College Savings: We've Saved — Now What?

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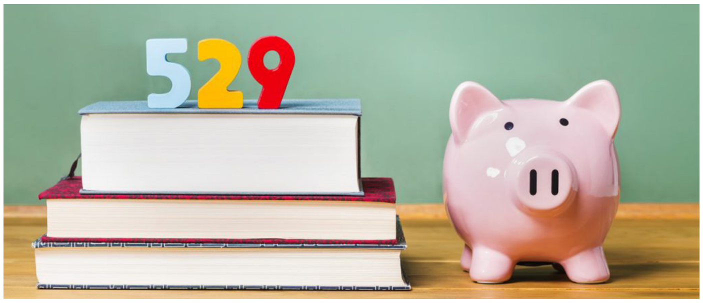
After having a child, parents usually ask themselves two questions: "What do I do now," and, "How will we pay for college?" They're both legitimate questions, as the price of secondary education has skyrocketed in the last few decades. According to U.S. News, the in-state tuition and fees at public National Universities have grown by 221% over the last 20 years.[1] So if you have felt stress due to saving sufficiently for your child's college education, you're not alone, almost everyone can use some help.

So let's look at where you are now. You've been serious about saving for college. That's great! You've been doing the heavy lifting. As people say: "start saving early," "Every little bit helps," "a dollar today means ten dollars tomorrow." It's old adage that's persevered because it's the truth.

If you opened a 529 savings plan, and you have been saving —either monthly or perhaps with big chunks every chance you got, you've done the hard part. Now what? Your child may be a year away from college, so you need to know how to avoid making a costly mistake and how to take advantage of cost savings at each turn.

Let's take a look at some questions, tips, and options that will help you to nail down and optimize your college savings plan.

The 529 Plan: How to Manage your contributions and where they should come from



If you're in college, have gone to college or sent your kids to college, you're likely to be very familiar with FAFSA. It stands for Free Application for Federal Student Aid. The purpose of the application is to determine how much financial aid a given student qualifies for, including both non-need-based aid and need-based aid. If this is starting to sound like a different language, we agree, you're not alone. Just bear with us while we break that down a little further.

The FAFSA application asks you a series of questions regarding the students' and parents' income and assets, as well as other family-related questions such as, the number of siblings residing in the home. They're looking to find out how much money your household has, both liquid and non-liquid. From this they will determine how much they think you can pay, and therefore how much assistance you would need or be entitled to. This is what they call the Family's Expected Family Contribution (EFC), which comes out to an expected amount for a yearly contribution. Keep in mind they're using their own numbers for how much of a person's income and assets are available for contribution. They've 'determined' that 20% of a student's assets, and 5.64% of the parent's assets should be available to pay for any one year of college. It assumes 50% of student income, and between 22-47% of eligible parent income are available. Another way of putting this is that's the amount of money the government is telling you you're going to pay for college one way or the other.

The FAFSA is completed annually and depending on how the 529 plan is titled, meaning where the money is coming from, the income and the assets (account value) are treated differently. This gets convoluted but it's important because this is where your college funds can be optimized if you pay attention to where you allocate the funds to come from. If the 529 plan is owned by the student or the parents, the assets are counted as the parents' asset for the application. This means that 5.64% of the assets are counted towards the expected family contribution. Distributions made from a

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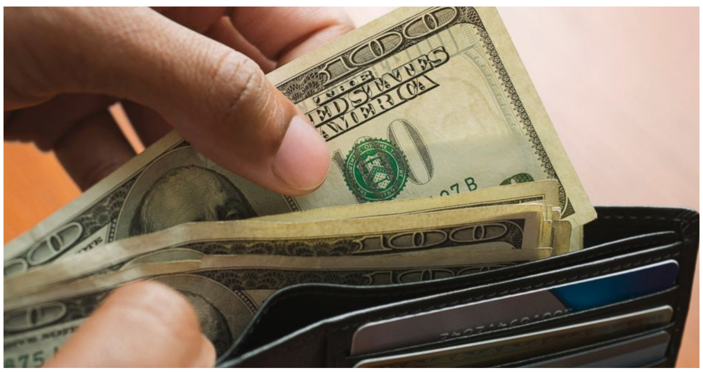
plan titled this way receive favorable treatment and are not included as income for student aid purposes. However, if the 529 plan is owned by anyone other than the parents or student, like a grandparent, things are handled differently. The plan's assets will have no effect on the FAFSA, but the distributions are treated as student income, which is assessed at 50%. So hypothetically, if a grandparent took out $10,000 to pay for their grandchild's tuition, the student's eligibility for financial aid will be reduced by $5,000!

Pro tip:
The FAFSA looks at the income of the student from two years prior. So, if you have any funds in a 529 owned by a grandparent, wait until the final semesters to use it, and that amount will not be counted as assets or income. Consult with your financial advisor to navigate the best plan for your assets, as the best path can be the difference in thousands of dollars in eligibility of financial aid.



How can I make sure I am paying as little as possible?

It goes without saying that your goal is to pay as little as possible, especially when it comes to large numbers like college tuition. The government offers many different programs and credits to help families cover the cost of your child's education. Just because you have assets available in a 529 does not mean you shouldn't take advantage of these other opportunities.

