TIAA

College savings and financial aid options including 529 plans and other 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. 529 plans offer beneficial income tax breaks. As of January 1, 2018 (until repealed or expiration), "education" includes elementary and high school, not just post secondary education.

Although your contributions are not deductible on your federal tax return, your investment can grow tax deferred, and distributions to pay for certain of the beneficiary's college costs come out free of federal income tax.

Qualified education expenses

Tuition—Tuition is a qualified expense for both full- and part-time students at accredited institutions. To be accredited simply means the institution has passed standards set by a reviewing committee. While the majority of colleges are accredited, be sure to ask the financial aid office ahead of time.

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.

Books and Supplies—Books and supplies are qualified expenses, but only the ones that are required.

You maintain ownership and control of the funds in the 529 account. If you withdraw the 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 family member, which allows for flexibility if the intended beneficiary does not use the funds.*

Your home state may offer some tax breaks (like an upfront deduction for your contributions or income exemption on withdrawals) in addition to the federal treatment. You should research what benefits residents receive for investing in a 529 plan.

A contribution to a 529 plan is a gift; you can pay gift taxes, use your lifetime exemption, or if you've given one person no more than $15,000, use your annual gift tax exclusion. 529s offer the added benefit of being able to pre-use up to five years of the annual exclusion amount. You can make a contribution to a 529 plan that allows you and your spouse the ability to give up to $15,000 without triggering gift taxes. This means you can give $75,000 in year one to a 529 plan for Beneficiary A using year one's annual gift tax exclusion of $15,000, 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 529s to be included as student income, even when the distributions are not reportable for federal income taxes (i.e., they are tax free).

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 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 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, your children 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 $75,000 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 December 2014, allows Americans who are living with disabilities to save money for college and other expenses in a tax-deferred account as a supplement to private insurance and public benefits.

529 ABLE (529A) accounts

Similar to a 529 college savings plan, 529A savings accounts are administered by the 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. The contribution for 2018 is $15,000 (the amount of the annual gift tax exclusion), and many states have total contribution limits that exceed $300,000.

However, if a person's 529A account balance exceeds $100,000, they will no longer be eligible for SSI benefits. Also, if the beneficiary dies, states will be able to recoup some of expenses paid by Medicaid.

The signing of the Protecting Americans from Tax Hikes (PATH) Act in 2015 removed residency requirements from 529A accounts, giving individuals the option of using any state's plan. Yet, some states may offer tax benefits for those who use their home state's plan.

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 to forfeit eligibility for government programs like Medicaid. The only way families could get around this was to set up a special needs trust, which is often very costly to do. As a result, there has been little incentive to save, and many people with disabilities end up living below the poverty level.

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 Social Security Income (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 such as autism.

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. However, in addition to college expenses, certain K-12 purchases are also considered qualified when using a Coverdell ESA.

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 2015, three separate Coverdell ESAs were set up for her, one by her parents, one by her grandfather and one by her aunt. In 2016, 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 less appealing, but it should still be considered. Plus, now that 529 plans allow withdrawals for elementary and high school educational 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 assistance
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 grant of up to $5,550 for students with a low expected family contribution (EFC) rate.
- **Stafford Loan (subsidized)**—As of July 1, 2013, any federal direct subsidized loan will have a fixed interest rate of 6.8%, and the interest is paid by the government while the student is enrolled at least half time. The federal direct unsubsidized loan also has a fixed interest rate of 6.8% and accumulates interest onto the outstanding balance.
- **Federal Perkins Loan**—A loan that is like the Stafford but is loaned directly by schools that are Title IV-eligible. The interest rate is fixed at 5%.
- **Federal Work-Study Program**—A program where students can get part-time work, up to a certain amount. In most cases, the federal government pays half of a student's wage and the school pays the other half.

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. This is the key difference between subsidized and unsubsidized student loans.

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

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

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 300 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 of 26 colleges that make up what is known as the 568 Presidents' Group, which was formed by the presidents of those institutions 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.

Calculating the EFC
There are three methods for calculating the EFC, which is the minimum amount the family is expected to contribute toward the cost of college, including:

- Federal Methodology (FM)
- Institutional Methodology (IM)
- Consensus Methodology (CM)

All three calculations are based on the income and assets of the parents and student as reported on the two financial aid forms, the FAFSA (FM) and the CSS Profile (IM and CM).

Parents are expected to use up to 5.64% (FM) and 5% (IM and CM) of those available assets each year on college. Students are expected to use up to 20% (FM), 25% (IM) and 5% (CM) of the available assets.

