Maximizing Financial Aid

In this lesson, you'll learn . . .

1. **The major factors impact financial aid.**
2. **Ways to maximize financial aid.**

Parents often want to know if ways exists to increase their chances for financial aid. They often think that positioning their money creatively will boost their chances. Much of the time this isn't wise or necessary.

Hugely Important Factors That Impact Aid

Whether your child will qualify for need-based financial aid will typically depend heavily on these factors:

- Parental income
- Number of people in household
- Number of children in college simultaneously
- Whether or not parents are divorced or separated

Some of a family's assets will matter, but not as much as you might think. Retirement assets are not counted in financial aid formulas, and not all of the cash in college accounts and taxable accounts is counted either. Maximizing eligibility for aid can often only be tweaked at the margins. Consequently, some of the suggestions that you'll see in this lesson may not have much, if any, impact on increasing financial awards.

> IMPORTANT
> *Before you try any strategies involving your assets, run the numbers on the College Board's Expected Family Contribution calculator. You may discover that making any moves will not lower your Expected Family Contribution.*

EXTREMELY IMPORTANT TO KNOW

Whether your child will receive the maximum financial aid award for which he or she is eligible, will be heavily dependent on your child's college list. You may position your income and assets in an effort to obtain more aid, but if the schools your child applies to are stingy, a larger financial aid package could simply include more loans.

Example

A family manages to lower its EFC from $30,000 to $25,000. The school the teenager wants to attend costs $55,000, but the school only provides a $15,000 grant. The family would have to pay $40,000 for the year even though the household's EFC is considerably smaller.

How to Maximize Financial Aid Awards

1 Complete the applications.

This might sound like obvious advice but each year millions of families never complete the Free Application for Federal Student Aid (FAFSA). The vast majority of colleges rely exclusively on the FAFSA to determine who gets financial aid.

When applicable, families also need to complete the CSS Profile. Here is the link to the Profile schools.

Don't expect schools to alert you about their financial aid deadlines or notify you if you fail to submit your aid application. These institutions, after all, can potentially save money if you don't seek financial aid. Without filing a financial aid form, your child can't receive need-based aid.

College consultants and high school counselors, in particular, might be interested in seeing just how many FAFSA applications are submitted at individual high schools in their area. Here is the federal link to the FAFSA Completion Rate by High School.

2 Don't include retirement assets on the FAFSA.

The vast majority of colleges and universities don't care how much money you have tucked away in retirement accounts, such as IRAs, 401(k)s, 403(b)s and Individual Retirement Accounts. You could have millions sitting in retirement accounts and the FAFSA won't even inquire about this money.

Consequently, you should NOT include retirement assets when completing the FAFSA! Unfortunately, the FAFSA is not clear on this issue. As you can see from the following screenshot of the FAFSA, the aid application inexplicably doesn't explain that parents and students should not include the value of qualified retirement accounts when asked about cash, savings and investments.

As of today, what is your (and your spouse's) total current balance of cash, savings, and checking accounts?

$ ______ .00

As of today, what is the net worth of your (and your spouse's) investments, including real estate (not your home)?

$ ______ .00

As of today, what is the net worth of your (and your spouse's) current businesses and/or investment farms?

$ ______ .00

While the Profile will ask parents and students how much money they have invested in retirement accounts, it's considered rare that a school would lower an aid award because of this.

3 Do not tap into retirement accounts.

Don't withdraw money from retirement accounts during your *base year*. Withdrawals from retirement accounts such as traditional IRAs and workplace accounts such as 401(k)s and 403(b)s will be treated as taxable income.

The base year refers to the year that the financial aid applications calculate a student's financial need. It refers to the calendar year from two years earlier. This is referred to as the *prior-prior tax year*. For instance, for the 2020-2021 school year, families will be using prior-prior tax returns (2018) when completing the FAFSA and Profile.

If you dipped into your retirement funds because of a financial emergency, ask the school to disregard it by seeking a professional judgment, but there is no guarantee that this will work.

4 Sink more money into retirement accounts.

If you can swing it financially, it's a good idea to invest more money into retirement accounts. You will boost your chances of enjoying a comfortable retirement and at the same time you'll be able to shield this money from financial aid calculations. Here is something, however, that aggressive retirement savers need to keep in mind:

If you receive a tax deduction for contributing to a retirement plan, such as a 401(k) or a traditional IRA, two years prior to the year your child is heading to college (prior-prior tax year) and every subsequent year that you file for aid, the financial aid formula will adjust your income upward. The formulas will add back to your income the contribution dollars directed to you or a spouse's retirement plan. This money is considered parental *untaxed income*.

