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Using Assets to Pay Debt to Help Financial Aid

Q. My daughter goes to college in one year. We've saved a lot in 529 plans and retirement accounts, and we only have about $45,000 in a brokerage account that would/ could work against us for financial aid purposes. I also have $20,000 in credit card debt. Should I sell the stocks and pay off debt so we appear to have less cash for financial aid purposes? The brokerage money has no real goal.

A. Paying off debt can be a great thing, but let's first talk about financial aid and how your assets will be considered. The first step in the financial aid process is completing a form called the Free Application for Federal Student Aid, better known as FAFSA, said Michael Maye, a certified financial planner and certified public accountant with MJM Financial in Gillette. Roughly 300 schools also require another form known as the CSS Profile, which is short for the College Scholarship Service Profile.

We'll focus on the more common FAFSA form and how it treats various assets for financial aid purposes. "On a macro level, the FAFSA formula treats income/assets as follows: 20 percent of student's assets (excluding 529s), 50 percent of student's income after some allowances, 2.6% to 5.6 percent of parental assets based on sliding income and allowances, and 22 to 47 percent of a parent's income based on sliding income and allowances," Maye said.

These percentages are all important for the starting point for need-based financial aid — the calculation of the Expected Family Contribution (EFC) — which considers income as well as assets of both the parent and student, said **Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge.** "Neither mortgage debt nor consumer debt such as auto loans and credit card balances can be used to offset the value of investment assets in calculating the net worth which is entered into the formula," Mott said. Now with your situation, Maye said, the 529 plans as a parental asset may reduce financial aid by a maximum of 5.64 percent, depending on your circumstances. "In terms of the retirement accounts, it is good news as the calculation excludes retirement assets such as 401(k)s, IRAs and Roth IRAs," Maye said. "However, if you tap a retirement asset to pay college bills — including a Roth IRA — that is considered income on the following year's FAFSA." Maye said your brokerage account receives the same treatment as a 529.

Using your assets to pay debt can reap multiple rewards, Mott said. "It may reduce the EFC, your cash flow should improve without the monthly payments and you will save the interest expense as well," she said. Assuming you have an adequate emergency fund, it likely makes sense for you to use the taxable brokerage account to pay off credit cards, Maye said. "The primary reason it makes sense to the pay off the credit card debt is it eliminates a non-tax-deductible, high interest rate liability," Maye said. "The fact that it might be helpful from a financial aid perspective is a secondary benefit."

But, before you use your brokerage account to reduce the outstanding balance on your credit cards, be sure you understand the tax consequences of the decision, Mott said. "The addition of possible capital gains to your adjusted gross income that aren't fully offset by taxes might actually increase your calculated EFC," she said. "You also don't want to end up with a tax bill you hadn't anticipated come next April." She recommends you speak with a tax professional to determine what if any capital gains might result from the sale and how that would affect your 2015 income tax profile. Think about how these might be shared or covered and where that money is going to be set aside as well."

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