# NATIONAL INSTITUTE OF CERTIFIED COLLEGE PLANNERS, LLC

## Certification Program

## Module 1

## Paying for College


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## Financial Aid Basics

- Financial aid definition
- Types of financial aid
  - Self-help
  - Gift
- Two determining factors
  - Merit
  - Financial need

# Section 1
# Financial Aid Basics

**Financial Aid Definition**
College financial aid is money given by the Federal and State governments and the colleges to help students pay for the cost of a college education.

**Two Types of Financial Aid**
There are two basic types of financial aid:

1. Self-help aid, which consists of interest-subsidized loans and work-study; and,

2. Gift aid, which consists of grants and scholarships. This money does not have to be repaid.

**Two Determining Factors**
The amount and type of financial aid is based on two factors:

1. The <u>merit</u> of the student (scholastic, athletic, musical, etc.); and,


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2. The financial need of the student. By far, this is the most important factor in determining financial aid. Most of the financial aid given by the Federal and State governments is based on the financial need of the student. Also, most of the financial aid given by the colleges is need-based.

**Note:** The Ivy league colleges and other highly selective private colleges base almost all of their grants and scholarships on the financial need of the student and not the student's merit.


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# Needs Analysis

Cost of Attendance (COA)
- Expected Family Contribution (EFC)
= Financial Need
- Resources of the Student
= Adjusted Financial Need

**Needs Analysis**
Needs analysis is the process of determining the financial need of the student. It is calculated using the above formula.

**Note:** If a student has no financial need (or adjusted financial need) the student will not be eligible for most types of federal, state, or college financial aid.

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# Needs Analysis Example

| | |
|---|---|
| COA | $12,000 |
| -EFC | - 4,000 |
| =NEED | 8,000 |
| -RESOURCES | - 1,000 |
| = ADJ. NEED | $ 7,000 |

**Example:** If the "cost of attendance" at a particular college is $12,000 and the "expected family contribution" is calculated to be $4,000, the "financial need" of the student would be $8,000. In this case, the student would be eligible to receive $8,000 in financial aid. Whether the student receives a financial aid award letter for the entire $8,000 is up to the discretion of the individual college. Nonetheless, the financial aid eligibility of the student is directly related to the financial need. If the student had other "resources" to help pay for the college cost, the financial need would be reduced on a dollar-for-dollar basis for these resources. In this example, assume the student had received a $1,000 private scholarship from the local Chamber of Commerce. Since private scholarships (scholarships that are not given from the college) are considered a resource, the $1,000 scholarship would reduce the financial need to $7,000. This means the student would now be eligible for only $7,000 in financial aid from the college.


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A closer look at the individual elements of this formula is warranted to fully understand exactly how the formula works.

**Cost of Attendance**

Cost of attendance (COA) consists of tuition, fees, room and board, books and supplies, personal expenses, cost of a computer, and transportation to and from college. The college must furnish the COA information (Beware of the accuracy of this "advertised" information: Colleges may omit the cost of personal expenses and transportation to and from college.) The "true" COA includes the expense of travel to and from college and personal expenses, such as clothing and entertainment. The COA of a college can be computed using the formula: COA = Financial Aid Award + PLUS Loan Eligibility.

The cost of attendance formula is not the same for all types of students. For students who are less than half-time their COA only includes tuition and fees, an allowance for books, supplies and transportation, and an allowance for dependant care expenses. Incarcerated students can only include tuition and fees, and if required, books and supplies. This type of student is unable to receive an SFA loan, and if the student has been incarcerated in a federal or state penal institution, they may not receive a Pell Grant. Students who take correspondence classes only can include only the tuition and fees in their COA. If this student is fulfilling a required period of residential training, their COA can also include required books, supplies, travel, and room and board costs specifically incurred. For a student who is taking classes through telecommunications courses, no determination can be made on the cost of their attendance. However, the cost of their equipment, either through rental or purchase, cannot be included in the COA. If the Financial Aid Administrator uses their professional judgement and determines that a course of instruction offered through telecommunications results in a substantially reduced COA to the student, the FAA must reduce the student's eligibility for grants, loans, or work-study assistance.


