



Saving for college and financial aid options

Paying for college may be a challenge given the rising costs of tuition. Below, you'll find tips for saving for college, as well as financial aid options if savings aren't enough to cover the cost.

Ways to save

529 plans

A Section 529 plan is an education savings plan sponsored by a state and operated by a state, educational or financial institution, designed to help families set aside funds for education costs. In the same way, a 401(k) or Roth IRA is designed to offer tax advantages to help you save for retirement, 529 plans were created to help save for college education. As of January 1, 2018, for federal tax purposes, "education" includes elementary and high school tuition, not just postsecondary education. Please note: Not all states have adopted this definition for state tax purposes.

Although 529 plan contributions are not deductible on your federal tax return, your investment can grow tax deferred, and distributions to pay for qualified education expenses for the named beneficiary come out free of federal income tax. In addition to the federal tax savings, more than 30 states currently offer a full or partial tax deduction or credit for 529 plan contributions. Be sure to research all of your options.

529 plans offer additional benefits beyond tax breaks. Unlike a UGMA/UTMA, where the child takes control of assets once legal age is reached, the 529 account owner maintains control of the account. There are also no income, age or annual contribution limits for 529 plans unlike Roth IRAs or Coverdell Education Savings Accounts (there are lifetime contribution limits for 529, which vary by plan and state, ranging from \$235,000 to over \$500,000).

Qualified education expenses

- **Tuition**—Tuition is a qualified expense for both full- and part-time students at any eligible educational institution in the country or abroad. An eligible educational institution is one eligible to participant in federal financial aid programs.

- **Room and board**—If the student is attending school half time or more, and the room and board are paid directly to the institution, this is a qualified expense.

For students living off campus, the amount of room and board expenses that may be treated as a qualified expense is generally limited to the room and board allowance included by the eligible educational institution in its "cost of attendance" for purposes of determining eligibility for federal education assistance for that year.

- **Books and supplies**—Books and supplies are qualified expenses, but only the ones that are required.
- **Computers and related technology expenses**
- **K-12 school tuition**, up to \$10,000 annually per student from all 529 plans.¹

The SECURE Act (Setting Every Community Up for Retirement Enhancement Act) added education expenses required for the participation in a certified apprenticeship program and the repayment of student loans as a qualified education expense. Up to \$10,000 may be used from a 529 plan to repay student loan principal or interest of either a 529 plan designated beneficiary or a sibling of the designated beneficiary. To be a qualified expense, the loan repayment amount for an individual is subject to a lifetime limit of \$10,000.¹

If you withdraw 529 plan funds and do not use them for qualified education expenses, there is a 10% penalty, and federal income taxes are due on the investment earnings. There are exceptions to the 10% penalty such as death, disability or receipt of a scholarship but taxes on the growth will still be due. You can also transfer the funds to another eligible family member, which allows for flexibility if the intended beneficiary does not use the funds.²

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Estate tax planning benefits

A contribution to a 529 plan is a gift to the beneficiary. You can pay gift taxes, use your lifetime exemption or if you've given one person no more than \$16,000, use your annual gift tax exclusion. 529 plans offer the added benefit of being able to pre-use up to five years of the annual exclusion amount. This means you can give \$80,000 in year one to a 529 plan for a beneficiary using year one's annual gift tax exclusion of \$16,000, and the next four years' worth of annual gift tax exclusions. If you pass away within this five-year period, however, a portion of these gifts may be includable in your estate for federal income tax purposes. Speak with your tax advisor for details regarding your situation.

529 plans funded by grandparents

Many grandparents report that they think it is important to help pay for their grandchildren's college education.

The value of assets owned by a grandparent (or other nonparent) is not reportable on the Free Application for Federal Student Aid (FAFSA) financial aid application. This rule extends to 529 plans owned by grandparents.

However, if a grandparent provides any type of financial support to the student, that support is reportable on the following year's FAFSA as student income. The financial aid formula counts student income just as it counts student assets (although the assessment percentages and allowances are different). Most financial aid offices interpret the rules as requiring distributions from grandparent-owned 529 plans to be included as student income, even when the distributions are not reportable for federal income taxes (i.e., they are tax free). Recent changes under the SECURE Act allowing 529 plans to be used to pay student loan principal or interest may provide a solution.

Structuring your 529 investment

Opening separate 529 accounts for your grandchildren is a good idea for several reasons:

1. You can tailor the selection of the 529 plan and investment options within that plan for each grandchild. For example, let's assume your grandchildren are located in different states. It could make sense to use the 529 plan in the state where the grandchild lives if there are special state tax breaks for withdrawals from the in-state 529 plan, or if the state provides preferable treatment to residents in its own 529 plan when awarding state grants.
2. You can maintain separate 529 accounts for each grandchild to keep your intentions clear. If something were to happen to you and all the funds you set aside

to help all your grandchildren are in the name of just one grandchild in a single account, your family could face a difficult time attempting to resolve the ultimate disposition of the 529 funds. With separate accounts, you can easily name the appropriate successor on each account and eliminate any confusion or discord in the event you die or become disabled.

