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Do Savings and Assets Reduce Need-Based Aid for Dependent Students?

By Margaret M. Clancy and Sondra G. Beverly

Federal programs such as Pell Grants, Federal Supplemental Educational Opportunity Grants, and Work-Study assistance provide financial aid for college[1] according to need. Although the federal government is the principal source of need-based student aid, almost all states offer assistance.[2] Rules governing student aid designate income as the primary indicator of ability to pay but assets are also considered. This policy brief documents the impact of assets on need-based aid for dependent students under current rules and formulas.[3] The main observation is that savings and assets do *not* affect need-based aid for most dependent students.

Asset Exclusions from Need-Based Student Aid Calculations

Students apply for federal need-based aid by completing the Free Application for Federal Student Aid (FAFSA). The government uses financial and demographic information from this form to calculate the Expected Family Contribution (EFC) of each student according to a formula established by federal law. The EFC determines the amount of need-based aid students are eligible to receive.

The main observation is that savings and assets do *not* affect need-based aid for most dependent students.

The primary determinants of the EFC are parent and student *income*. After considering certain income allowances—such as for basic living expenses, taxes, and family size—the balance of parents' income counts toward the EFC on a sliding scale, with rates ranging between 22% and 47%. After allowances, available student income, regardless of the amount, is assessed at 50%.[4]

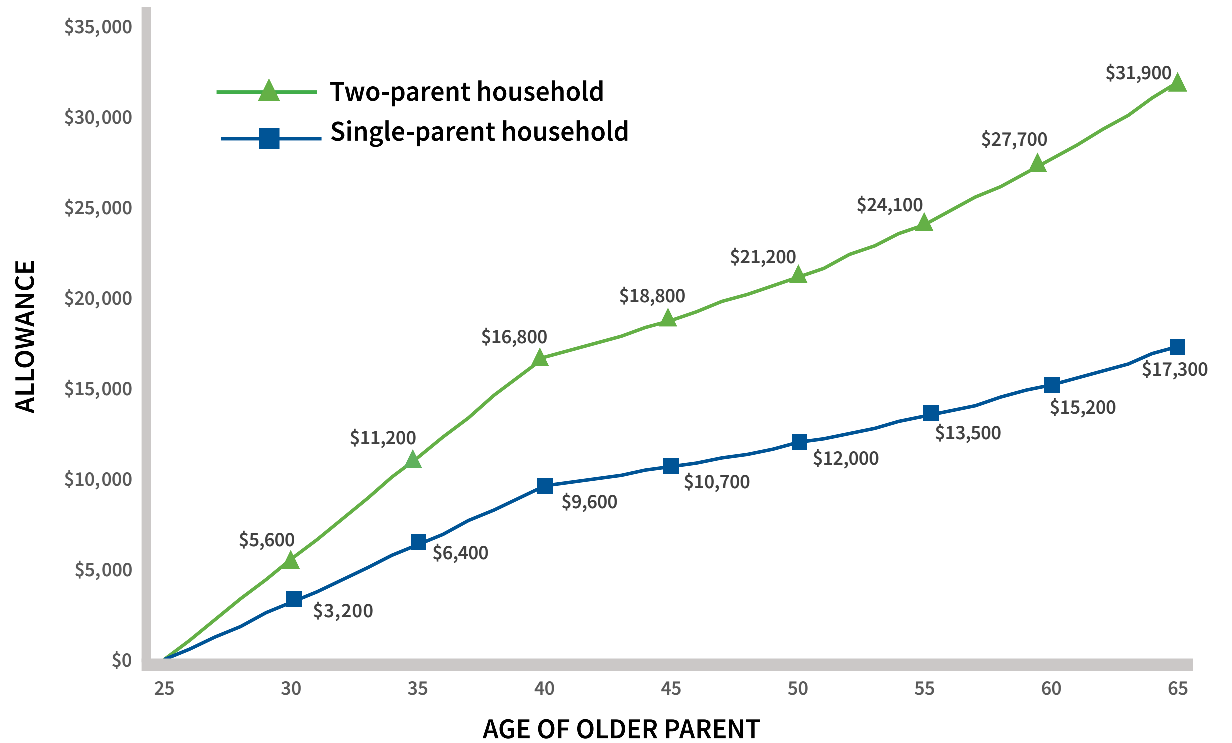
Assets can also increase the EFC and therefore decrease need-based aid, but many provisions in the formula greatly reduce or eliminate the impact of assets, especially for low- and moderate-income students. First, assets do not affect the EFC for students whose parents have adjusted gross incomes (AGI) below $50,000 and who meet at least one of three other qualifications: (1) anyone in the parents' household received federal means-tested public assistance in the previous 2 years;[5] (2) parents were eligible to file an IRS Form 1040A or 1040EZ (i.e., were not required to file an IRS Form 1040, which is the most complex of the three major individual tax forms); or (3) a parent is a dislocated worker. These students qualify for a *simplified EFC formula,* which disregards all parent and student assets. Or, if parent income is $25,000 or less, students qualify for the *automatic zero EFC,* which sets the family contribution to zero. Because of these provisions, assets have no impact on aid for the neediest students.

