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by Gregory Gann

Structuring Divorce Settlements to Benefit College Funding

Any college or university that awards federal student aid must require applicants to complete the Free Application for Student Aid (FAFSA). There is a relatively small number of institutions that may require an additional aid form known as the CSS Profile.

While married, the incomes for both spouses are factored into determining eligibility. However, if the parents are legally separated or if they live in separate households as if they were unmarried, then only the income of the parent with whom the student lived the greatest number of overnights over the past 12 months is considered for purposes of FAFSA eligibility.

Furthermore, certain assets are given preferential treatment and are not counted when determining FAFSA eligibility. Examples of assets that are not counted include a family-owned small business, home equity, life insurance cash value, as well as IRA accounts and qualified retirement plans such as 401ks and 403bs. However, contributions made to an IRA or qualified retirement fund in the previous year are re-characterized as income for purposes of the FAFSA income guidelines.

Parents are expected to contribute close to 50% of their net income after taxes to provide for college funding before qualifying for FAFSA aid. So, more than assets and net worth, income is the biggest driver in determining aid. With this in mind, particularly when there is a big discrepancy in terms of wages between the spouses, there are major funding advantages in terms of having the student spend at least one additional overnight with the lower earnings parent after separation and divorce.

Alimony is considered income to the recipient spouse. Therefore, alimony can substantially impact the student's financial aid package. Knowing this, there are ways to creatively structure divorce settlement agreements whereby the lower wage earning and custodial parent agrees to take a larger property settlement in lieu of taking as much alimony. This is particularly beneficial when the property exchanged is in the form of a retirement plan because these assets are outside the purview of FAFSA.

The point is that in structuring settlements that maximize what each spouse ends up with as well as what most supports the entire family unit, it is important to have a solid understanding of tax brackets and tax consequences for each party as well as a variety of other financial implications of a settlement proposal such as college funding. The financial strains of stretching the same combined incomes from two parents and one home into two separate homes with the same combined incomes are ameliorated with tax and financial planning strategies that take a comprehensive and holistic approach.

Disclaimer:

Because everyone's situation is unique, this should be considered as general information and should not be construed as providing individual tax or financial planning advice.