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Saving for College

A Critical Piece of the "Paying for College" Puzzle

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Agenda

Saving for College

- Common Savings Vehicles
  - 529s
  - Coverdell Education Savings Accounts
  - Savings Bonds
  - Roth IRA
  - Taxable Investment Accounts
- Impact of Saving on Financial Aid Eligibility
  - What Assets Are Counted?
  - In Whose Name Are They Counted?
  - How Does the FAFSA Treat Assets?
  - Caveats
- Closing Thoughts

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Savings Vehicles – 529s

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- 529s
  - Tax Highlights
    - Earnings on contributions are tax-free if withdrawn for "Qualified Higher Education Expenses" (tuition, fees, books, supplies & equipment)
    - Contributions are not deductible for federal tax
    - Maine offers a $250 state tax deduction (AGI < $100,000 single filers, < $200,000 joint filers)
  - Generous Account Limit
    - In Maine, account limit is $360,000

Savings Vehicles – 529s

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- 529s
  - Maine Matching Grants – something for everyone!
    - Harold Alfond College Challenge Grant: $500 for Maine resident children under the age of 1
    - NextGen Initial Matching Grant: $200 upon opening account with $50 (no age limit)
    - NextStep Matching Grant: 1/3 match up to $400 on contributions made in first 24 months of account opening
    - Automated Funding Grant: $50 upon selecting automated contributions to the program

Savings Vehicles – 529s

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- 529s
  - Assets can be transferred to another beneficiary
  - No age limits
  - Account owner retains control, account is not considered child's asset (for financial planning purposes)
  - Qualified Expenses Only: Be fairly certain that the student will pursue higher education (or that funds can be used for another member of the family)
  - Limited to investment choices offered in the plan

Savings Vehicles – Coverdell ESA

- Coverdell Education Savings Account
  - Tax Highlights
    - Earnings on contributions are tax-free if withdrawn for "Qualified Higher Education Expenses" OR "Qualified Elementary and Secondary Education Expenses" (tuition, fees, books, supplies & equipment)
    - Contributions are not deductible for federal tax
    - Generally, states do not offer a deduction for contributions

Savings Vehicles – Coverdell ESA

- Coverdell Education Savings Account
  - Currently can be used for K-12 expenses as well
  - Greater choice in investments
  - Can only fund until age 18
  - $2,000 limit per year
  - Distributed to the child if not used for college – must be withdrawn by age 30 (or rolled to another beneficiary)
  - Withdrawals must be coordinated with other federal tax benefits (Hope and Lifetime Learning credits)

Savings Vehicles – Savings Bonds

- Savings Bonds
  - Series EE (fixed rate) and Series I (fixed rate plus inflation rate) bonds
  - Interest can be excluded under certain conditions if used for qualified higher education expenses
  - Interest is always excluded from state and local taxes
  - Easy to purchase and issued in values as low as $25
  - Maximum purchase of $5,000 annually

Savings Vehicles – Savings Bonds

- Savings Bonds
  - "Qualified Higher Education Expenses" include only tuition and fees for the bond owner, spouse, or dependent
  - Must be coordinated with other federal tax benefits (Hope and Lifetime Learning credits), scholarships, and qualified distributions from other plans (makes using a combination of savings bonds and 529 or Coverdell complex)
  - Several limitations apply: Income limitations are relatively low ($70,100 single/$105,100 joint)

Savings Vehicles – Roth IRA

- Roth IRA
  - Using an IRA (Traditional or Roth) to fund education stems from the exception to the 10% penalty rule for education expenses
  - Roth IRA: Only the earnings are taxed, basis (your original contributions) is always tax-free
  - Broad choice in investments
  - Parent retains control - if funds are not used for education, they are available for retirement
  - $5,000 per year IRA contribution limits ($6,000 if over 50)
  - Caution against using valuable retirement assets for education

Savings Vehicles – Taxable Investment Acct.