Second, for students who do not qualify for the simplified or automatic zero EFC, *the formula excludes certain parent-owned assets*, including home equity and qualified retirement assets such as 401(k)s or Individual Retirement Accounts. The value of family-owned businesses, insurance policies, and annuities is also excluded.

Finally, after these parent-owned assets are disregarded, an additional exclusion—the *parents' education savings and asset protection allowance*—lets parents maintain a certain level of savings in case of an emergency and for future college expenses. This allowance increases with parents' age (Figure 1). For example, in two-parent families in which the older parent is 45 years old, the asset allowance is $18,800 for the 2017-2018 academic year. In single-parent families in which the parent is 45, the allowance is $10,700.[6] Together, these provisions greatly reduce and often eliminate the impact of parent assets on need-based student aid.

If parents own any assets that are not disregarded because of the provisions just described, a small percentage counts toward the EFC. The assessment rate is progressive, with the assets of lower-income parents assessed at a lower rate than those of higher-income parents. The maximum assessment rate for parent assets is 5.64%.[7]

Figure 1. Parents' Education Savings and Asset Protection Allowance for Need-Based Student Aid



Note: This Allowance is one component of the federal Expected Family Contribution (EFC) formula used to calculate how much financial aid students are eligible to receive. It establishes savings allowances for every parent age between 25 and 65 years so that parents of dependent students may hold a certain level of savings for emergencies, future college expenses, or other needs. Many other assets owned by parents (e.g., home equity, qualified retirement assets, family-owned businesses, insurance policies) are categorically excluded from the EFC. Data come from Table A5 in The EFC Formula, 2017-2018. There are separate EFC formulas and exclusions for independent students.

Figure 2 illustrates the impact of parent assets on need-based aid in six hypothetical households. As noted, parent assets have no impact on need-based aid for most dependent students. Even for families with high levels of assets, the impact may be quite small, if much of the parent assets are held in home equity and/or qualified retirement savings. (Of note, these are two of the most commonly held assets, and home equity is the single largest contributor to net worth across U.S. households.[8])

As noted above, *student assets* are disregarded if the household qualifies for the simplified or automatic zero EFC. When student assets are counted, the assessment rate is 20%, regardless of income.[9]

Like the federal government, most *state* governments use the FAFSA to determine eligibility for need-based aid.[10] Therefore, assets are also unlikely to reduce state need-based student aid.[11]

The two most common vehicles for postsecondary education savings are basic bank and credit union savings accounts and 529 college savings plan accounts.[12] Two important attributes favor 529 savings. First, starting in 2009, 529 savings owned by a student are defined as parent assets, assessed at 5.64% or less, rather than the 20% student assessment rate. In addition, 17 states (Arizona, Georgia, Indiana, Iowa, Kentucky, Michigan, Mississippi, Missouri, Nebraska, New Jersey, New Mexico, New York, Pennsylvania, Rhode Island, Texas, West Virginia, and Wisconsin) categorically exclude 529 savings from their need-based aid calculations.[13]

Table 1 summarizes how the choice of savings vehicle affects need-based student aid calculations. The most important observation is that, because of EFC asset exclusions and simplified formulas, assets are very unlikely to jeopardize federal or state need-based aid for low- and moderate-income students. When assets count toward the EFC, savings held in 529 plan accounts have less impact on need-based aid than savings held in basic savings accounts.