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**Note**: The student loan interest deduction requires that the loan proceeds must be used for qualified education expenses. The definition of these expenses is the total COA as described in this section. Hopefully, the colleges will be required to provide the true COA figures to the parents for not only this tax deduction, but also to enable parents to determine the true COA for the college. This should make comparisons of colleges clearer for the parents and student.

**Note:** In most cases, the student cannot affect the COA that is set by the college. However, if the student can convince the financial aid officer at the college that the student has special needs, such as extraordinary medical or handicap needs, the financial aid officer may increase that individual's COA to reflect the increased costs associated with the special needs.

**Note:** Childcare costs could be considered as part of the COA. The financial aid officer should be notified of these costs and, if necessary, an appeal should be made to add these costs to the COA.

**Planning Tip:** One way to reduce the cost of college is to shop for textbooks on the Internet. Internet sites, such as www.amazon.com and www.bkstore.com, provide competition for the traditional colege bookstore. By utilizing these new sources for books, the student can reduce the cost of college.


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**Note:** If a student is considering attending an out-of-state public college, there can be a substantial increase in COA because of out-of-state tuition fees. Unfortunately, for the student the out-of-state public colleges often do not meet this additional cost with additional financial aid funds. Some states have reciprocal tuition agreements with their neighboring states. Should this be the case, this out-of-state tuition is reduced or eliminated. However, if the student plans to attend an out-of-state public college that does not have a reciprocal tuition agreement with the student's state of residency, the student has the option of trying to establish residency in the state where the college is located; this can be difficult.

For a detailed discussion of out-of-state residency requirements, it is recommended that the book, *How To Cut Tuition*, by Daryl F. Todd, Jr., be researched.


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## Expected Family Contribution (EFC)

| | | | | | |
|---|---|---|---|---|---|
| Parents' AGI plus Untaxed Income & Benefits | - | Income Allowance<br>Federal Income Taxes<br>Social Security Taxes<br>State Taxes<br>Employment Exp. Allowance | x 22 to 47% | = | Parents' Contribution from income<br>+ |
| Parents' Assets | - | Asset Protection Allowance | x 2.6 to 5.6% | = | Parents' Contribution from assets<br>+ |
| Student's AGI plus Untaxed Income & Benefits | - | Federal Income Taxes<br>State Taxes<br>Social Security Taxes<br>$2,330 Allowance | x 50% | = | Student's Contribution from income<br>+ |
| Student's Assets | - | Nothing | X 35% | | Student's Contribution <u>from assets</u> |
| | | | | = | Expected Family Contribution |

**Expected Family Contribution**

Expected Family Contribution (EFC) is how much the family is expected to contribute to the total cost of college for that singular year. EFC can be thought of as the family's "college tax liability". The EFC is computed by using family financial data submitted on financial aid application forms. There are two formulas that can be used to calculate the EFC. They are the Federal Methodology formula and the Institutional Methodology formula. These formulas are contained in the Appendix.

**Federal Methodology Formula**

The Federal Methodology Formula (FM) is a federal formula used to calculate the EFC. It is used by every accredited college in the United States to determine how much federal money can be disbursed by the college to cover the student's COA. Most states also use this formula as a basis to distribute state financial aid funds.

**Note:** The rates used to assess the parents' income and assets are graduated rates and the rates used to assess the student's income and assets are flat rates.


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**Note:** In the previous formula, the maximum assessment rate of 47% for the parents' financial aid income is reached when the parent's AGI is approximately $45,000.

**Observation:** Since the parents' assessment rates are lower than the student's assessment rates, especially when comparing the asset assessment rates, a tax or financial planning strategy which shifts income and assets from the parents to the student may backfire when the EFC financial aid formula is considered.

**Caution:** Tax strategies of deferring income from one tax year to the next, or shifting income from a parent to a child, may not prove beneficial if financial aid planning is ignored.

