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College Planning During and After Divorce

The purpose of this presentation is to give CDFAs some background on college planning and how to add value to your clients by identifying these issues.

Issues to consider

- Who is going to pay for college?
- What is the best way to advise your clients in terms of saving for college?
- What rules do CDFAs need to pay attention to for financial aid purposes?
- Are the tax benefits available to the divorced parent paying for college?

2 Different Processes

Saving for College

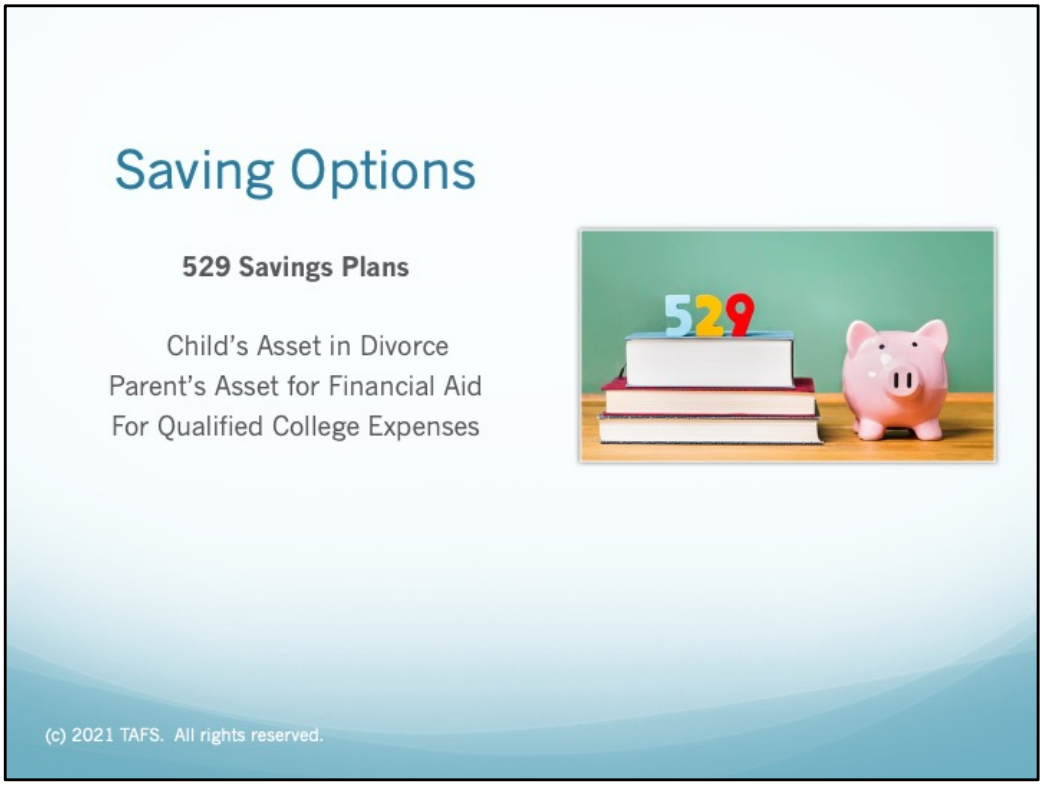
Paying for College

Saving for College

Savings vehicles that can be used:

- 529s
- Roth IRAs
- Life Insurance
- Savings accounts
- Equity in House

Note: Some of these vehicles will count against parents for financial aid purposes



529s are considered the child's asset in a divorce, however a parental asset for financial aid purposes. 529s can be used for qualified college expenses like:

Tuition and fees
Room and board (if the student is enrolled at least on a half time basis)
Books and supplies
Computers and internet access (for college only)