Figure 2. How Parent Assets Affect Need-Based Student Aid and Expected Family Contribution (EFC): Six Examples

Single Parent, Age 45

	AGI[a] < $50,000 SINGLE PARENT SAVES	AGI = $50,000 SINGLE PARENT SAVES	AGI ≥ $50,000 SINGLE PARENT SAVES
529 college savings	$2,000	$6,000	$9,000
Emergency savings	$700	$700	$3,400
Qualified retirement savings	$2,000	$5,000	$16,000
Home equity	$15,000	$25,000	$40,000
	NO IMPACT Parent income and status qualify for simplified or automatic zero EFC.[b]	**NO IMPACT** Countable assets[c] are below $10,700 allowance.	**SMALL IMPACT** Countable assets equal $1,700 after $10,700 allowance and increase the EFC by < $100.[d]

Two Parents, Older is Age 45

	AGI < $50,000 TWO PARENTS SAVE	AGI = $50,000 TWO PARENTS SAVE	AGI ≥ $50,000 TWO PARENTS SAVE
529 college savings	$3,000	$8,000	$ 12,000
Emergency savings	$1,200	$3,000	$7,400
Qualified retirement savings	$4,000	$7,000	$58,000
Home equity	$20,000	$32,000	$70,000
	NO IMPACT Parent income and status qualify for simplified or automatic zero EFC.	**NO IMPACT** Countable assets are below $18,800 allowance.	**SMALL IMPACT** Countable assets equal $600 after $18,800 allowance and increase the EFC by < $35.[e]

529 college savings **Emergency savings** **Qualified retirement savings** **Home equity**

[a]Adjusted Gross Income [b]Assets do not affect the EFC for students whose parents have AGIs below $50,000 and who meet at least one of three other qualifications: 1) anyone in the parents' household received federal means-tested public assistance in the previous two years; 2) parents were eligible to file an IRS Form 1040A or 1040EZ; or 3) a parent is a dislocated worker. These students qualify for a *simplified EFC formula* (which disregards all parent and student assets) or, if parent income is $25,000 or less, the *automatic zero EFC* (which sets the family contribution to zero). [c]Countable assets include 529 college and emergency savings.
[d] If parents own assets that are not disregarded, a small percentage counts toward the EFC, depending on parent income. Here, EFC increases (and aid decreases) between $45 and $96. [e] EFC increases (and aid decreases) between $16 and $34.

Note: The EFC formula is used to calculate how much financial aid students are eligible to receive. Illustrations are for dependent students and are based on The EFC Formula, 2017-2018. This federal formula categorically excludes specific assets owned by parents (e.g., home equity, qualified retirement assets, family-owned businesses, insurance policies) and establishes savings allowances for every parent age between 25 and 65 years so that parents may hold a certain level of savings for emergencies, future college expenses, or other needs.

Table 1. How Savings Vehicle Affects Need-Based Student Aid		
	529 Savings	Bank or Credit Union Savings
Federal Aid	Through EFC asset exclusions and simplified formulas, assets are disregarded for most low- and moderate-income families.	
	When not excluded, 529 savings in a student's name are assessed at the lower parental rate.	When not excluded, bank or credit union savings in a student's name are assessed at the higher student rate.
State Aid	In states that use the federal EFC formula, assets are disregarded for most low- and moderate-income families.	
	When not excluded, 529 savings in a student's name are assessed at the lower parental rate. 17 states categorically exclude 529 savings from need-based student aid calculations.[a]	When not excluded, bank or credit union savings in a student's name are assessed at the higher student rate. No state categorically excludes bank or credit union savings from need-based student aid calculations.

