529 Savings Plans, Trick or Treat?

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College Admissions/Financial Aid Expert & Author

Financial aid offices all across the county have been in a state of euphoria ever since Congress made the tax exemption on 529 Savings Plan gains permanent. Adding to their joy is the increasing number of states making contributions to 529 accounts state tax deductible. Sadly, this will only encourage more unsuspecting families to set up these plans, which will take many of them down a path paved with financial hazards. Ultimately, any family who qualifies for *substantial* need-based financial aid and opens one is inviting potentially *devastating* consequences when withdrawals are taken to pay the bill.

Colleges are likely to count their blessings for every *needy* student who has a 529, as it will make it possible for them to reduce some of their own financial aid awards *dollar for dollar*, thereby enriching their billion dollar endowment funds.

In the financial aid formulas, students have no asset protection allowance (APA), and each year lose 20 cents in financial aid for every dollar they have in cash, checking, savings, UGMA/UTMA accts., stocks, bonds, savings bonds, mutual funds, and the like.

Parents fare far better as their assets are only assessed at 5.64% per year over their asset protection allowance. A two parent family with an older parent of 48 has an APA of $33,000, while a single parent of 45, has only $7,100!

It gets even worse for families who are eligible for substantial need-based financial aid. Since the value of a 529 Plan is considered a parent asset, colleges first apply the assessment. Next, distributions in excess of the EFC (Expected Family Contribution - the minimum the federal gov't determines a family will pay at any college) are considered a *resource,* and schools reduce some of their portion *dollar for dollar*.

The good news is that the assessment can be avoided if the owner of the account is either a small business with less than 100 full time employees that is owned and controlled by the parents, or a family member who is not part of the household, i.e. a grandparent.

Unfortunately, tens of millions of dollars per year are *unnecessarily* lost by college families who are unaware of the consequences when setting up 529 Savings Plans. In fact, numerous brokerage firms have been sued and/or suspended for misrepresenting the so-called benefits of these accounts.

Solution: Once a family becomes aware they will qualify for *need-based* financial aid, and that some of their 529 monies are at risk of being assessed or worse, it is not too late and very easy to change ownership and liquidate the account. Timing the distribution can be tricky, but if it takes place well before the student enters college, then the owner must contact the company managing their account and indicate they want a "non-qualified" (taxable) distribution. They will receive a redemption form and their check will follow shortly after the form is submitted.

If on the other hand, it's time to make a tuition payment, then a "qualified" (tax-free) distribution equal to the EFC should be made to the college or university the student is attending or will attend. The next step will be to liquidate the account as mentioned previously.

Of course, liquidation is not without consequence either. All gains are subject not only to a 10% penalty tax, but also the applicable income tax based on the account owner's tax bracket. Nonetheless, it is certainly the far lesser evil.

Example: A family who invested $40,000 and had a $10,000 gain would receive a check upon liquidation for $50,000. Assuming a 20% tax bracket, the $10,000 gain is subject to a $1,000 penalty tax, plus a $2,000 income tax. While many families have as much as $100,000 and more, the net result here is that $47,000 (net after taxes) would avoid a maximum of $10,600 ($47,000 x 5.64% x 4 years) in assessments were it part of the financial aid calculations. If the money was *legally* repositioned into financial vehicles not included in the financial aid calculations, some or all of it would still be there at graduation time!

Here are two actual examples of what can be accomplished when assets are *legally* repositioned:

Princeton University Tuition:	$15,252	University of Tampa aid eligibility:	$ 2,000
Financial Aid Received	$18,030	After repositioning aid increased:	$28,215

The following illustrates exactly how 529 Savings Plans cause families to lose thousands in financial aid.

In a 2 parent family, let's assume: an older parent of 44; 1 child, 17; AGI of $68,900; taxes paid $5,500; parent assets of $10,000; asset protection allowance of $30,000; student assets of $124:

Scenario A: $0 in a 529 Savings Plan

1. Cost of Attendance: $ 65,000
   (COA = tuition, fees, room & board, books and related expenses)
2. Expected Family Contribution: $ 20,000
   (EFC = the minimum the fed. gov't. determines a family will pay at any college)
3. Financial Need (FN) **$ 45,000** ($65,000 - $20,000)
   (FN = the maximum amount of aid a family will qualify for)
4. The student qualifies for the following aid:

(A)	Stafford Loan	$ 5,500
(B)	Perkins Loan	5,500
(C)	Federal work-study award	3,500
(D)	State grants, etc.	5,000
(E)	Private scholarship	2,000
(F)	College scholarships, grants, tuition waivers, etc.	23,500
(G)	Total	**$ 45,000**

The student will qualify for a maximum of $23,500/yr in financial aid from the college. However, the private scholarship is a bonus for the school, not the student. It enables them to reduce their aid dollar for dollar, because if (E) were $0, (F) would be $25,500.

Scenario B: $50,000 in a 529 Savings Plan

1.	COA	$ 65,000
2.	EFC	- 11,000
3.	FN	**$ 54,000**

4. The student qualifies for the following aid:

(A)	Stafford Loan	$ 5,500
(B)	Perkins Loan	5,500
(C)	Federal work-study award	3,500
(D)	State grants, etc.	5,000
(E)	College scholarships, grants, tuition waivers, etc.	34,500
(F)	Total	**$ 54,000**

With $50,000 in the 529 Savings Plan, the family will most likely take a "qualified" distribution of $12,500/yr for 4 years; $11,000 of which will pay their EFC. The college saves and the family will lose $1,500/yr in financial aid for 4 years. The college's contribution (E) will now be reduced to $19,500.

<u>Scenario C</u>: $100,000 in a 529 Savings Plan

1.	COA	$ 65,000
2.	EFC	- <u>12,800</u>
3.	FN	**$ 52,200**

4. The student qualifies for the following aid:

(A)	Stafford Loan	$ 5,500
(B)	Perkins Loan	5,500
(C)	Federal work-study award	3,500
(D)	State grants, etc.	3,000
(E)	College scholarships, grants, tuition waivers, etc.	<u>32,700</u>
(F)	Total	**$ 52,200**

With $100,000 in the 529 Savings Plan, the family will most likely take a "qualified" distribution of $25,000/yr for 4 years; $12,800 to pay their EFC.

The college will save and the family will lose $12,200/yr in financial aid because $12,200 of aid the college would have offered was replaced by the 529 distribution. The college's contribution, (E), will be reduced to $7,000.

If the money were in a financial vehicle not included in the financial aid calculations, the EFC would be reduced to $10,000 (Scenario A), and they would qualify for $22,000/yr for 4 years in financial aid from the college.

<u>Summary</u>:

In the above Scenario C, a family with a modest EFC and a substantial 529 balance will lose the most. The break even point is when 529 annual distributions equal the EFC, and the account has a zero balance at the end of 4 years – an unlikely occurrence. There are a myriad of scenarios that can be played out here, but as always, it's the "neediest" of families who lose the most.

Do not fall for the 529 trick at Halloween, or any other time of the year. Careful planning must be employed before purchasing a 529 Savings Plan so it doesn't become costly. In order to win the college funding *game*, which repeats itself every year, a family must have the most up to date information, precise timing and persistency. Also, families should never lose sight of the fact that all the financial aid in the world is useless without that coveted admission ticket!

For over 35 years, noted financial advisor, Reecy Aresty, has helped thousands of high school and college families to obtain the American Dream; a superior education at a cost far less than they ever dreamed possible. He is the author of the highly acclaimed admissions and financial aid manual, ***How To Pay For College Without Going Broke***. For further information on admissions and financial aid, please visit: www.paylessforcollege.com.