Parents won't generate untaxed income, however, if they contribute to a Roth IRA because those contributions are made with after-tax dollars. People who contribute to a Roth don't receive an upfront tax break like investors, for instance, who sink money into a 401(k) or a traditional IRA.

5 If possible, avoid IRA rollovers.

Try to avoid rolling a 401(k) or other workplace account into an IRA while you are seeking financial aid! In theory, moving money from a workplace account to an IRA should not impact financial aid as long as the transfer was done directly from your employer to bank or investment firm (highly preferable) or within 60 days if the money was initially sent directly to the investor.

There have, however, been cases where that rollover amount is added to the parent's income! This has happened when parents have used the federal Data Retrieval Tool to update their FAFSA after they have filed their federal income taxes.

Two former colleagues of mine at the *Los Angeles Times* had this happen to them after the wife moved her newspaper 401(k) to an IRA rollover. The parents had a heck of a time trying to convince American University, where their daughter wanted to attend, that their EFC was vastly inflated because of this federal mistake.

6 Move money out of child's name.

Financial aid formulas penalize money held in a child's name more harshly than parents' assets. Most students don't have enough assets for this to make a difference. A major exception can be money tucked away in custodial accounts—Uniform Gift to Minors Act (UGMA) and Uniform Transfer to Minors Act (UTMA).

You can close down an UGMA or UTMA and pay any applicable taxes and then move the cash into a custodial 529 college savings account for the child. The FAFSA will treat money in a custodial 529 plan as a parent asset with its lower assessment rate for financial aid purposes. Many Profile schools, however, will treat custodial 529 accounts as a child's asset.

The money from a custodial account can also be used for the benefit of the child before a parent completes any financial aid applications. Here are some of the things that parents can spend custodial money on that must be for the benefit of the child:

- Summer camps
- Private school
- Car
- Insurance
- Computer and other electronics
- Tutoring
- SAT/ACT test prep
- Taxes generated by the custodial account

Be careful about the timing of shifting money from a custodial account to a custodial 529 account. Liquidating the account can generate capital gains (reportable on the FAFSA and PROFILE) so it's best to make this move before the first base year.

Keep in mind that if a child has a retirement account, such as a Roth, this money should stay put. It should not hurt a child's aid chances as long as it remains in the account.

7 Don't assume trusts funds are an answer.

You might assume that a trust fund will protect parental and/or student assets from financial aid formulas. These funds very rarely do. Trusts funds, which are usually set up for the benefit of the child, will be considered an asset of the student even if he or she doesn't currently have access to the money.

A trust that can't be drawn down by an individual can put a family in a real financial bind. If the beneficiary has restricted access to the principal, the trust assets will continue to reduce aid for the child's entire time in college. In contrast, a parent can deplete the money in a 529 so eventually there would be no assets left to hurt aid. If the student or parents don't know a trust exists they can't report it. This is something grandparents should keep in mind if they are tempted to create trusts for grandchildren.

8 Have a child take a gap year.

A family's EFC will shrink if more than one child is in college at the same time. With two children in college, the parent EFC for a Profile school will drop 40%. Consequently, the Profile EFC would end up being just 60% of the parent EFC if only one child was in college.

Here is a handy chart that shows you how the number of children in school will reduce an EFC for the federal methodology (FM) and the institutional methodology (IM).

Number in College	FM	IM (CSS/Financial Aid PROFILE)
1	100%	100%
2	50%	60%
3	33%	45%
4	25%	35%

9 Spend child's money first.

If you end up with assets in the child's name, spend that money first to cover college costs rather than parent assets. Once the child's assets are gone, the student's EFC will drop.

10 Explore whether you qualify for the simplified means test.

If the parents' adjusted gross income is less than $50,000 and meets certain other criteria, including being eligible to file the IRS Form 1040A or 1040 EZ, they do not have to share their non-retirement assets on the FAFSA.

This could be a huge boon to parents who have lost their jobs or are underemployed, but have accumulated a significant nest egg over the years. It can also be helpful for a divorced parent who has assets from a divorce settlement, but who does not have a good-paying job.

11 Apply for aid early.

It's best to apply for financial aid as early as possible. You can apply for financial aid beginning on October 1 each year. Studies have shown that families who apply within three months of the beginning financial aid date receive considerably more money from state aid programs and public universities. Some states dispense money on a first-come, first-served basis, as do some colleges. And some state programs have early aid deadlines.