If the parent of your grandchild has an established 529 plan that accepts third-party contributions, you can contribute to that plan in lieu of opening a new account. Keep in mind, however, the effect that ownership has on a student's financial aid. Also keep in mind that the IRS has not yet indicated whether a contribution you make to a 529 account owned by someone else will be treated as two gifts, the first from you to the account owner and the second from the account owner to the beneficiary. This is especially important if you want to take advantage of the special gifting rule for 529 plans that allows you to gift up to \$80,000 and elect to have it treated as advancement against your five-year annual gift tax exemption. Consult a tax advisor regarding your plans.

The Achieving a Better Life Experience (ABLE) Act

The ABLE Act, which was signed into law in 2014, allows Americans who are living with disabilities to save money for a wide variety of expenses like education, housing, transportation and medical expenses.

529A ABLE accounts

Similar to a 529 college savings plan, 529A savings accounts are administered by states. Money can be withdrawn tax free when the funds are used to pay for qualified disability expenses, including education, job training and support, healthcare and financial management. Typically, the maximum annual contribution for 2022 is \$16,000 (the amount of the annual gift tax exclusion). However, if the beneficiary is working, and the beneficiary or his or her employer is not contributing to a retirement plan, an additional amount may be contributed equal to the lesser of the beneficiary's annual gross salary or the individual Federal Poverty Level.

Be sure to understand the impact of the balance of the ABLE account on benefits such as Social Security Income (SSI), which will be reduced if the balance exceeds \$100,000. You should also review whether the state paying any other benefits will seek estate recovery after the death of the account owner that received such benefits.

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Why 529A accounts are so important

Prior to the ABLE Act, if a person with a disability earned more than \$700 per month, or had savings or other assets in excess of \$2,000, they risked having certain means-tested benefits suspended. The only way families could get around this was to set up a special needs trust, which is often very costly.

Eligibility

To qualify for a 529A account, individuals must have been diagnosed with a significant disability expected to last at least 12 consecutive months before they turned 26 years old. The individual must also receive benefits under SSI and/or Social Security Disability Income (SSDI) or be able to obtain a disability certification from a doctor.

Parents who have saved money in a 529 college savings account may be able to roll the funds into a 529A account in the event the beneficiary is later diagnosed with a disability. State tax treatment varies.

Coverdell Education Savings Accounts (ESAs)

These accounts work very much like a 529 plan, offering tax-free investment growth opportunity and tax-free withdrawals when the funds are spent on qualified education expenses. Coverdell ESAs can be used to pay for qualified elementary and secondary education expenses. This includes not only tuition at an eligible K-12 school but also books, supplies, equipment, academic tutoring and special needs services (tax-free withdrawals from 529 plans are limited to \$10,000 per year in K-12 tuition).

Unlike 529 plans, ESAs are subject to both annual income and contribution limits. If your modified adjusted gross income (MAGI) is less than \$110,000 (\$220,000 if filing a joint return), you may be able to establish a Coverdell ESA to finance the qualified education expenses of a designated beneficiary. For most taxpayers, MAGI is the adjusted gross income as figured on their federal income tax return.

There is no limit on the number of separate Coverdell ESAs that can be established for a designated beneficiary. However, total contributions for the beneficiary in any year can't be more than \$2,000, no matter how many accounts have been established.

Example: When Maria Luna was born in 2019, three separate Coverdell ESAs were set up for her, one by her parents, one by her grandfather and one by her aunt. In 2020, the total of all contributions to Maria's three Coverdell ESAs can't be more than \$2,000. For example, if her grandfather contributed \$2,000 to one of her

Coverdell ESAs, no one else could contribute to any of her three accounts. Or, if her parents contributed \$1,000 and her aunt \$600, her grandfather or someone else could contribute no more than \$400. These contributions could be put into any of Maria's Coverdell ESA accounts.

The low contribution limit and income limitations may make the Coverdell ESAs less appealing. Plus, now that 529 plans allow withdrawals for elementary and high school tuition expenses, they may be much more appealing. Families who are currently saving with a Coverdell ESA and want to switch to a 529 plan can do a rollover with no tax consequences.

