Mastering Financial Aid Eligibility

Presented by Todd Cottingham

For many families, financial aid programs help make higher education attainable. The first step in applying for aid is to complete the Free Application for Federal Student Aid (FAFSA). It is used to determine the student's eligibility for federal aid programs, such as grants, work-study options, and loans. Schools also use the FAFSA to assess whether additional aid is available from an applicant's state of residence and from the school itself.

The FAFSA's more than 100 questions ask for a host of personal information, including marital and citizenship status, tax- and income-related information, household size, and the schools the student will apply to. It also asks for details about the income, assets, and education history of the applicant's parents.

Please note: Many private colleges and universities require aid applications in addition to the FAFSA. The most common of these is the CSS Profile. Check with each school's financial aid office to determine which applications are required.

Tips for navigating the income-related questions

The role of tax returns. Information from the student's and his or her parents' tax returns is used to complete the FAFSA's income-related questions. Due to a recent change, there is a two-year look-back regarding the data required. This means that a family filling out the 2019–2020 FAFSA should use the data from its 2017 tax returns. Consequently, tax returns filed in the student's last two years of college will not affect aid awards.

Whose data should be used? When parents live apart and are divorced or separated, the custodial parent is the one who needs to provide information for the FAFSA. But because a custodial parent is not defined as the parent who has legal custody, other factors must be evaluated to determine which parent's information must be provided. Such factors include which parent the student lived with most or which parent provided the most financial support to the student during the 12 months preceding the date that the FAFSA is to be filed.

For situations where the custodial parent has remarried, the stepparent's information must also be included on the FAFSA. If the student's parents are divorced, are separated, or were never married *but* they live together, both are required to provide information on the FAFSA.

Determining the expected family contribution

One reason the FAFSA requires so much detailed information is because the data is used to calculate each student's expected family contribution (EFC). It is a measure that determines how much federal aid a family may receive.

The formula for determining an EFC considers parental assets and income, student assets and income, and factors such as the number of family members attending college at the same time. Many people believe, incorrectly, that the EFC is the amount of money the family is expected to contribute to education costs. It is not. Rather, the EFC is simply a number used by educational institutions to determine whether federal aid is available and, if so, how much.

- **Parental assets.** The questions that the FAFSA asks about parental assets pertain to ownership interest at the time the application is completed. Reportable parental assets include cash and funds held in bank accounts, trust funds, 529 accounts, and more. Parental assets are considered low-impact assets for financial aid purposes—only up to 5.64 percent of the value of parental assets affect the EFC.
- **Student assets.** Student assets include property in which the student has an ownership interest at the time that the FAFSA is completed. For example, UTMA/UGMA accounts fall into this category. (Custodial 529 accounts and 529 accounts owned by the student are not considered assets of the student and should be listed as parental assets.) Student assets are considered high-impact assets for financial aid purposes—up to 20 percent of the value of his or her assets will affect the EFC.
- **Protected assets**. Some assets are protected and don't need to be listed on the FAFSA, including 401(k) plans, pension plans, 403(b) plans, IRAs, and other retirement plans. Equity in a family's primary residence, certain family-owned businesses and farms, life insurance, annuities, and personal possessions are also nonreportable.

If your children are approaching college age, it may be helpful to get an estimate of your family's EFC. The U.S. Department of Education's FAFSA4caster is a free calculator that can be used to create an estimate of financial aid eligibility.

Grandparent-owned 529 plans

Because assets owned outside of the immediate family are not included on the FAFSA, grandparents often own 529 plans for the benefit of their student grandchildren. Although this may make sense in certain cases, there are some details to consider before moving forward with this strategy.

Funds in a grandparent-owned 529 plan are not considered countable assets on the FAFSA, but money that's taken out of the 529 plan and used to pay for education expenses is considered nontaxable income to the student. Distributions from a grandparent-owned 529 plan reduce the eligibility of a student for need-based aid by as much as 50 percent of the amount of the distribution. If grandparents do own a 529 plan for the benefit of their grandchild, the family may want to reserve those funds for the last two years of college because, as previously noted, FAFSA uses the prior-prior year's tax return to complete the income questions.

Resources for completing the FAFSA

For many parents and students, completing the FAFSA is a complicated process. Fortunately, several resources are available to help. Among the best is the Notes section at the end of the FAFSA itself. It offers guidance for answering some of the trickier questions.

Additional resources for completing the FAFSA include the Federal Student Aid website, which features a robust FAQs page, a live chat feature, and other contact information for questions and assistance.

As always, before making any decisions, a best practice is to consult your financial advisor and a tax professional.

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