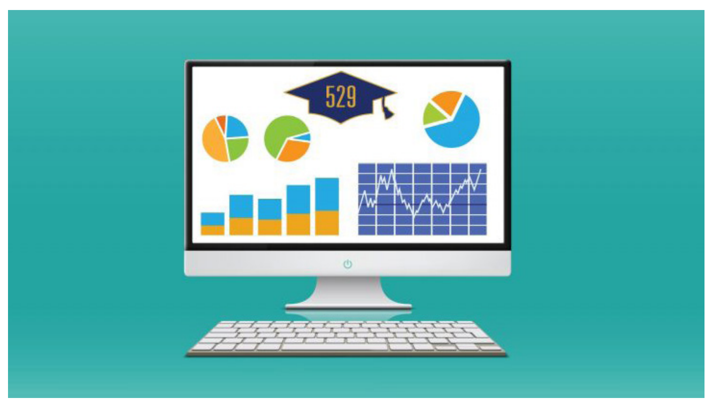
One available credit to keep your eye on is the American Opportunity Tax Credit (AOTC)[2]. The AOTC is a credit you can receive for qualified education expenses paid by the student for the first four years of secondary education. An added benefit of AOTC is that a portion of it is refundable. If you owe zero taxes, you can have $1,000 refunded to you based on this credit! Who doesn't want a bigger tax refund? The key point to remember here is that you have to pay for the expenses. Monies taken from a 529 plan do not count. The government does not allow you to use two different tax advantages at once. You need to spend $4,000 on qualified expenses outside your 529 every year to claim this credit. This credit is subject to a Modified Adjusted Gross Income (MAGI) threshold for taxpayers. Additionally, the credit begins to "phase out" for couples filing jointly with a MAGI of $160,000.

Another credit to look into is the Lifetime Learning Credit. This credit is worth 20% of the first $10,000 of qualified education expenses. That's a total of $2,000 per year per tax return. We should note that there are some major differences between these two credits. One of them is that the MAGI limit for the Lifetime Learning Credit is lower and starts at $136,000 for couples filing jointly. This credit is also per tax return and not per student like the AOTC. You cannot claim both credits. However, this a viable option if you are going to school for longer than four years.

Pro tip:
A comprehensive financial plan considers income expectations and factors in the timing to use certain credits. A team of experts including a financial advisor, accountant, and an attorney can help you navigate the different aspects of your plan.

Should you use the 529 funds until they are gone, or spread them out?

Yes, managing your assets and allocations for college savings isn't just convoluted, it also involves a degree of discipline with how to use it, where to use, and how much of it to use. So, if you're thinking that using the 529 assets as soon as possible would be the most beneficial path to take, you may need to think again. The assets in a 529 plan mean that 5.64% of that balance is available to pay for college and thereby eliminates the ability to get financial aid. Therefore, using those assets early on would make the most sense.



However, you cannot qualify for the AOTC if you only use assets from the 529 plans. So, if you pay for everything in the first two years, you ruin your chance to qualify for the refundable credit the government provides. You also need to consider your cash flow situation. The FAFSA assumes at least 22% of income should be available for college. Perhaps you should be contributing yearly on top of the AOTC and the 529 savings.

As we stated before, the options you have available to you are diverse. Another option is borrowing money from the government. There are two types of Federal Student Loans worth reviewing; subsidized and unsubsidized. On a subsidized loan, the government pays the interest on the loan while you are in school and during any deferment period. Unsubsidized means you are responsible for the interest payment on the loan from day 1. You must qualify through the FAFSA to be eligible for a subsidized loan. Maybe you want to take advantage of that subsidized loan in year one so that you do not have to take an unsubsidized loan in years three, four, or five. Every situation is different, and the important thing is that you make the right choice for you and your family. There is no one-size-fits-all plan, or any one rule that always makes sense when it comes to paying for college.

Pro tip:
You can have the college's cost analyzed and estimated for the length of time needed. This will allow you to look at different scenarios to see which options make the most sense financially and, more importantly, that you are comfortable paying.

Bonus Pro tip:
One of the most common distribution mistakes is taking the distribution in a different year than paying the bill. Many semesters start or end near the end of the calendar year, and you need to ensure that you pay the bill in the same year you have requested the disbursement from the 529.

What happens if my child does not go to college?
Another large decision to consider after saving, is whether to go to college or not. There is no right or wrong answer here, but not attending college does bring the question of what to do with the money saved in a 529? Well, there are a surprising number of options.

First, you need to have a conversation about what they plan to do. Do they want to go to a Vocational School or a Technical School? You can contact those schools to see if they qualify for using 529 Plan funds. Are they taking a year off? Maybe the best option is to wait. Just because a child doesn't go to school right away, does not mean they'll never go. You could also use the money to further your own education with another degree.

You can use the money to pay off student loans of your child's siblings or any loans already incurred by your child. You're permitted to spend up to $10,000 on student loan debt. Another option would be to transfer the 529 plan assets to a relative. The list of available recipients is more robust than you might think. It includes first cousin, spouse, stepparent, step-sibling, brother or sister-in-law, and all of your immediate family.

You could leave the money inside the 529 plan with the intention of changing the beneficiary to your grandchildren. This would give your child the benefit of not having to save for their children's education, which would in turn enable them to focus on their retirement. If those options don't sound like they would work for your situation, you can always take the money out and pay the penalty and federal taxes. Typically, you pay the penalty and taxes on the earnings of the account. You do need to be careful here if you received a state tax break from the contributions and may owe state taxes on top of the federal taxes.

Pro tip:
Consult with your tax advisor on the timing of the distribution to minimize taxes.

The critical thing to remember is that every situation can and will be different. Your next-door neighbor may have the same family dynamic and a very different plan for paying for college. Due to the unique aspects of every family's situation, we encourage an individualized plan specific to you and your family to meet your goals. Open communication between your family and a team of advisors can help ensure that you are comfortable with your plan.

[1] 20 Years Of Tuition Growth At National Universities
https://www.usnews.com/education/best-colleges/paying-for-college/articles/2017-09-20/see-20-years-of-tuition-growth-at-national-universities

[2] AOTC: Internal Revenue Service at https://www.irs.gov/credits-deductions/individuals/aotc