Financial aid

Nearly every student is eligible for some form of assistance. Federal aid comes in many forms. The four most common types of aid offered from the federal government are:

- **Pell Grant**—A needs-based grant of up to \$6,495 reserved for students of families with lower incomes that may equate to a low expected family contribution (EFC) rate.
- **Stafford Loan for undergraduate students (subsidized)**—The current interest rates (first disbursed on or after July 1, 2021, and before July 1, 2022) for direct unsubsidized loans are 3.73% (Undergraduate Student) and 5.28% (Graduate or Professional Student). The interest rates are fixed for the life of the loan.
- **Federal Work-Study Program**—A program where students with financial need can get part-time work, allowing them to earn money to help pay education expenses. In most cases, the federal government pays half of a student's wage and the school pays the other half.
- **Stafford Loan (unsubsidized)**—Students who may not be eligible for need-based aid may still be eligible for an unsubsidized Stafford Loan regardless of income or circumstances. An unsubsidized Stafford Loan is a federally guaranteed student loan that is not based on financial need. For unsubsidized student loans, interest accrues from the time the loan is disbursed to the school and is the responsibility of the student. This is the key difference between subsidized and unsubsidized student loans.

Eligibility

To determine if you are eligible, schools generally use a formula to determine the EFC.

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Expected family contribution

Colleges use various methods to determine whether a prospective student is eligible for any need-based aid. Under each methodology, eligibility is based on the following formula: Cost of Attendance – Expected Family Contribution = Need.

Assets in accounts owned by a dependent student or one of their parents are considered parental assets on the FAFSA. The parental assets may be entitled to a small asset protection allowance. For parents who save more than the allowance, only a maximum of 5.64% of parental assets are counted. This is quite favorable compared to other student assets, which are counted at 20%. Higher EFC means less financial aid.

When a grandparent withdraws the funds to pay for their grandchild's college expenses, it will be counted as student income on the FAFSA. Student income is assessed at 50%, which means if a grandparent pays \$5,000 of college costs it would reduce the student's eligibility for aid by \$2,500. One strategy to avoid this problem: If the student will graduate in four years, a grandparent can wait to contribute until after the student's third semester of college, since the FAFSA looks at income from two years prior.

It's important to discover as early as possible how savings, investments, retirement accounts, 529 college plans and income affect eligibility. To do so, you will need to determine:

1. Which colleges use which aid forms and formulas
2. How your family's finances will be assessed under each formula and, therefore, at each college
3. If the income of a parent will disqualify a child for need-based aid regardless of the amount and type of assets or who owns them

Application process (the FAFSA and CSS Profile)

The process of applying for need-based financial aid for college begins by students and parents completing one or two financial aid forms, the FAFSA and/or the College Scholarship Service (CSS) Profile.

Any college or university that awards federal student aid must require that students complete the FAFSA in order to determine eligibility for federal aid (it works for most state aid, too). Most colleges and universities nationwide use the FAFSA as their sole application for need-based financial aid. Students applying for aid at those colleges only need to complete the FAFSA.

However, there are about 250 colleges that require the CSS Profile be completed in addition to the FAFSA. Those colleges use the CSS Profile to assess the student's eligibility for their own institutional aid dollars.

Typically, "Profile" colleges are very selective private colleges, but the University of Michigan at Ann Arbor, Georgia Institute of Technology and the University of North Carolina at Chapel Hill are examples of flagship state universities that require the Profile, not just the FAFSA.

There is also a group known as the 568 Presidents' Group, which was formed by a group of 28 college and university presidents for the purpose of assessing students' ability to pay for college using a "consensus" methodology. The 568 Presidents' Group schools also require students to complete the CSS Profile, but they treat students' assets and parents' home equity different (more favorable to families) than the institutional methodology. Thus, there are two financial aid forms but three methodologies of calculating a student's EFC.

Next steps

Being educated on the financial aid process is necessary as education costs continue to rise. Your TIAA advisor can help you examine these and other costs in an analysis of your life goals.

Helpful websites to learn more about financial aid and college savings:

- TIAA.org/public/offer/products/529-educational-savings
- ablenrc.org
- bigfuture.collegeboard.org/pay-for-college/paying-your-share/expected-family-contribution-calculator
- collegeboard.org
- collegesavings.org
- fafsa.ed.gov
- finaid.org
- savingforcollege.com

There are also private loans that may be available to students. These loans can be obtained through banks, Sallie Mae or online. Generally, private loans are more expensive and have higher interest rates, so you may want to consider federal student aid first.

Please note that we do not endorse nor are affiliated with the third-party websites, but are providing them merely as examples from which you can obtain additional information. We are not responsible for the information or services they provide.



¹ Some states do not fully conform with the federal laws regarding distributions for K-12 tuition, apprenticeship programs and student loan repayment. Distributions used to pay for tuition expenses at a public, private or religious elementary, middle or high school, registered apprenticeship programs and student loans may be considered nonqualified and the earnings portion of the withdrawal is subject to state income tax. In addition, nonconforming states offering a state income tax deduction for 529 plan contributions may impose a recapture if funds are used for K-12 tuition, apprenticeship programs and student loan repayment. You should talk to a qualified professional about how tax provisions affect your circumstances.

² See the plan's disclosure booklet for allowable family members.

Examples included herein, if any, are hypothetical and for illustrative purposes only.

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Most states offer a 529 college savings plan. Before investing, check your state's website for information about any favorable state tax benefits that are only available if you invest in that state's plan.

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