Note. EFC = Expected Family Contribution. [a] savingforcollege.com/compare_529_plans [Accessed December 15, 2016]

Implications for Design of Child Development Accounts

Child Development Accounts (CDAs) are savings or investment accounts that help people accumulate assets for medium- and long-term developmental goals such as postsecondary education and home purchase. The policy vision is a national system of accounts opened automatically for all at birth with a substantial initial deposit and some progressive component to subsidize asset accumulation for low- and moderate-income children. Automatic and progressive CDAs are viewed as a tool to set early expectations for postsecondary education, help families prepare financially for educational expenses, and distribute public asset-building subsidies more fairly.[14]

When assets count toward the EFC, savings held in 529 plan accounts have less impact on need-based aid than savings held in basic savings accounts.

CDA savings are typically held in 529 plan accounts or basic savings accounts. These accounts may be owned by a government or other nonprofit agency or an individual (typically a parent). One common ownership model has two types of accounts: (1) *agency-owned* accounts for the initial "seed" deposit, match money, and other program deposits, and (2) *individually-owned* accounts for deposits from parents, grandparents, and other individuals.[15] CDA savings accumulated in agency-owned accounts (regardless of savings vehicle) typically *do not affect* need-based aid because students and parents do not own the savings.[16] CDA savings held in individually-owned accounts may reduce need-based aid, but, for the reasons noted above, are very unlikely to do so. This is especially true for savings held in 529 plan accounts.

Thus, as long as formulas for need-based student aid remain the same, policymakers and program designers should consider holding initial deposits, savings matches, and other CDA program funds in agency-owned accounts and personal savings in individually-owned 529 plan accounts, which have some advantages over basic savings accounts.[17]

Looking Forward

Again, the most important conclusion is that assets are very unlikely to reduce federal or state need-based aid for low- and moderate-income dependent students. This includes CDAs and other college savings, regardless of savings vehicle but especially when held in a 529 plan account. Still, student aid eligibility rules and formulas are very complex, and a growing body of evidence supports the common sense notion that such complexity hinders college access.[18]

Though the most common need-based student aid formula does not penalize saving by low- and moderate-income families, current U.S. public policy does not incentivize saving by those most in need. The tax benefits of saving in 529 plan accounts and other education savings accounts go almost exclusively to middle- and especially upper-income families, making these subsidies highly regressive.[19] And because it is very difficult for low-income families to save (especially for expenses that are several years in the future),[20] any approach to college financing that relies heavily on family savings strongly favors advantaged families.[21] Looking forward, inclusive college finance policies would rely less on a complex financial aid system and more on progressive subsidies provided early in a child's life.

End Notes

1. Federal need-based student aid may be used at vocational schools, two-year colleges, and four-year colleges and universities. For simplicity, we refer to all accredited postsecondary educational institutions as "colleges."

2. See https://www.nasfaa.org/State_Financial_Aid_Programs.

3. There are three need-based aid formulas: one for dependent students and one each for independent students with and without dependents. The focus of this paper is dependent students. Going forward, we refer simply to "students." Dependency status is defined by student responses to several questions about age, marital status, participation in the armed forces, and more. Dependent students must report their own and their parents' financial and demographic information when applying for financial aid. See The EFC Formula, 2017-2018.

4. Similar to federal income tax rates, EFC assessment rates for parent income are marginal. Thus, even for high-income families, only a portion of available parent income is assessed at the 47% rate. However, available student income is assessed at a flat rate. For every $2 a student earns above the allowances, $1 goes toward the EFC. For more details about the effect of income on the EFC, see Tables A3 and A6 in The EFC Formula, 2017-2018 and Collins (2016).

5. Federal means-tested benefit programs include Medicaid, Supplemental Security Income (SSI), the Supplemental Nutrition Assistance Program (SNAP), Free and Reduced Price School Lunch, Temporary Assistance for Needy Families (TANF), and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). See The EFC Formula, 2017–2018.

