Filing Guide

IRS Publication 970:
Tax Benefits for Higher Education

Deadlines

College financial aid decisions are based on the previous year's income and assets -- in most cases, with the "base year" starting January 1 of the child's junior year in high school. This means it's best to start planning no later than the start of your child's junior year. FAFSA forms are due annually so long as the student seeks aid.

Tax Savers

Assessable income does not include loan proceeds. This rule may make borrowing against life insurance, retirement or investment accounts, or your primary residence an appropriate source of tuition funds.

Traditional tax planning seeks to minimize tax -- period. But some tax strategies actually cost you when it comes time to apply for need-based college financial aid. So it's important to know how your tax choices affect the Free Application for Federal Student Aid ("FAFSA") that schools use to assess financial need.

All schools use a "federal methodology" to calculate how much federal aid they can disburse. Some schools also use an "institutional methodology" to calculate their own aid. Both methodologies work as follows:

The student's "assessable income," *minus* taxes and an "income protection allowance" *times* 50%
\+ The student's "assessable assets" *times* 20%
\+ The parents' "assessable income," minus taxes and a living allowance *times* 22% to 47% (depending on income)
\+ The parents' "assessable assets," *minus* an "asset protection allowance" (based on the older parent's age) *times* 5.6%
= Expected family contribution ("EFC")

"Cost of attendance" minus EFC equals "financial need." The key, then, is to minimize assessable income and assets until after the *last* FAFSA reporting period. Here are key points to consider:

- Assessable assets generally include cash, checking and savings accounts, discretionary securities and investment accounts, and vacation home equity -- but not qualified plan or retirement account balances, home equity, or personal assets. Some schools using the "institutional methodology" also include life insurance and annuity cash values, home equity, family farm equity, and siblings' assets.
- Assessable income includes AGI (adjusted gross income) *plus* various "untaxed income and benefits" such as:
  - earned income and child tax credits
  - tax-free interest income
  - child support received
  - IRA and retirement plan contributions (be careful making contributions before your child enters college, as they are considered "up for grabs" to pay for school)
  - untaxed gain on the sale of your primary residence
  - gifts of cash (but not property) from friends and relatives (if grandparents or family want to make gifts, consider waiting to until after the student's last FAFSA is due, or even making gifts after graduation to retire student loans)
  - some schools using the "institutional methodology" also include flexible spending and health savings account contributions.

College costs are high enough that even families earning six-figure incomes can qualify for need-based aid. So don't assume that your income automatically disqualifies you.