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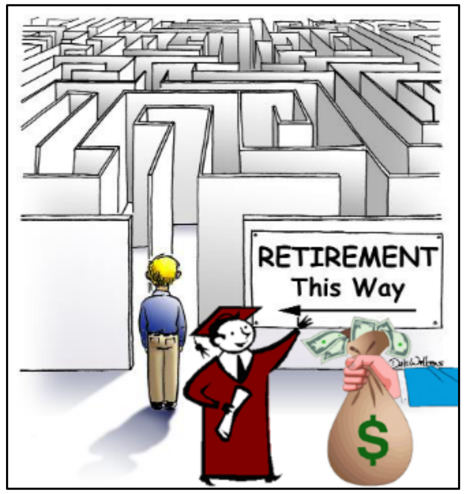
College financial aid: "Show me the money!"

Navigating the Retirement Maze



"Show me the money. SHOW! ME! THE! MONEY! Jerry, doesn't it make you feel good just to say that?"

– Ron Tidwell from the movie "Jerry Maguire" (1996)

Last month, I discussed how to adjust your selection criteria for candidate colleges based on the additional factors of affordability and generosity. Today, I'll address the main sources of college grants, and how to recoup a portion of your tuition payments through tax breaks.

Follow the money

Willie Sutton said he robbed banks because that's where the money is. Similarly, locating money for college means first considering the largest sources of college financial aid. The U.S. Government provides 41 percent of all college grants in the U.S., and colleges another 38 percent, according to the College Board. To receive support from either of these sources requires filling out the form that has become an annual exercise for families with children in college: the Free Application for Federal Student Aid, or FAFSA for short.

The FAFSA is used to determine yet another financial aid acronym, the EFC, or Expected Family Contribution. This is the amount that a family is expected to contribute towards the cost of college in a given school year. Whether it is a fair indication of a family's ability to pay for college isn't relevant. (The criteria were developed by Congress, not the Department of Education, so draw your own conclusion here.) What is important is that is that the FAFSA form is your primary means for receiving grants and subsidized loans.

FAFSA's main factor for determining financial need is income, both parental and student. What FAFSA does not include in its EFC equation are retirement accounts or home equity. (Note: There is an additional form used by close to 300 colleges, the College Board's CSS, that does consider home equity.) FAFSA also looks at non-retirement financial assets, parents' marital status, the number of children attending college at the same time, and parental ages. Starting with the 2017-18 school year, it will use tax returns from two years earlier instead of the previous year (i.e., 2015 tax return for 2017-18).

It's difficult to manipulate your finances to improve your chances for higher grants. The best way to increase your financial aid is to reduce your income during FAFSA-reported years by contributing more to retirement accounts and by not taking discretionary capital gains, keeping in mind the new two-year reporting lag. A more effective way to increase your aid is to have your child apply to colleges where their SAT scores are in the top 90th percentile or higher compared to other applicants. Many colleges will award merit grants well in excess of financial need in order to attract the top students, and sometimes even offer free tuition, so be sure to add this to your college screening criteria.

Making tuition less taxing

An indirect source of government tuition subsidies are income tax credits and deductions. The largest one is the American Opportunities Tax Credit (AOTC), up to $2,500 per student. It can be taken for the first four years of college, but it phases out as parental adjusted gross income (AGI) increases beyond $80K and $160K for singles and couples, respectively. However, with a few additional steps, there is a way that many students can take this credit on their own tax return, which I help some of my clients do. It's a credit, not a deduction, so it's worth the same regardless of the marginal tax rate.

The Lifetime Learning Credit is less generous, only $2,000 per year per return and with lower AGI phase-out limits, but it can be taken for more than four years and for qualified courses other than college. There are also tax deductions for interest on qualified student loans. IRS Publication 970 describes all of the possible education credits and deductions in detail, including the criteria for taking them.

A few other tips

Paying the least while getting the most for your education dollars is a subject that could easily fill a book, and it does, judging from the number of publications available on this topic. You can visit the "College Resources" page on my company Web site for additional advice and resources. Finally, here are few important points worth mentioning that you can follow up with some additional research:

- The initial aid package from a college shouldn't be viewed as the final offer. It's a buyer's market, so don't hesitate to negotiate. Use offers from comparable schools as leverage.
- Don't view the FAFSA as a reason not to save for college. 529 Plan assets in the name of the parent or child are assessed at the 5.64% parental annual contribution rate, not the child's 20% rate.
- Some schools award aid on a first-come, first-served basis, so file as early as possible.
- 529 Plans owned by a grandparent are not included on the FAFSA. However, if they are used to pay for a grandchild's college expenses, it is considered by FAFSA as "unearned income" by the child, and increases the family EFC. Solution: Wait until after the child files their junior year FAFSA during their sophomore year (because of the new 2-year delay on tax return filings), and then the grandparent pays the college.
- College funds currently going into a UTMA/UGMA account for your child? These are considered a child's assets, and assessed at the 20% rate on the FAFSA. Those assets can be transferred into a 529 Plan at any time without penalty, but first consider the tax consequences before doing this.

College costs are a major family expense. However, with some adjustment to how you define the "best colleges," combined with sufficient research before your child begins applying to schools, you should be able give your children quality educations without having to retire at 80.

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