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by Gregory Gann

You Are Getting Divorced. How Will You Afford College?

Affording college is challenging enough for parents living under the same roof. Therefore understanding and maximizing rules for qualifying for the most comprehensive financial aid post- divorce is particularly crucial. State universities rely on information provided in the Free Application for Federal Student Aid (FAFSA). Private universities and colleges typically rely on guidelines which are not nearly as generous as FAFSA, thereby significantly increasing the family's expected financial contribution well above the FAFSA limits.

The Department of Education in creating the FAFSA has created a uniform financial formula to equalize the expected family contribution irrespective of a particular family's lifestyle or expense choices. In other words, when completing the FAFSA, the government does not care what particular or unique expenses and debts you took on to maintain your lifestyle. The two crucial determinants of aid are income and assets, and who earns the income and who owns the assets.

Income and Asset Protection Allowances

There are both income and asset protection allowances which provide a threshold or a baseline of assets and income which are excluded when computing the expected family contribution. For the academic year 2019-2020, a dependent student can earn $6600 in the tax year without it being counted in the expected family contribution. However, all income earned by the student above this threshold is multiplied by 50% and that product is deducted from any potential aid. Furthermore, the income protection allowance under FAFSA (not the case for private colleges) is based EXCLUSIVELY on the adjusted gross income of the custodial parent.

Make Sure to Specify the Custodial Parent

The custodial parent is the one with whom the student spends the majority of his or her overnights. However, the university will accept whichever parent the student identifies as the custodial parent. The admissions office does not police this, and has no interest in inserting itself into family dynamics. Therefore, if there is a big discrepancy in incomes between the parents, which often is the case post-divorce, there are major financial aid advantages listing the lower earning parent as custodian. This is perhaps the single and greatest financial advantages of divorce, and one that definitely involves planning and negotiation.

Income Protection Allowance

The income protection allowance is based on the size of the family and the number of other dependent college students who the custodial parent claims. For the 2019-2020 academic year, if the custodial parent's household includes herself and two college students, i.e. a family size of three, then her income protection allowance will be just under $20,000. Therefore, if her adjusted gross income for tax purposes is say $68,000, then the approximately $20,000 will be deducted, resulting in an adjusted, adjusted income for purposes of FAFSA of $48,000. This is significant because if the custodial parent's adjusted gross income combined with the income protection allowance is less than $50,000, then like playing the game of Monopoly, she would pass go, and immediately qualify for financial aid without having to count assets.

Asset Protection Allowance

There is also a calculation of assets owned by the custodial parent which has to be factored in along with the adjusted income formula to determine aid. Assets which are excluded from this calculation include qualified retirement plans such as 401k and 403b plans, IRAs, life insurance and annuity policies, home equity, and the value of a business in which there are less than 100 employees. All other assets over and above the asset protection allowance are included. The asset protection allowance is based on the age of the custodial parent. The asset protection allowance has been decreasing monumentally since peaking in the 2009-2010 school year. For the 2019-2020 academic year, the allowance for a single parent age 45 is $5800. All countable assets above this threshold allowance are considered "discretionary net worth". For the 2019-2020 school year, when a parent's discretionary net worth reaches $33,601, then the parent's contribution from assets equals $9097 plus 5.64% (47% of the 12% discretionary net worth conversion rate) of all assets above the $33,600 threshold.

Calculation

The calculation of aid is basically a combination of the parent's net available income determined from the formula above, plus the discretionary net worth derived from the formula above that are determinants of the expected family calculation which provides a baseline of family money that has to be used before financial aid will be considered. It obviously gets complicated. What's more, it has to be re-applied every year. The amount of aid can vary each year due to changes with respect to assets and income as well as the changing pool of applicants competing for aid each year as seniors graduate and a new crop of freshmen matriculate.

Other Sticky Points, Including Remarriage

There are a few other sticky points which need to be understood with respect to FAFSA and college aid, particularly as they relate to divorce. In addition to strategically identifying the custodial parent, it is important to note that if the custodial parent remarries, the income of the step-parent is factored into determining available income. Consequently, college financial aid may very well have to be factored to determine financially how practical it is to remarry, and more importantly what is the most financially advantageous date to do so. Also, child support and alimony even if it is not treated as taxable income to the recipient will still be counted in the income calculations. Furthermore, 50% of income distributions made directly to the student, even if they are from a 529 college plan will be counted towards the family contribution expectation. Therefore, it's best to have distributions made directly to the school. In addition, aid will be reduced by 20% of the value of assets owned in the student's name, and this includes UGMA/UTMA accounts. So, while there may be some estate or other tax planning reasons to amass assets in a child's name, for purposes of qualifying for financial aid, it could be disastrous.

Who Owns What Matters

The point is that how assets are titled and distributed is very important. To further emphasize the point, if title to the student's 529 plan is held with the custodial parent, then aid can be reduced by 5.64% of the account's value, but distributions are ignored. However, if title is held with the non-custodial parent, then it will not be deemed an asset of the custodial parent, but distributions will count as income to the student and can reduce aid by 50%. For this reason, the less-moneyed custodial parent should own the 529 plan. Furthermore, strategically investing in retirement accounts or other excludable investment accounts should be considered beyond simple investment calculations to take into consideration potential outside support for financing college.

Laws have also made it challenging for parents who consider their offspring emancipated after graduating from high school and seek for the student to collect financial aid based on his or her personal financial status. This is because to qualify as an independent student for purposes of qualifying for aid under FAFSA, the student must be over age 22, married, or in the armed services.

In summary, planning for college funding is in itself a reason for working with a professional financial planner. However, based on the complexities divorce adds to the equation, irrespective of the age of their children, parents should not legally bind themselves to a divorce decree without seeking the counsel of a certified divorce financial analyst.

Gregory E. Gann, Esq.

Juris Doctorate * LPL Investment Advisor Representative * Certified Divorce Financial Analyst
Gann Partnership, LLC

3 Church Lane

Baltimore, Maryland 21208

(For GPS directions: input "Pikesville, MD")

gregory.gann@gannpartnership.com

410-415-5505

410-415-5503 fax

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