**Example:** At the end of 2002, Albert, a parent, had the opportunity to defer $10,000 of income into 2003. His accountant informed him that his tax bracket would be the same for both years. Therefore, it made no difference tax-wise whether Albert paid on the income in 2002 or deferred it to 2003. However, the decision to defer or not defer the income could have a huge impact on the financial aid eligibility of his child who was a junior in high school in 2002 and would be a senior in 2003. Since Albert's 2003 income would be assessed in the financial aid formula for the child's freshman year in college, the $10,000 of additional income in 2002 could cause a potential financial aid loss of $4,700 (47% x $10,000) for the child. Therefore, the decision to defer or not defer income should not be solely based on income tax planning, but also needs to include financial aid planning.

**Example:** A tax accountant was approached by a client who wanted to be able to deduct some of the college expenses the client was about to incur for his child who was a senior in high school. Since the client owned a sole-proprietor business, the accountant recommended that the client pay his child $6,330 for work performed during the summer and on college breaks. The


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child could use the wages to pay for upcoming college costs. Therefore, the client was indirectly receiving a tax deduction for the college costs. In this scenario, the child could possibly lose $2,000 in financial aid ($6,330 - $2,330 allowance x 50%). A large portion of the $2,000 loss could consist of grant or scholarship aid (Remember the award letters at the end of Chapter 1). The financial advisor should always consider both the tax and financial aid ramifications of any income shifting strategy.

**Dates of Assessment**
Incomes of the parents and the student are assessed using year-end data from the year (commonly called the "base year") prior to the year when the student will be entering college. For the 2002-2003 college year, income will be assessed using the 2001 calendar year information (e.g., 2001 tax return).

Assets of the parents and the student are assessed as of the date the financial aid application forms are signed.

**Planning tip:** Since a student will file the financial aid application form in the spring of the junior year in college, the income the student makes in that calendar year will not affect the student's eligibility for financial aid. Therefore, the student can have unlimited income during that calendar year without a reduction in financial aid eligibility. It may be a tax benefit for the student's parents or grandparents to shift income to the student during this period.

**Example:** On January 15, 2002, Judy, a junior in college, filed her financial aid application form for her senior year in college. Her financial aid eligibility for her senior year in college is based on her income for the calendar year 2001. In the summer of 2001, she received a gift of highly-appreciated stock from her parents. She will sell the stock and report a capital gain of $18,000 on her 2002 income tax return. Since the income is reported in 2002, the income had no effect on her financial aid eligibility and the family tax savings was $1,800, $3,600 capital gain tax if reported by her parents minus $1,800 paid on her tax return.


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# Qualifying Parameters

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Parents' Income | $100,000 | $100,000 | $150,000 | $150,000 | $150,000 | $150,000 | $200,000 | $200,000 |
| Assets | $100,000 | $100,000 | $100,000 | $100,000 | $200,000 | $200,000 | $100,000 | $100,000 |
| Number in College | 1 | 2 | 1 | 2 | 1 | 2 | 1 | 2 |
| Number in family | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| EFC | $20,200 | $ 10,100 | $ 39,700 | $ 19,850 | $ 45,300 | $ 22,700 | $ 53,800 | $ 26,900 |

**Qualifying Parameters**

To get a rough estimate of the EFC produced by various combinations of income and assets, reference the above table (The table assumes the student has income of less than $2,200 and there are no assets in the student's name).

**Note:** In the above table, note the drastic drop in EFC (The EFC is on a per student basis) if there are two members of the family in college. Also note that if the COA at a particular college is less than the EFC shown in the table, the child will not be eligible to receive financial aid at that particular college.

**Caution:** A financial advisor should not assume that a client who does not appear to qualify for financial aid based on the above table will not currently, or in future years, qualify for financial aid. Future events, such as death, disability, divorce, or unemployment, may make a client eligible for financial aid. Also, if the student qualifies as an "independent student", the income and assets of the parents are not considered in the EFC calculation.


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