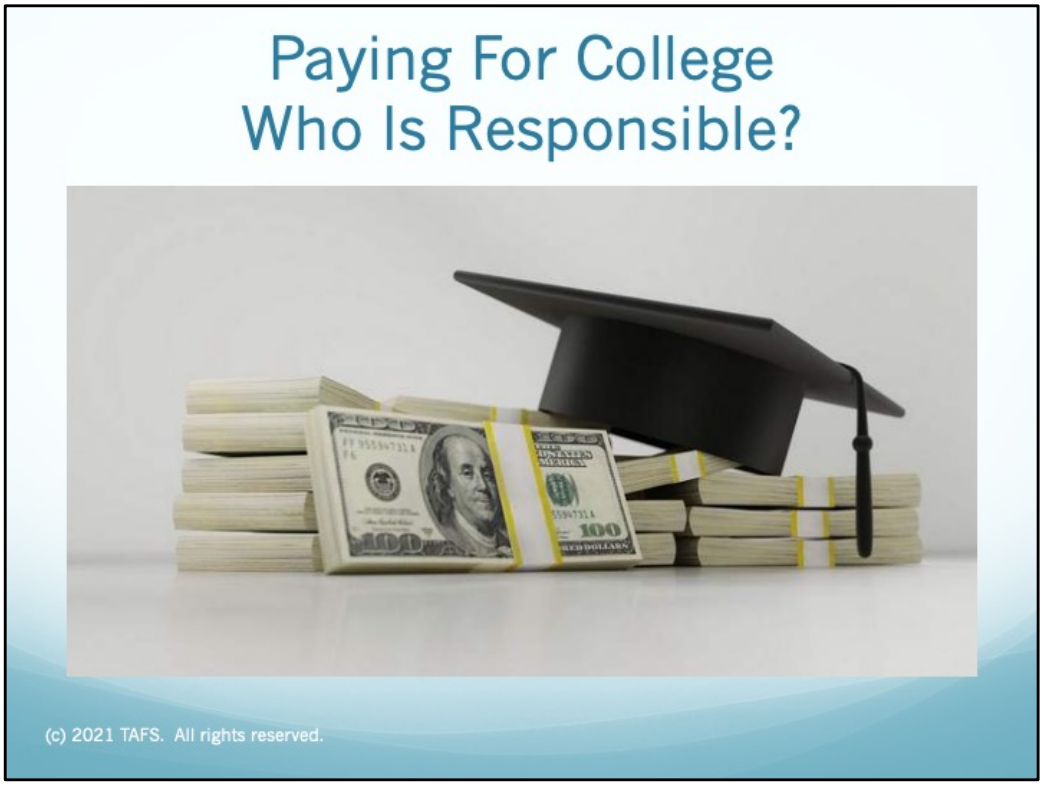
Other uses:
K-12 private school tuition up to 10K per year
Student loans, up to 10K for the lifetime

Special Issues with 529 Plans

1. 529 plans are considered assets of the account owner and not the beneficiary
   a. The account owner can legally take distributions for non-qualified expenses and deplete a child's college fund
   b. The account owner can change the beneficiary to a child or stepchild with a new spouse without notice
   c. Use the funds to further their own education or pay down their own student loans
2. How will it be funded in the future? Is there a minimum/maximum required contribution?
3. Who will be the custodian?
4. Who will receive statements for the account?
5. Approval requirement of both parents to change a beneficiary
6. Who has the right to withdraw money?

Special Issues with 529 Plans

8. Notification requirement for non-account owner parent before a distribution is taken
9. What if a child decides not to go to college, what then?
10. What happens with any leftover 529 plan funds after the child finishes college, who owns it?
    a. Are there siblings?
    b. What about graduate school?
    c. Who pays the taxes and 10% federal penalty for a nonqualified withdrawal?
11. Do 529 plan funds count toward a parent's college support obligations?



College is the **largest distribution of assets prior to retirement**

Often after divorce, if there is a large disparity in income between the spouses, while one spouse will be okay financially, the other spouse might be looking at a struggle to even save enough to consider retiring. How will you split the costs? Consider proportionate to income.

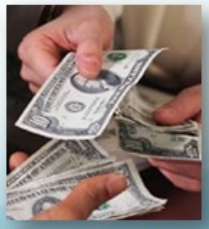
In CA, after the children emancipate, the financial obligation is terminated, but it still deserves a discussion while you two are making decisions. Working this out now can prevent future arguments. It can prevent a lot of unnecessary worry in the years leading up to college.

College agreements in a settlement agreement are not enforceable by family court once the child reaches 18, but college agreements can be enforced in a civil court under the contract law rules. Note that this could bring your child into the case as a beneficiary and a party with standing.

How do most families pay?

Most people pay for college from the following sources:

- Income
- Assets
- Scholarships or Grants
- Loans
- Not go at all



Evaluate

If kids are older and closer to college, CDFA needs to do an overall evaluation of how best to pay for college

What assets can be used?

How do spousal and child support factor into income?

- Spousal support is considered untaxable income on FAFSA
- Child support is considered untaxable income on FAFSA (if still receiving for other children under 18)
- Look at overall debt

Qualifying for Financial Aid

Current rule for divorced parents - The parent that has the most custody is the financial information that should be used.

Upcoming rule change: It will not matter who the custodial parent is, it will be the info of the higher-income parent required on FAFSA.

