BAIRD

Financial Aid Strategies

Parents often think it's smarter to save for college in their child's name, taking advantage of the lower tax rate on the earnings. But this tactic can backfire when it comes time to apply for need-based financial aid. The expected family contribution (EFC) in the federal formula factors in the student's assets at a much higher rate of 20%, than the parent's assets, which are assessed at no more than 5.64%. If you think you might qualify for need-based aid, keep as little in your child's name as possible. Note that just because you demonstrate financial need doesn't mean that you are assured of getting a grant or scholarship. As a general rule, unless the family is fairly destitute, a decrease in the EFC may yield an increase in eligibility for student loans and work-study, but not grants. Couples earning more than $200,000 probably won't have a shot at need-based aid but your child may qualify for merit-based aid.

Honesty is the Best Policy. You must fill out the financial aid forms accurately. The information you provide can and will be verified by the college, your state or the U.S. Department of Education. If you get federal student aid based on incorrect information, you will have to pay it back; you may also have to pay fines and fees. If you purposely give false or misleading information on your application, you may be fined $20,000, sent to prison, or both.

The tips below will have the largest impact on need-based aid eligibility:

1. **Save money in the parent's name, not the child's name.** Use a financial aid friendly savings vehicle that is treated as a parental asset, such as a 529 college savings plan or Coverdell Education Savings Account (ESA).
2. **Pay off consumer debt.** Consumer debt isn't counted in the need analysis formula, so there's no benefit to having a credit card balance. Paying off your credit card balances and auto loans will reduce your available cash, thereby increasing your eligibility for financial aid.
3. **Spend down the student's assets.** The tax code allows you to spend the child's assets for the benefit of the child but *not* as part of the usual parental obligations. For instance, you could pay your child's private elementary and high school tuition, or to pay for summer camp but *not* for groceries, clothing, health care or the mortgage payment. An accountant will be able to help you identify which expenses qualify. Reduce assets in your child's name before the base year to reduce the impact on the need analysis process. Use whatever's left of your child's assets to pay for his/her first years of college. That will help when you renew your aid application in later years.

> The Deficit Reduction Act of 2005, which took effect on 7/1/06, provides that UTMA/UGMA assets held within a 529 savings plan will be treated as parent assets for federal financial aid purposes. Before filing the FAFSA consider converting the custodial assets into an UTMA529 college savings plan.

4. **Accelerate necessary expenses.** For example, if you need a new car or computer, buy it before you file the Free Application for Federal Student Aid (FAFSA) so that your liquid assets are reduced.
5. **Unusual family circumstances.** If you feel that your family's financial circumstances are unusual, make an appointment with the financial aid administrator at your school to review your case. Sometimes the school will be able to adjust your financial aid package to compensate using a process known as Professional Judgment.
6. **Minimize capital gains.** Capital gains are treated like income. Sell your stocks and bonds that have capital gains during your child's sophomore year in high school or in April of their junior year in college, after their last FAFSA has been filed. Selling these securities at other times will reduce your eligibility for aid in the subsequent year.
7. **Maximize contributions to your retirement fund.** Retirement funds and pensions are generally not considered assets by both the Federal Methodology and the Institutional Methodology need analysis formulas. You can shelter a considerable portion of your assets by making the maximum contributions to these funds in the years *before* the base year. Tax-deferred annuities and life insurance policies are also not considered assets in the need analysis.
8. **Choose your FAFSA submission date carefully.** Assets and marital status are specified as of the application date.

9. **File Early.** Some schools and states award aid money on a first-come, first serve basis until the funds are depleted.
10. **Don't raid your retirement funds.** Distributions from your pre-tax retirement funds count as income, reducing next year's financial aid eligibility. If you withdraw too much money from your pension, or make a withdrawal before the FAFSA is filed, these funds become an included asset. It is much better to spend your liquid assets, such as cash in bank accounts, first. And remember, you can borrow for college, but not for retirement.
11. **Ask relatives who want to help to wait.** Having family and friends who want to help is great. But, any "aid to the student" can impact the following year's financial aid package. Here are some strategies that may help:
    - Have them make a contribution to your 529 plan.
    - Ask them to wait until the student's last year in school.
    - After the student graduates they can help pay down loans.
    - Gift the money to the parents, not the children, so that the money is assessed at the parent's rate in the need-based analysis.
    - Ask if the school has an option where a relative can pay the money directly to the school to cover the child's educational expenses *without* impacting the child's eligibility for financial aid. (These contributions are not subject to the IRS's $14,000 tax-free gift limit).
12. **Decrease your income.** Here are ways to reduce your income that may increase your federal financial aid eligibility:
    - Take an unpaid leave of absence.
    - Sell off securities that have a capital loss.
    - Postpone any bonuses until after the base year.
13. **Trusts funds can backfire on you.** Trust funds are generally ineffective at sheltering money from the need analysis process. If the trust is set up to prevent the trustees from spending the principal, it can harm the student's eligibility for financial aid. The school will assess the entire trust as if it were a student asset, regardless of any restrictions on the principal. Since the student can't spend down the principal, the trust will represent an annual drain on the student's finances by increasing the student contribution.
14. **Prepay your mortgage.** The federal need analysis methodology doesn't consider the equity in the family's primary residence. So to maximize your eligibility for federal aid, you could use your cash and other included assets to prepay part of your mortgage. Note that private schools that use the CSS Profile may include the equity in your home so that your family's "Borrowing Power" can be assessed.
15. **Non-parental owned 529 plans.** 529 college savings plans are the asset of the account owner. If neither the parent nor the student is the account owner, it's not reported on the FAFSA. Grandparent or other non-parent owned 529s are not reportable on the FAFSA. ***However,*** if someone other than the parent provides any type of financial support to the student, that support is reported as student income on the following year's FAFSA.

    If a grandparent or non-parent were to use the 529 account to pay for the final year of college, the income rule wouldn't make any difference. The earnings portion of a withdrawal not used for qualified higher educational expenses will be subject to a 10% penalty and income tax.
16. **You have to apply!** If you don't file the FAFSA form you won't get any aid. Even if you think you may not qualify, you should still submit the forms.

Investors should consider the investment objectives, risks, charges and expenses associated with a 529 Plan before investing. This and other information is available in a Plan's official statement. The official statement should be read carefully before investing.

Depending on your state of residence, there may be an in-state plan that provides tax and other benefits not available through an out-of-state plan. Robert W. Baird & Co. does not provide tax advice. Before investing in any state's 529 plan, you should consult your tax adviser.