifting) and the 529 Plan (Education IRA) analysis. It will not be included in the No Plan (Wait Until The Last Minute) analysis.

After – Tax Discount Rate

Enter the after - tax discount rate. This is a very important factor in computing the present value of the payments made to fund education. One could use an estimated average after - tax rate of return on the parents' investments for the discount rate.

By using a reasonable discount rate and calculating the present value of payments into education accounts, the total present value will be the estimated value that the parent's gave up, including future earnings, in terms of current dollars.

For example, 4% should be entered as 4, not .04.

For more information, see "Discount Rate" on page 6 and see "Present Value Analysis" on page 7.

Annual Education Cost Inflation Rate

Enter the annual inflation rate for educational costs. Recently this rate has been higher than the general inflation rate. For example, 4% should be entered as 4, not .04.

Pre – Tax Rate Of Return On Education Fund

Enter the annual pre - tax rate of return on the education funds. For example, 4% should be entered as 4, not .04. If one invests $100 at the beginning of the year, and the investment is worth $104 at end of the year, the rate of return is 4%.

Parent's Tax Rate

Enter the parents' tax rate. For example, 10% should be entered as 10, not .1

Student's Tax Rate

Enter the student's tax rate. For example, 10% should be entered as 10, not .1

Tutorial -- Examples

A New Scenario Example

Most of the time it doesn't make much difference whether you use the **TAB** or **ENTER** key. This tutorial will use the **ENTER** key whenever possible. When the tutorial directs you to use the **TAB** key, that would be a situation where using the **TAB** and **ENTER** keys will make the program function differently.

Start the program. If you have any questions on how to do this, see "Starting the DTS Education Funding Planner" on page 4.

The first screen is the *About Education Funding Planner* window. **Click** on the **OK** button.

At the *Startup Options* screen, **click** on the **New Scenario** button. This will immediately bring up the input screen.

.

Click on the *Change or set filename* button.
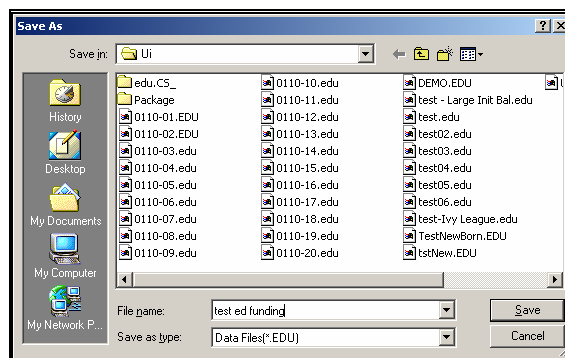
In the *Save As* screen, type **test ed funding** in the *File name* input. **Click** the **Save** button to return to the input screen. Press the **TAB** key.

For the *Student's Name* input enter **John Doe** and press the **ENTER** key.

For the *Optional Second Line* input enter **Just Testing** and press the **ENTER** key.

For the *Date Of Birth* input enter **01011999** and press the **ENTER** key. That date should then change to 01/01/1999. Always enter the year as four digits.
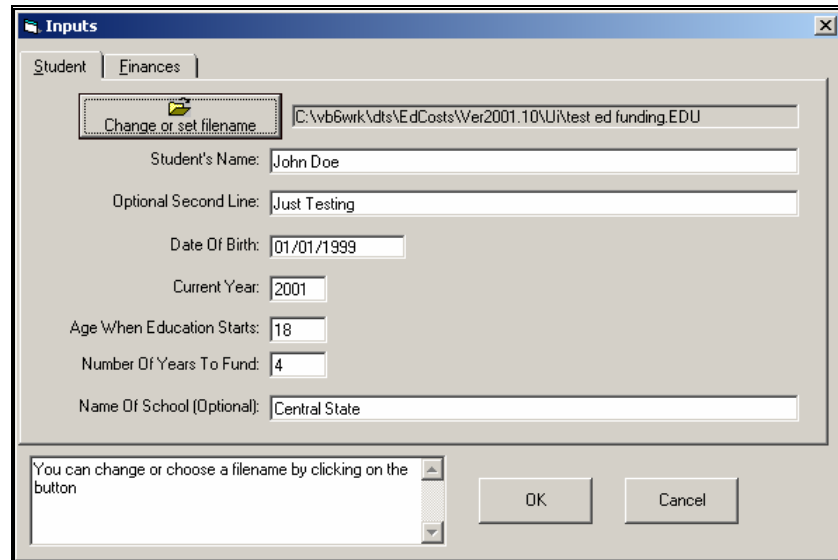
For the *Current Year* input enter **2001** and press the **ENTER** key.

