# How 529 Plans Affect Financial Aid

529 college savings plans can affect eligibility for need-based federal student aid in one of two ways, as an asset or as a distribution. The financial aid treatment depends on who owns the college savings plan and whether a distribution is qualified or non-qualified.

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## Account Ownership Matters

Normally, student assets are treated differently than parent assets on the Free Application for Federal Student Aid (FAFSA). A student asset will reduce aid eligibility by 20 percent of the net asset value. A portion of parent assets are sheltered on the FAFSA, and the remaining assets are assessed on a bracketed system, reducing eligibility for need-based aid by at most 5.64 percent of the remaining unsheltered net asset value.

College savings plans, however, have special treatment, due to an amendment effective on July 1, 2009 that was enacted by the College Cost Reduction and Access Act of 2007. This legislation changed the treatment of college savings plans as assets and as distributions.

## Treatment of College Savings Plans on the FAFSA

Whether a 529 plan is reported as an asset on the FAFSA depends on who owns the 529 plan account:

- If a 529 plan is owned by a dependent student or a dependent student's custodial parent, it is reported as a *parent asset* on the FAFSA.
- If a 529 plan is owned by an independent student, it is reported as a *student asset* on the FAFSA.
- If a 529 plan is owned by a grandparent, a noncustodial parent or anybody else other than the student or a dependent student's custodial parent, it is not reported as an asset on the FAFSA.

Whether distributions from a 529 plan are reported as income on the FAFSA depend on whether the distribution is qualified or non-qualified and on whether the 529 plan was reported as an asset on the FAFSA.

- If a 529 plan distribution is a non-qualified distribution, it is included in adjusted gross income (AGI) on the beneficiary's federal income tax return and so will be counted in total income on the FAFSA.
- If a 529 plan distribution is a qualified distribution, it is reported as *untaxed income* to the beneficiary on the FAFSA if, and only if, the 529 plan is not reported as an asset on the FAFSA. If the 529 plan is reported as an asset on the FAFSA, qualified distributions are ignored.

Thus, a grandparent-owned 529 plan will not be reported as an asset on the FAFSA, but distributions from such a 529 plan will be reported as untaxed income to the beneficiary (the student). This can have a severe impact on the student's eligibility for need-based financial aid.

## Workarounds

The most common scenarios in which a college savings plan will be owned by someone other than the student or a dependent student's custodial parent include 529 plans owned by a grandparent, another relative or a non-custodial parent. Since such 529 plans can significantly reduce eligibility for need-based aid, the family will want to find a workaround that reduces the harmful impact on aid eligibility.

There are several possible workarounds:

- **Change the account owner.** The simplest solution is to change the account owner to be the student or the parent. Nothing prevents a grandparent or other relative from contributing to a 529 plan owned by the student or parent. Changing the account owner, however, may affect the former account owner's eligibility for state income tax deductions on contributions to the 529 plan, since some states (e.g., Maryland) require the taxpayer to be the account owner in order to claim the deduction.

  If the grandparent or non-custodial parent is concerned that the custodial parent might take a non-qualified distribution, they could change the account owner to the student, with themselves as custodian in the custodial version of the 529 plan account.

  It is best to wait until after the FAFSA has been filed to change the account owner, so that the 529 plan is not reported as an asset on the FAFSA. After the account owner is changed, the distributions will not be reported as untaxed income on the subsequent year's FAFSA.
- **Wait to take qualified distributions.** If the student is not planning on enrolling in graduate or professional school, the family could wait until after the FAFSA is filed for the student's senior year in college to take distributions from the 529 plan, when there's no subsequent year's FAFSA to be affected.

- **Take non-qualified distributions after graduation.** The family could also wait until after the student graduates to take non-qualified distributions to pay down any debt the student might have incurred.