12 Pay attention to college aid deadlines.

Don't give a school an excuse not to award your child financial aid. Make sure that you meet the aid deadlines for each school. If your child is applying Early Decision or Early Action, it's likely that the schools will want you to complete your aid application as soon as possible.

13 Know the rules for divorce and separation.

Make sure the right parent files for financial aid—it can make a significant difference in how much aid the child receives. Learn more by reading the lesson on divorce, separation, and financial aid.

14 Understand your financial aid award letter.

Many financial aid awards are misleading. Some schools intentionally make their letters confusing, such as making loans appear to be grants, in the hopes that parents won't appreciate how poor the awards are. If you can decipher the award letters, you'll be in a better position to make a successful appeal. You'll learn more about evaluating financial aid letters in the lesson that focuses on why your Expected Family Contribution is important after applying to colleges.

15 Don't hide your home equity.

Most schools don't even inquire about the value of your house, which makes your home equity irrelevant if you are only filing the FAFSA. Profile schools will inquire about home equity. You can read more about this topic in the lesson on how assets impact financial aid.

16 File the FAFSA and Profile on a bad day for Wall Street.

While you will be using two-year-old income taxes when completing financial aid applications, you will use your current assets. You are expected to report the value of your assets, as well as your child's assets, on the day you file the FAFSA and Profile. Consequently, it would be better to submit the applications on a day when the stock market has performed poorly or you have paid your bills. For financial aid purposes, the lower the account balance, the better. The family should preserve documentation of the value of the assets, such as monthly statements or printouts, from the web site of the bank or brokerage firm.

And, by the way, if the financial markets crash after you have filed the aid applications, you can't go back and update them with your assets' lower value.

17 Be careful with grandparent contributions.

Grandparents and other relatives and friends can hurt financial aid chances if they aren't strategic when helping out with college costs. Grandparents, aunts, uncles or other relatives or family friends can save for college without jeopardizing a child's chances for need-based financial aid as long as the money stays in their accounts. These can be 529 college savings plans or other investment accounts. The FAFSA does not inquire about third parties saving for a child's college years. Schools that use the Profile rarely ask.

When grandparents eventually withdraw money from an investment account to use for their grandchild, parents are supposed to report this money as the child's untaxed income on the FAFSA and Profile (if applicable) and the child's income tax return. This income can reduce aid eligibility by as much as half of the cash withdrawn from the college account.

Let's say a grandmother contributed $10,000 to help defray her granddaughter's tuition cost. When the family was completing the FAFSA, the parents are supposed to declare this gift. This contribution would be treated as the child's income and be assessed at 50%.

$$\$10,000 \times 50\% = \$5,000$$

Based on the formula, the child's financial aid eligibility would drop by $5,000. Put another way, the child's EFC would rise by $5,000.

The FAFSA does provide a way to help blunt or eliminate the penalty triggered by a grandparent's largesse. The FAFSA gives each student an automatic income allowance that is adjusted annually. For the 2019–2020 school year, the allowance is $6,660. A student can earn $6,660 without having his or her income subject to the 50% assessment. Consequently, in this example the student's income allowance would help blunt the impact of the grandparent's $10,000 gift to help pay her college costs.

If financial aid is at stake, grandparents should be strategic about when they help. Assuming a child will graduate in four years, relatives could safely help with college costs after the financial aid applications are filed for the junior year in college. The parents should file for aid in the second semester of the child's sophomore year.

Why is it safe to help after this time? Since the FAFSA and Profile use two-year-old tax records any grandparent help with college costs wouldn't be picked up by the FAFSA and the Profile when a parent filed the FAFSA for the senior year.

18 Consult real college experts.

You should also consider consulting a tax professional or financial planner who is an expert on college financing before making any significant moves. Be careful whom you select. Unfortunately, many self-described college financing experts are insurance agents who know little about college financing.

These agents often troll for clients by holding free college workshops. They will promise to help you boost your financial aid, but their prime goal is typically to sell you annuities or life insurance to hide your assets. This is a very expensive move and the insurance agent will pocket a hefty commission for a misguided financial transaction.

Here is a link to an old, but still relevant article from *Money* magazine about the hazards of depending on product pushers for college advice: College Aid: Don't Take the Bait

BOTTOM LINE

1. One of the best ways to boost chances for financial aid is to aim for schools that are generous with need-based aid.
2. Apply early for financial aid. Overall, early birds get significantly more money from state programs, as well as from colleges.
3. Be careful of "experts" who want to sell your insurance products to hide your assets. efore you try any strategies involving your assets.
4. Understand how grandparents and other relatives can help out with college costs without jeopardizing aid eligibility.