6. See Table A5 in The EFC Formula, 2017-2018.

7. The EFC formula effectively uses marginal rates to assess assets. Thus, even for high-income families only a portion of parent assets is assessed at the maximum 5.64% rate. See The EFC Formula, 2017-2018. Analysis by the General Accounting Office (2012) shows that, because of asset exclusions and simplified formulas, assets had *no impact* on the EFC for about 75% of dependent students who filed a FAFSA for the 2007-2008 school year.

8. See Bricker et al. (2014, Table 3) and Kochhar, Fry, & Taylor (2011, Chapter 5).

9. See The EFC Formula, 2017-2018.

10. See McBain (2011).

11. Some states require all students applying for state aid to report asset information, even students who did not have to do so on the FAFSA. See Collins (2016).

12. See Figure 5 in Sallie Mae (2015). College savings plans (commonly called 529 plans after the relevant section of the Internal Revenue Code) offer tax-preferred saving through investment accounts. Qualified withdrawals used for education-related expenses at accredited 4-year colleges, community colleges, and vocational schools (both in-state and out-of-state) are exempt from federal and state taxes, and most states allow qualified contributions to be deducted from state income taxes (Lassar, Clancy, & McClure, 2010).

13. See www.savingforcollege.com/compare_529_plans/.

14. See Sherraden (1991; 2014) and Beverly, Elliott, & Sherraden (2013).

15. See Clancy & Beverly (2017) and Clancy, Sherraden, & Beverly (2015).

16. One exception is a practice called financial aid award displacement, which occurs when schools reduce previously committed institutional aid for students who receive a private scholarship. See National Scholarship Providers Association (2013). Legislation has been introduced in at least one state to ban award displacement, but federal legislation is necessary to eliminate this counterintuitive and regressive practice. See Burd (2016) and Weinstein (2014). If the practice continues, award displacement could affect CDAs because agency-owned CDAs are typically treated as scholarships (see Clancy & Sherraden, 2014).

17. This account structure is typical of large CDA programs, including 3 of the 4 statewide CDA programs and the CDA in SEED for Oklahoma Kids. See Clancy & Beverly (2017) and Nam, Kim, Clancy, Zager, & Sherraden (2013).

18. See Dynarski & Scott-Clayton (2013). The Rethinking Student Aid study group has issued a number of recommendations to reduce complexity and uncertainty, including calculating Pell Grant eligibility from federal income tax return data,

removing assets from the Pell Grant formula, and making Pell Grant awards predictable. See Rethinking Student Aid Study Group (2008).

19. Because low-income families are much less likely than high-income families to save in 529 plans, they are much less likely to receive any tax benefit. When low-income families do save in 529 plans, they receive less benefit from the tax-free growth of savings and any state tax deduction because their tax rates are lower. In contrast, high-income families have relatively high rates of participation in 529 plans (often with large balances) and receive large tax benefits; therefore, they receive substantial public subsidies. See Dynarski (2004), Government Accountability Office (2012), and U.S. Department of the Treasury (2009). Some states match 529 deposits for state residents, but these incentives are not always progressive, and most of these states require families to complete a separate application and supply tax returns each year, activities that likely greatly reduce participation by less financially-sophisticated families. One desirable savings match model is in Louisiana. This 529 plan maximizes inclusion by using state tax records to automatically calculate and deposit a progressive annual match. Families do not have to apply for the match and can contribute as little as $10 to open an account (Lassar, Clancy, & McClure, 2011).

20. See Gray, Clancy, Sherraden, Wagner, & Miller-Cribbs (2012).

21. This statement is supported by multiple studies of multiple college savings programs. See, for example, Beverly, Kim, Sherraden, Nam, & Clancy (2015), Government Accountability Office (2012), Sallie Mae (2015), and U.S. Department of the Treasury (2009).

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Authors

Margaret M. Clancy
CSD Policy Director

Sondra G. Beverly
Senior Scholar

Contact Us

Center for Social Development
George Warren Brown School of Social Work
Washington University in St. Louis
Campus Box 1196
One Brookings Drive
St. Louis, MO 63130
csd.wustl.edu

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Washington University in St. Louis
George Warren Brown School of Social Work