For the *Age When Education Starts* input enter **18** and press the **ENTER** key.

For the *Number Of Years To Fund* input enter **4** and press the **ENTER** key.

For the *Name Of School (Optional)* input enter **Central State** and DO NOT PRESS A KEY.

At this point, the input screen should look like:

To advance to the Finances inputs either **click** on the **Finances** tab or press **Alt – F**.

For the *Annual Education Cost Now* input enter **10000** and press the **ENTER** key.

For the *Amount Of Funds Already Accumulated* input press the **ENTER** key to skip.

For the *After – Tax Discount Rate* input enter **4.8** and press the **ENTER** key. This should appear as 4.8%.

For the *Annual Education Cost Inflation Rate* input enter **7** and press the **ENTER** key. This should appear as 7%.
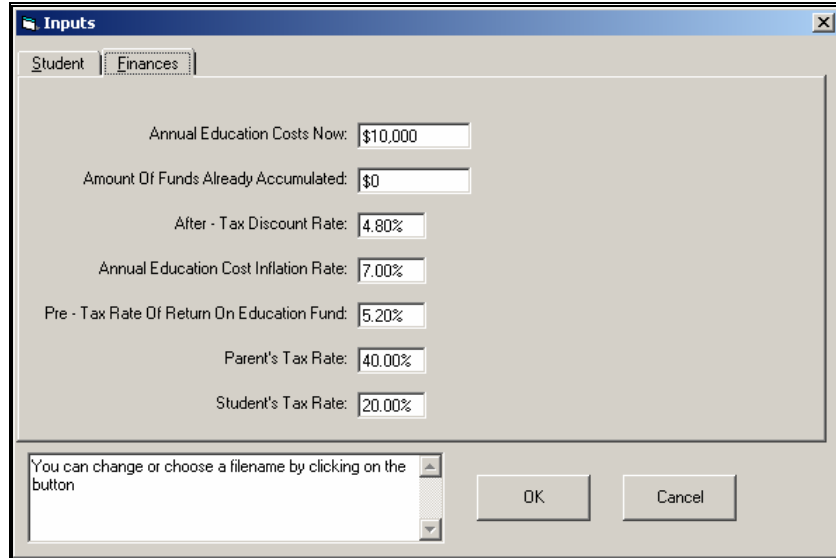
For the *Pre – Tax Rate Of Return On Education Fund* input enter **5.2** and press the **ENTER** key.

For the *Parent's Tax Rate* input enter **40** and press the **ENTER** key.

For the *Student's Tax Rate* input enter **20** and press the **ENTER** key.

At this point, the input screen should look like this:
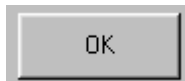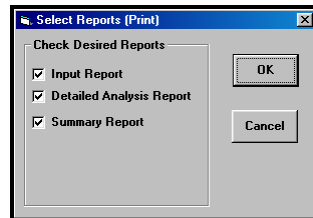
 Click on the **OK** button. This automatically saves your information. There is no need to take further actions to save the data!

 Lets get the results. **Click** on the **Print** button.

 In the Select Reports screen you can select the reports that you want to run. If all three reports are not already checked, please check all three boxes now. **Click** on the **OK** button.