- Taxable Investment Account
  - Most flexible, least tax benefit
  - Income and capital gains taxes apply to account earnings, basis (after-tax contributions to the account) is always tax-fee
  - Good choice when all other options are exhausted (or are not available) or when a high degree of flexibility is needed
  - Broad choice in investments
  - No risk of over-funding

Savings Vehicles – UGMA/UTMA

- UGMA/UTMA
  - Not a favorite solution for college savings
  - Generally, there are better solutions
  - Child gains control of assets at age 21
  - Unfavorable treatment for financial aid
  - Can’t transfer the assets to a different beneficiary

Some Thoughts on Saving

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- Always….
  - Encourage evaluation of suitability of investments as children approach college age – more conservative as they approach matriculation
  - Remember the power of human psychology and behavior – every bit saved toward a goal sets an expectation
  - Encourage keeping the child up-to-date and involved
- Remember….
  - Every little bit helps, as does starting early
  - Good idea for kids to save to accounts earmarked for college

What Assets Are Counted?

- Certain assets are EXCLUDED from the FAFSA
  - Primary Residence
  - Retirement Accounts
    - These include 401K plans, pension funds, annuities, non-education IRA, Keogh plans
  - Small Businesses
    - Do not include the value of a small business if the family owns and controls more than 50% of the business and it has 100 or fewer full-time employees

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In Whose Name Are Assets Counted?

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- 529s
  - Counted as an asset of the account owner – for dependent whose parents own the account, it would be a parent asset
- Coverdell Education Savings Account
  - Counted as an asset of the account owner
- Savings Bonds
  - Asset of registered owner

In Whose Name Are Assets Counted?

- Roth IRA
  - This is a retirement account so will not be required to be listed as an asset at all
- Taxable Investment Accounts
  - Asset of the account owner
- UGMA/UTMA Custodial Account
  - Asset of the beneficiary

How Does the FAFSA Treat Assets?

- We say that savings doesn't have a huge impact, but how can you be sure?
  - Simple Needs Test
  - Education Savings and Asset Protection Allowance
  - Savings Conversion Rate

Simplified Need Test Criteria

- Simplified Need Test Criteria
  1. Anyone in household received benefits for 2010 or 2011 from one of these Federal programs: SSI, Food Stamps, Free and Reduced Lunch, TANF or WIC; **OR**

     The student's parents filed or were eligible to file a 1040A or 1040EZ or were not required for file a tax return; **OR**

     The student's parent is a dislocated worker

  AND

  2. The 2011 income of the student's parents is 49,999 or less

If this criteria is met, <u>**NO ASSETS**</u> are included!

Asset Protection Allowance

- Even if assets are taken into account, parents have an Education Savings and Asset Protection Allowance
- For example, a married couple who are 45, have an asset protection allowance of $41,300
  - Their assets have to exceed that amount before there is ANY impact on the EFC
- Keep in mind which assets are excluded:
  - Primary residence
  - Retirement funds

Savings Conversion Rate

- How much will be expected?
  - Even if assets exceed the Asset Protection Allows, only a small portion is considered to be available
  - Parent assets are assessed on a bracketed system, with a top rate of 5.64%

$50,000 in assets

- 41,300 APA

$ 8,700 Assets to be assessed

$8,700 X 5.64% = **$490**

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Caveats

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- Dependent students do not have an asset protection allowance
- Student assets assessed at a maximum of 20%
- CSS Profile works differently
    - Primary residence is taken into account
    - No simplified needs test
    - Good news – there are allowances
        - Emergency Reserve Asset
        - Cumulative Education Savings Allowance
        - Low Income Asset
        - Assessment rate after allowances is between 3 – 5%

Closing Thoughts

- In closing
  - There are numerous ways to save
  - Families who have saved are always in a better position to pay for college
  - It is cheaper to save than to borrow
  - It is never too late to start saving

Every dollar saved is a dollar that doesn’t have to be borrowed and repaid with interest!

Resources

Saving for College

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- www.savingforcollege.com
  - "World's Simplest College Cost Calculator" and good information comparing college savings vehicles
- www.nextgenplan.com
  - NextGen is Maine's Section 529 college savings plan
- www.finaid.org
  - Information on financial aid and savings
- "The Best Way To Save For College," by Joseph Hurley
  - An excellent and in-depth guide to 529 plans, including comparisons to other savings vehicles

Questions?

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