Parents are allowed a deduction (called an asset protection allowance) from the available assets for an emergency reserve of about $30,000 to $50,000. Students do not have this deduction.

Which assets count
The type of asset determines whether it must be disclosed on the aid application form (the FAFSA or CSS) and whether it is included in calculating the EFC (depending upon which of the three methodologies is used).

529 plans and Education Savings Accounts (ESAs)
529 plans are always included in both the FAFSA and CSS forms and under all methods.

The sole difference is that under the federal need analysis formula (the FM) only (not the IM or CM), 529 and ESA assets owned by students are considered assets of the parent for federal aid purposes; therefore, they get more favorable aid treatment than other assets like savings accounts, mutual funds, stocks and bonds. This is because of the inclusion ratio applied to student's assets versus parent's assets.

529 plans owned by grandparents are not counted as an asset when a student completes the FAFSA, but some colleges do ask for grandparent-owned 529 assets as a supplemental question on the CSS Profile. Grandparent-owned 529 assets are also not factored into the EFC calculation. Financial aid officers may examine the balances to give them a more complete financial profile of the family.

However, distributions from grandparent-owned 529 plans do count against aid eligibility under all of the aid formulas. Distributions from grandparent-owned 529 plans are considered a gift to the student and treated as untaxed income for financial aid purposes, which can impact a student's aid eligibility by up to 50% of the distribution.

This means that having an asset in the form of a 529 plan account that is owned by the grandparent does not count as an asset in the student's EFC toward the cost of college, but if the grandparent makes a distribution from that 529 plan to help the grandchild pay for college, that distribution will be considered untaxed income of the student when the student completes the aid forms the following year.

Which assets count toward the EFC?

	FAFSA and CSS Profile	Countable toward EFC on CSS Profile
Retirement accounts	No	No
Life insurance	No	No, except at highly selective colleges
Small businesses	No, if under 100 employees & family controlled	No, if under 100 employees & family controlled
Personal assets	No	No
Non-qualified annuities	No	Yes
Home equity	No	Yes
Collectibles	Yes	Yes
Rental properties	Yes	Yes
After-tax accounts	Yes	Yes
Trust accounts*	Yes	Yes

*Depending upon the trust terms, it may be a present-value calculation.

The math
Let's see how assets affect the EFC.

Example: Parent's assets under the FM

If there are $30,000 in reportable assets that you own, and your asset protection allowance is $35,000, then there will be no contribution expected from the assets because the total reportable assets do not exceed the asset protection allowance.

If you have $1 million in reportable assets, you would be expected to make a contribution of $54,426 each year ($1 million - $35,000 x 5.64%).

Example: Student's assets under the FM

If there are $30,000 in reportable assets that the student owns, the student will be expected to use up to $6,000 ($30,000 x 20%) because the student does not have an asset protection allowance.

If the student has $1 million in reportable assets, the student would be expected to make a contribution of up to $200,000 ($1 million x 20%).

Should you reposition your assets to qualify for more college financial aid?
Before doing so, you should determine which aid application form is likely to be applicable to the situation. Next, if possible, determine which of the three methodologies will be applied. If this cannot be determined, you may wish to prepare a spreadsheet applying all three and then determine the resultant savings from moving an asset from the "available" category to the "unavailable" category.

The example below shows a repositioning of assets, but it does not include income in the calculation. There are several college aid calculators that can help you with a precise calculation of your EFC.

EFC calculation: Asset Test—No Income Included

	With Cash	Cash to Life Insurance
Retirement Accounts		
Qualified Annuities	$391,676.00	$391,676.00
Qualified Accounts	$1,250,000.00	$1,250,000.00
Cash and Investments		
Cash	$415,000.00	
Life Insurance		$415,000.00
Home Equity	$800,000.00	$800,000.00
Total Assets	$2,856,676.00	$2,856,676.00

Expected Annual Family Contribution

Parents' Contribution for Student = $5,812	Parents' Contribution for Student = $0
Student's Contribution = $0	Student's Contribution = $0
Total Estimated FM Contribution = $5,812	Total Estimated FM Contribution = $0
Parents' Contribution for Student = $55,967	Parents' Contribution for Student = $35,217
Student's Contribution = $202,000	Student's Contribution = $202,000
Total Estimated IM Contribution = $257,967	Total Estimated IM Contribution = $237,217

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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:

- **https://www.tiaa.org/public/offer/products/529-educational-savings**
- **bigfuture.collegeboard.org/pay-for-college/paying-your-share/expected-family-contribution-calculator**
- **fafsa.ed.gov**
- **finaid.org**
- **collegesavings.org**

There are also private loans that can 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.

* 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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