College Keystones
A College Planning Relief Publication

Income and Asset Shifting

Families often lose thousands of dollars each year because of their failure to properly plan for their financial aid application. That's right, it is not enough simply to complete the FAFSA. If you want to maximize the amount of aid you are eligible to receive, it is going to require planning.

The federal methodology for calculating your Expected Family Contribution (EFC) uses seven different factors to determine the amount of money your family should be able to contribute annually to your child's college expenses. Those factors are: parent's income and assets; student's income and assets; age of parents; number in household; and number of college students in the family. While some of these factors leave you with few alternatives, others like parents' and student's income and assets provide you with some opportunity for planning if done early.

We will first focus on income shifting strategies. Your child's financial aid package for their freshman year in college will be based on financial data from their sophomore year in high school. So for students graduating in 2018, their FAFSA will be using 2016 information. This is considered the base year. In order to effectively implement most income strategies it will require planning the year before, so in this case 2015. This means parents of freshman should be looking into these strategies TODAY.

The first thing you want to do is avoid any large bonuses in the base year. If you have any opportunity to defer the income into the next year, this would be advantageous as the income would not be reported on the FAFSA. In addition, when doing your tax planning, you should attempt to avoid any tax refund. This does not mean that we want you to pay more taxes, but we want you to pay only what you owe and not any excess that will be refunded to you in the following tax year as this would constitute income, thus raising your EFC.

Avoid selling stocks during this period of time as well as your capital gains will be treated as income once again raising your EFC. If at all possible, until your child is past April of their junior year in college you should avoid selling any assets with substantial capital gains. Unlike the income tax calculation where long term capital gains are treated more advantageously than ordinary income tax, there is no differentiation on the FAFSA form.

In addition, having assets that pay substantial dividends will also have an adverse effect. Although their taxation is more favorable than ordinary income, the impact on FAFSA is the same.

While these rules may seem harsh or unfair, the converse also works; if you have assets that have embedded losses, you have the ability to offset other gains of ordinary income from capital losses. Every little reduction of income should be viewed as a possible chance for more financial aid.

Unlike your income, assets are broken down into two categories, those that impact your EFC and those that don't. The family's primary residence is not counted. Retirement assets such as 401(k)s, IRAs, Roth IRAs, 403(b)s and 457 programs do not impact your EFC, primarily because of the inability for most parents to access those accounts without incurring severe penalties and taxation.

Making extra contributions to these types of plans prior to the base year can be a good method for keeping assets from accumulating in non-qualified accounts that would have a negative impact on your EFC. However, keep in mind that once those dollars are deposited in these accounts, you lose the opportunity to use those dollars for college expenses.

In addition, any 529 plans under your ownership and equity in rental real estate will also be counted toward the EFC calculation. Before moving assets around you must know your APA (asset protection allowance). APA is the amount of these types of assets that you can own without raising your EFC. This figure is based on the older parent's age. Parents should not be concerned with being slightly over their APA as the calculation does not count these assets too harshly. Parents greatly exceeding these limits should consider shifting some assets to accounts that will not impact the calculation.

Annuities, a tax-deferred retirement vehicle, allow you to invest an unlimited amount of money at any given time. While this vehicle does not allow for access to the funds for college, it is a viable option for sheltering large amounts of assets at one time.

Cash value life insurance is a unique instrument in that it will allow you to shelter assets in large amounts like an annuity, but with the opportunity to have immediate access. This strategy is very effective in the right situations, but be cautioned that there are hundreds of cash value life insurance policies and they are not all the same. This strategy requires a very specific design.

Any shifting of assets needs to be weighed against the tax ramifications that it may cause. Keep in mind those tax consequences will also impact the income calculation portion of the FAFSA.

An asset in your child's name is a poor place to have assets if you are looking for financial aid. As opposed to the 5.6% figure used on parental assets, it is 20% for students! While you want to remove assets from your child's name, you cannot always transfer them back to your name as it depends on the type of asset.

Moving investments, assets, and income around can be a minefield with substantial consequences on financial aid and taxes, and should be done under the direction of a knowledgeable and qualified financial professional.

We are in the business of helping families through the major life transition of sending their children to college. For many, it will be the most expensive time of their lives and, if not handled properly, could cost them their retirement. If you or someone you know needs the help and guidance of a trained financial professional, don't hesitate to contact us. Remember, you shouldn't have to choose between your child's college and your retirement.