# How Your Savings Can Impact Financial Aid

*Presented by Charles J Ferrari and Mark L Miller*

If you're like many parents, you may be wondering whether saving too much for college will decrease your child's chances of receiving need-based federal financial aid. Here's an overview of how different types of assets fit into the financial aid equation.

**The EFC calculation**

First, let's look at the Expected Family Contribution (EFC), a critical component of the Free Application for Federal Student Aid (FAFSA). The EFC—or the amount you're expected to contribute toward your child's education costs— factors in the following financial resources:

- 20 percent of the student's assets, such as money, investments, business interests, and real estate
- 50 percent of the student's income (after certain allowances)
- 2.6 percent–5.6 percent of the parent's assets, such as money, investments, business interests, and real estate, based on a sliding income scale (after certain allowances)
- 22 percent–47 percent of the parent's income, based on a sliding income scale (after certain allowances)

**Your assets and the EFC**

Now, let's examine how specific types of assets affect the EFC formula.

**Retirement accounts.** Retirement accounts, such as IRAs and 401(k)s, whether yours or your child's, are not counted at all in determining the EFC for federal financial aid. Be careful, however, about taking money out of your IRA (or any retirement account) to pay for college. Though the tax law permits penalty-free withdrawals from a traditional or Roth IRA to pay for qualified college costs, doing so could jeopardize financial aid in the following year. The entire withdrawal, including principal and earnings, counts as income on the following year's aid application.

**Different types of equity.** The equity in your primary home, a family-owned business, insurance policies, and annuities is also excluded from your assets when determining the EFC.

**Student assets.** Assets that belong to the student result in a greater reduction in financial aid. UGMA and UTMA accounts are counted as student assets. In addition, they may increase the student's included income to the extent that interest, dividends, or capital gains are reported on the student's income tax return. Often, the income tax benefit of setting aside investment assets in a child's name is offset by the reduction in the child's financial aid package.

**529 plans and Coverdell Educational Savings Accounts (ESAs).** These vehicles may be two of the better options to save for college without jeopardizing financial aid. They offer special advantages when it comes to aid eligibility:

- If a parent owns the 529 account or ESA, up to 5.6 percent of the value is included in the EFC as a parent asset. If grandparents own the account, none of the value is included.

- A 529 account or ESA owned by a dependent student, or by a custodian for the student, is to be reported on the FAFSA as a parental asset.
- Withdrawals from 529 plans and ESAs are also treated advantageously. When used to pay for college, such withdrawals are excluded from your federal income tax return and don't need to be added back in when reporting family income on the FAFSA.

**Please note:** Some colleges calculate financial need using a different formula when offering their own grants and tuition discounts. The institutional methodology used by these colleges may count home equity, siblings' assets, and certain investment accounts in a manner that differs from the federal methodology.

The fees, expenses, and features of 529 plans can vary from state to state. 529 plans involve investment risk, including the possible loss of funds. There is no guarantee a college-funding goal will be met. Earnings must be used to pay for qualified higher education expenses to be federally tax-free. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10-percent penalty. By investing in a plan outside your state of residence, you may lose any state tax benefits. 529 plans are subject to enrollment, maintenance, and administration/management fees and expenses.

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