Understanding the effects of income and savings on financial aid.

Financial aid will play an important role in many people's college-funding strategies. That's why it's important to understand the impact that higher education savings can have on financial aid calculations.

Two factors help determine the amount one will receive:

1. Parent and student income and assets

Parent and student earnings and assets get factored into financial aid calculations. Generally, parental income and assets are treated more favorably than child-owned assets and income. The example below indicates the percentage of assets and income one could be expected to contribute annually toward college-related expenses.

How income and assets factor into the EFC

Owner	Assets*	Income†
Student	20%	50%
Parents	5.64%	22%–47%
Others (including grandparents)	0%	0%

Source: FAFSA

2. The investing vehicle housing the assets

The type of investing vehicle housing the assets – 529 college savings plan, Coverdell Education Savings Account, UGMA/UTMA account, Roth IRA or taxable account – helps determine the impact of the assets on aid eligibility.

Expected Family Contribution or "EFC"

The Free Application for Federal Student Aid or "FAFSA" form helps determine how much a student and his or her family are expected to contribute toward college. That amount is known as the expected family contribution or "EFC". The difference between the EFC and the cost of attendance (college tuition, room and board, etc.) is the amount of federal financial aid for which one is eligible.

For example, using the FAFSA formula, if the cost of attendance is $45,000 and the expected family contribution is $35,000, the student would be eligible for Federal Financial Aid totaling $10,000.

Cost of attendance	$45,000
– **EFC**	$35,000
Federal Financial Aid	$10,000

*Total current balance of cash, savings and checking accounts; net worth of investments, including real estate, excluding the home in which parents and student live; net worth of parent and student current businesses and/or investment farms, excluding family farms or businesses with 100 or fewer full-time or full-time equivalent employees. Net worth means current value minus debt. Income includes the adjusted gross income from the parents' and students' Forms 1040 along with certain other items representing untaxed income and benefits, e.g., untaxed portions of IRA distributions and veterans non-education benefits, such as disability.

† 30% income tax rate used for illustration purposes. Actual rate may differ.

A new FAFSA form is filled out each year in which a student seeks financial aid.

Financial aid and tax issues can be complicated. Be sure to work with your advisor and tax professional to determine the investments and decisions that make sense given your specific circumstances.

Account type and owner are important

The type of investment account housing the assets and the account owner have an impact on how much financial aid a student receives.

Asset/investment type	How assets factor into financial aid calculations:
529 College Savings Plan	
• Dependent student (parent or student owned)	• Both parent- and dependent-student-owned 529 college savings plans factor into aid calculations at 5.64%. • Withdrawals from 529 plans do not count as parental or student income.
• Independent student* (parent or student owned)	• Whether owned by the student or parents, assets in a 529 plan account earmarked for an independent student are factored into financial aid calculations at 20%. • Withdrawals from 529 plans do not count as parental or student income.
• Grandparent-owned	• Assets in grandparent-owned 529 plans do not factor into financial aid calculations. • However, distributions from a grandparent-owned account are counted as income to the student and factored into future aid calculations at a 50% rate.
Taxable investments	
• Parent-owned	• 5.64% of assets are factored into calculations; income is factored in at between 22-47%, depending on the owner's tax bracket.
• Student-owned	• 20% of assets are factored into calculations; income is factored in at 50%.
UGMA/UTMA accounts	
	• 20% of assets are factored into calculations. • Interest, dividends, capital gains and distributions from UGMA/UTMA accounts reported on the student's tax return are factored in at the 50% rate. • UGMA/UTMA-owned 529 plans are reported as parental assets and factored into aid calculations at the 5.64% rate.
Roth IRA	
• Parent-owned	• Qualified retirement assets including money in Roth IRAs do not factor into financial aid calculations. • Roth IRA withdrawals count as income to the parent, which factors into future financial aid.
Coverdell ESAs	
	• Both parent- and dependent-student-owned Coverdell education savings accounts factor into aid calculations at 5.64% of the account balance.

* A variety of factors determine whether one is considered an independent student. These include, but are not limited to, whether a student turns 24 by December 31 of the year in which the aid is given, is a graduate or professional student, is married, has legal dependents other than a spouse, etc. Please consult with your financial advisor and/or tax professional to determine a student's status.

How can Grandparents help?

529 plans are a great way for grandparents to help fund their grandchildren's higher education. Here are some things to consider:

- Assets in a grandparent-owned 529 account do not generally factor into a student's financial aid calculations.
- Distributions from a grandparent-owned 529 plan *do* count as income to the student and factor into the EFC at the 50% rate.
- To limit the impact of grandparent-owned 529 assets on financial aid eligibility, it may be advisable to tap those assets last.

Five arguments for using a 529 plan to pay for college

1. Whether owned by the parent or the student, 529 plan assets factor favorably into financial aid calculations.
2. 529 plan distributions do not count as parental or student income.
3. 529 plans allow growth free from federal tax, provided assets are used to pay qualified higher education expenses.
4. Many states offer a state-tax benefit for investing in 529 plans sponsored by the state; some states offer tax benefits for contributions to *any* state's plan.
5. 529 plans offer considerable flexibility should the beneficiary receive a scholarship or choose not to attend college. Your financial advisor can tell you more.

If withdrawals are used for purposes other than higher education, the earnings will be subject to a 10% federal tax penalty in addition to federal and, if applicable, state income tax. Depending on your state of residence, there may be an in-state plan that provides tax and other benefits not available through CollegeAmerica.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses, summary prospectuses and CollegeAmerica Program Description, which can be obtained from a financial professional and should be read carefully before investing. CollegeAmerica is distributed by American Funds Distributors® and sold through unaffiliated intermediaries.

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