The next screen will be the standard Windows print dialog box. **Click** on the **OK** button, and the reports will now print.

 You are done. Simply exit the program by **clicking** on the **X** button in the upper right corner.

An Old Scenario Example

To modify a previously created scenario, we will use the example that we saved in the New Scenario Example. We will change the Annual Education Cost Now from $10,000 to $11,000.

Start the program. If you have any questions on how to do this, see "Starting the DTS Education Funding Planner" on page 4.

The first screen is the *About Education Funding Planner* window. **Click** on the **OK** button.

 At the *Startup Options* screen, **click** on the **Old Scenario** button. This will immediately bring up the Open screen.
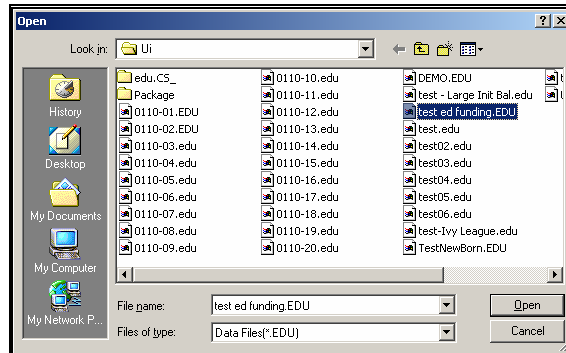
In the *Open* screen, **click** on **test ed funding.EDU** text. **Click** the **Open** button to return to the input screen.
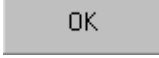
 Click on the **Finances** tab or press **Alt - F**. The Finances inputs will now appear.

Press the **TAB** key to highlight the $10,000 in the **Annual Education Costs Now** edit box.
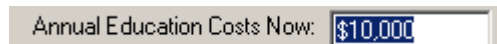
 In the **Annual Education Costs Now** edit box change $10,000 to **11000** and press the **ENTER** key. **Click** on the **OK**

button, , that will save the revised scenario.

 Lets get the results. **Click** on the **Print** button.
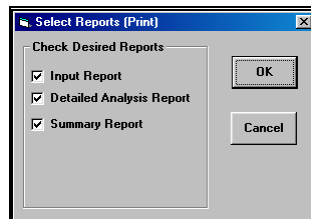
 In the Select Reports screen you can select the reports that you want to run. If all three reports are not already checked, please check all three boxes now. **Click** on the **OK** button.

The next screen will be the standard Windows print dialog box. **Click** on the **OK** button, and the reports will print.

 You are done. Simply exit the program by **clicking** on the **X** button in the upper right corner.

Input Sheet

Printed Copies Of The Input Sheets

The fastest way to get blank printed input sheets is to print them from the program's

Help ? routine. **Click** the **Contents tab**. **Click** the on **Input Sheet** selection. **Click** on the input section that you are interested in. When you see the input sheet on the help screen, **click** on Help's **Print button**.

Student Inputs

Student's Name: _____

Optional Second Line: _____

Date Of Birth (mmddyyyy): _____

Current Year: _____

Age When Education Starts: _____

Number Of Years To Fund: _____

Name Of School(Optional): _____

Finances

Annual Education Costs Now: _____

Amount Of Funds Already Accumulated: _____

After – Tax Discount Rate (5.5% enter as 5.5): _____

Annual Education Cost Inflation Rate (5.5% enter as 5.5): _____

Pre – Tax Rate Of Return On Education Fund (5.5% enter as 5.5): _____

Parent's Tax Rate (42.5% enter as 42.5): _____

Student's Tax Rate (42.5% enter as 42.5): _____

License Agreement

DENVER TAX SOFTWARE LICENSE AGREEMENT

LICENSE AGREEMENT -- READ THIS BEFORE CONTINUING

EDUCATION FUNDING PLANNER

by
Denver Tax Software, Inc.

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