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 a 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.

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, ranging from $235,000-$520,000).

Qualified education expenses
- Tuition—Tuition is a qualified expense for both full- and part-time students at any accredited university, college or vocational school nationwide—and many abroad. 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. 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

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 family member, which allows for flexibility if the intended beneficiary does not use the funds.²

Estate tax planning benefits
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. 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.

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. The maximum annual contribution for 2019 is $15,000 (the amount of the annual gift tax exclusion).

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.

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 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 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 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. 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 $5,500 reserved for students of families with lower incomes that may equate to 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.
- **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. 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.

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 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 a maximum of 5.64% (FM) and 5% (IM and CM) of those available assets each year for college. (Note: For the FM, the percentage of assets used to calculate EFC decreases as the age of the oldest parent increases.) 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).

Which assets count toward the EFC?

<table>
<thead>
<tr>
<th>FAFSA and CSS Profile</th>
<th>Countable toward EFC on CSS Profile</th>
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</thead>
<tbody>
<tr>
<td>Retirement accounts</td>
<td>No</td>
</tr>
<tr>
<td>Life insurance</td>
<td>No</td>
</tr>
<tr>
<td>Small businesses</td>
<td>No, if under 100 employees &amp; family controlled</td>
</tr>
<tr>
<td>Personal assets</td>
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</tr>
<tr>
<td>Non-qualified annuities</td>
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<tr>
<td>Home equity</td>
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</tr>
<tr>
<td>Collectibles</td>
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</tr>
<tr>
<td>Rental properties</td>
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</tr>
<tr>
<td>After-tax accounts</td>
<td>Yes</td>
</tr>
<tr>
<td>(including 529s, ESAs and UGMA/UTMA)</td>
<td></td>
</tr>
<tr>
<td>Trust accounts*</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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

529 plans may be reported as assets on the FAFSA; it depends on who owns the 529 plan.

- If a 529 college savings plan is owned by a dependent student or by a dependent student’s custodial parent, it is reported as a parent asset on the FAFSA. Distributions are ignored and the inclusion ratio is less than if the asset is owned by the independent student.

- If a 529 plan is owned by an independent student, it is reported as a student asset on the FAFSA. Distributions are ignored, but the inclusion ratio is higher than if the custodial parent owned the account.

- If a 529 plan is owned by anyone else, such as a grandparent, aunt, uncle, or non-custodial parent, it is not reported as an asset on the FAFSA. Instead, distributions count as untaxed income to the student (beneficiary) and can impact eligibility as a portion of that income will be considered in an aid determination.
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Here’s the impact:

- ESAs and 529 plans reported as an asset owned by the dependent student’s custodial parent or by the dependent student on the FAFSA will reduce eligibility for need-based aid by as much as 5.64% of the asset value.
- UGMA/UTMA and 529 plans reported as an asset owned by an independent student on the FAFSA will reduce eligibility for need-based aid by as much as 20% of the asset value.
- Distributions from a 529 plan owned by anyone other than a custodial parent or dependent student will reduce eligibility for need-based aid by as much as 50% of the amount of the distribution.

College savings impact on financial aid

The below hypothetical illustrates that, all things being equal, 529 or ESA savings of $50,000 increases the EFC by $663.

Note: This illustration assumes a family of four with one child in college.

Source: finaid.org Quick EFC Calculator.

<table>
<thead>
<tr>
<th>Illustration</th>
<th>Parent A</th>
<th>Parent B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parental income</td>
<td>$75,000</td>
<td>$75,000</td>
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<td>Age of oldest parent</td>
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<td>45</td>
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<tr>
<td>Balance of 529 Plan (the only variable)</td>
<td>0</td>
<td>$50,000</td>
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<tr>
<td>Estimated family contribution (EFC)</td>
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<td>$8,314</td>
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<tr>
<td>Difference</td>
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<td>$663</td>
</tr>
</tbody>
</table>

Planning options for 529 plans not owned by the student or parent

If the 529 or ESA account owner is a grandparent, non-custodial parent or non-parent, assets will not be factored into the EFC, but distributions will be considered income to the student, which has a greater impact on financial aid (except under the Consensus Methodology). There are a few planning options that can mitigate the impact on financial aid from 529 plans not owned by the student or parent.

Repositioning the asset by changing the account owner to the student or the student’s parents:

- Change account owner. The owner can change the account owner to the parent or student if permitted by the 529 plan to yield a more favorable financial aid treatment. However, this could trigger gift and generation-skipping taxes, and some states will recapture state income tax benefits if the account owner is changed.

- Transfer 529 plan funds to existing parent-owned plan. If the transfer occurs after the FAFSA is filed, the funds won’t be reported as an asset on the FAFSA (assuming the funds are spent before the next FAFSA is filed). Distributions from this 529 plan also will not affect aid eligibility because the 529 plan is owned by the parent. As noted above, some states may seek to recapture state income tax benefits, so the parent-owned 529 plan should be in the same state as the other 529 plan.

Defer the distribution

- Take a distribution later. The grandparent can wait until after January 1 of the beneficiary’s sophomore year in college to take a distribution. Since the FAFSA uses the prior year for income and tax information, there will be no subsequent year’s FAFSA to be affected by the distribution if the student graduates in four years. If the student will graduate in five years, the family should wait until January 1 of the junior year to take a distribution.

- Wait until after graduation. The owner can wait until after the student graduates to take a distribution to pay down the student loan debt. This distribution may not be a qualified distribution and therefore subject to ordinary income tax at the owner’s rate, plus a 10% penalty (IRS regulations are unclear on the time frame required between withdrawals and qualified expenses). But, the tax and penalty are assessed only on the earnings portion of the distribution, not the full distribution. Alternatively, changing the ownership to the beneficiary can make the withdrawal subject to the beneficiary’s tax rate. This may be not much different than if the owner had saved the money in a taxable account. State taxes can vary and may include recapture of previous tax deductions, if applicable. Consult a qualified tax professional.

Should you reposition your assets to qualify for more college financial aid?

As you can see from the chart, there are several types of assets that are not counted to determine the EFC. You could consider moving assets from one category to another, but 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 or use one of the online calculators applying all three and then determine the resultant savings from moving an asset from the “available” category to the “unavailable” category. Remember to consult a financial aid professional for expert guidance.
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/offfer/products/529-educational-savings
- bigfuture.collegeboard.org/pay-for-college/paying-your-share/expected-family-contribution-calculator
- fasfa.ed.gov
- finaid.org
- ablenrc.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.

Please note that we do not endorse nor are affiliated with the third party web sites 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. Distributions used to pay for K-12 tuition may be considered non-qualified and the earnings portion of the withdrawal is subject to state income tax. In addition, non-conforming states offering a state income tax deduction for 529 plan contributions may impose a recapture if funds are withdrawn to pay for K-12 tuition.

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

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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.

Consider the investment objectives, risks, charges, and expenses before investing in a state 529 college savings plan. Carefully read the Disclosure Booklet available on each state’s site, or call us at 888-381-8283. Investments in a state 529 college savings plan are neither insured nor guaranteed and there is risk of investment loss.

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