FAFSA – Federal Application for Federal Student Aid
Comes out October 1, 2021

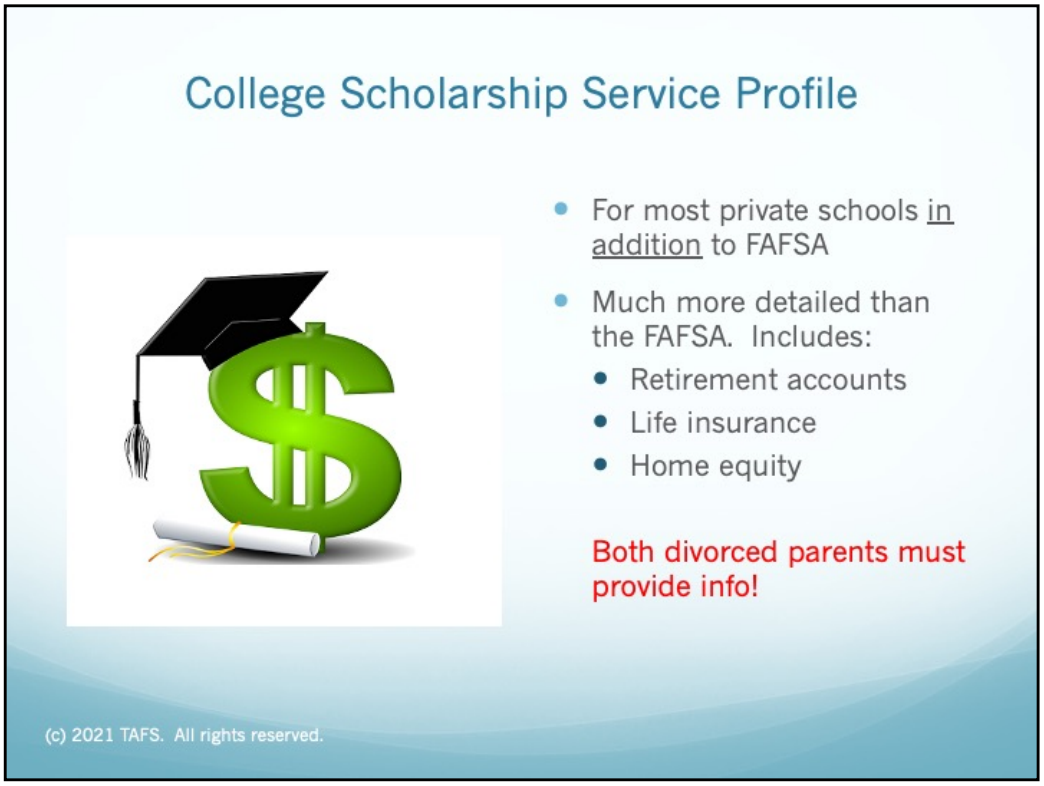
Only one parent's financial information is included in the FAFSA (however, if parent is remarried, both incomes count – will reflect on taxes)

FAFSA uses taxes from 2 years prior the start date of student in college

Factors considered include, but are <u>not limited</u> to:

- Income
- Assets
- Household size
- How many other children in college

- Reporting the equity in the house you live in
- Reporting retirement assets
- Reporting cash value life insurance and annuities



The CSS is used for most private schools in addition to FAFSA,
It is designed to give institutions a closer look into the finances of the student and family.

It's much more detailed than the FAFSA – it will include retirement accounts, life insurance, equity and value of business.

Both parents must fill out the CSS Profile, even if they are divorced

- One will be the custodial parent and the other will be the noncustodial parent
- If parents are remarried, all income and assets of both parents will be evaluated
- If noncustodial parents chooses not to submit, child will not be eligible for financial aid unless noncustodial waiver is granted (case-by-case basis)

Tax Considerations For Divorced Parents

- Tuition and Fees Deduction (IRC §122)
- Student Loan Interest Deduction (IRC §221)
- American Opportunity Tax Credit
- Lifetime Learning Credit
- No Double Dipping

Tuition and Fees Deduction (IRC §122)
- Above the line deduction
- $4000 of qualified expenses need to be incurred
- Does not need to be studying full-time or pursuing a degree
- Only one deduction per household

Student Loan Interest Deduction (IRC §221)
- Above the line deduction
- Qualified student loan interest
- Annual limit of $2500 deduction

American Opportunity Tax Credit (AOTC)
- Dollar for dollar reduction in tax liability
- Enrolled in school at least half the time
- Pursuing a degree or certificate
- Available per student
- Maximum credit is $2500

Lifetime Learning Credit
- Dollar for dollar reduction in tax liability
- Expenses incurred to acquire or improve job skills
- Annual limit of $2000 deduction

NO DOUBLE DIPPING – Expenses used to calculate AOTC cannot be paid for buy 529 distribution

MSA Language

Add language asking both parents to contribute and prove that they are saving for college.

Add language that each parent is contractually obligated to pay percentage or dollar amount of student loan. Not enforceable by family court, but by civil court under contract law.

CONCLUSION

- CDFAs should make their clients aware of the issues that may arise if divorced clients choose to send kids to college.
- There are two parts to the college discussion – saving and paying
- No way to force parties to pay for college after kid turns 18, but can create contractual obligation
- Creative solutions can be done through mediation