The New York Times

BUSINESS DAY

Cracking the Books for Financial Aid to College

By HILLARY CHURA JAN. 27, 2007

As the price of a degree at a private college shoots toward the cost of a Lamborghini, parents and grandparents are looking for a leg up as well as to correct mistakes that could cost them dearly when applying for need-based financial aid.

Mistakes range from giving money directly to a minor to selling investments in the year that an aid application is made. College counselors, financial advisers and aid specialists say that beyond mending these missteps, there are many legitimate ways to increase the amount of aid. The advice, they say, is not intended to skirt the system or to support an extravagant lifestyle but to put students and their families on firmer financial footing as college costs skyrocket.

"There are better and ethical ways to organize your finances going into this portion of your life," said Bari Norman, director for mycollegecounselor.com, an admissions advisory service. "It's not necessarily unethical to reorganize things."

She said people shortchange themselves if they wait to understand their options until they are in the thick of filling out aid applications.

"People tend to learn about things too late and get information in the first inning as opposed to the preseason," Ms. Norman said. "The problem is that you really need to learn the rules of the game in the preseason, which means 9th, 10th or 11th grade."

The cost of higher education is expected to continue to outpace inflation. Many colleges now cost more than $40,000 a year, including tuition, room and board, books, fees, supplies and associated costs. In 15 to 16 years, that could grow to more than $90,000 a year, assuming a 5 percent inflation rate. Even state colleges, relative bargains at $15,000 a year now, will probably run about $31,200 a year by the time today's 3-year-old enrolls.

Darlene Marsh and her husband, Michael, are shifting funds from the custodial accounts of their two daughters into college savings plans known as 529s, which are tax-free accounts used to pay for higher education. The couple, who live in Pinckney, Mich., opened the custodial accounts on the spur of the moment a while back, based on advice from someone who worked at their bank. They have since realized they do not want the children to have access to the money unless it is for higher education.

Were the money to remain in custodial accounts, like a Uniform Gifts to Minors Act or Uniform Transfers to Minors Act account, the girls would gain control of it when they became adults at 18 or 21, depending on the state where they live. Most 529 plans, on the other hand, are owned by parents, grandparents or other relatives. If money from a child's custodial account is contributed to a 529, the child technically becomes the owner and can use the money, after paying penalties, for something other than education when they reach adulthood.

A part-time dental hygienist, Mrs. Marsh and her husband, the superintendent for a commercial construction company, earn about $95,000 a year and have a total of $6,000 invested in accounts for their two daughters. In addition to shifting the money into tax-deferred or tax-free 529s, they are consolidating accounts and are moving money out of underperforming accounts, including one that earned just $20 in interest over eight years.

Giving large sums to the future student is unwise for another reason. In determining college aid, the portion of money expected to go for college is higher for funds held in a student's hands than if it were the parents' money.

"Financial aid takes a larger portion of a student's contributions than a parent's because we assume the student doesn't have any other obligations and parents have a house and other kids and other costs," said Alison Rabil, director for financial aid at Barnard College.

If a child's custodial account has $150,000, and college will cost $40,000 a year, then 20 percent of that money each year would be expected to pay for college. That means all but $10,000 of the college cost would come from the child in the first year. If that same $150,000 were in a parent's name, then only about 5.6 percent a year would be expected to pay for college. That means that $8,400 would go to the college, with up to $31,600 possibly covered by financial aid.

About 75 percent of undergraduates applied for financial aid in 2003-4, the latest available data, up from 31 percent in 1989-90, according to the National Center for Education Statistics.

Susan Tukel of West Bloomfield, Mich., is paying college application fees and other legitimate expenses out of her son Adam's custodial account to maximize the amount of aid he will receive when he enters college as a freshman this fall. Ms. Tukel, who will apply for aid this month, said she wished she had funneled money into Adam's 529 rather than into his custodial account.

Her son is applying to an in-state public university as well as to private and out-of-state colleges. Costs could range from $18,000 to more than $30,000 a year.

"I wish I had thought more about where he might like to go to school and investigated about the price," said Ms. Tukel, president of a specialty insurance company. "I would have put the money in a different account."

If a 529 ends up with more money than the student needs for college, the excess could finance educations for siblings or parents, or even remain until the student's children need the money, creating an education legacy fund. Money can also be withdrawn if there is no one else to designate as a beneficiary, including the 529's owner, but it is subject to taxes on the gains, a 10 percent federal penalty on the earnings portion of any withdrawal, and possibly even state or local taxes.

Not applying for aid is a major mistake. Even families that do not expect to receive help should ask because they may have extenuating circumstances, like several children in college at the same time, that will make aid officers look on them more favorably.

Missing deadlines is another mistake. “Most deadlines really are drop-dead deadlines,” said Maureen McRae Levy, director for financial aid at Occidental College, a private liberal arts college in Los Angeles that costs about $45,000 a year. “You are better off to get your foot in the door with an application you change later than to have no application at all.”

Advisers suggest prepaying a 529 for five years — at $12,000 a year per recipient — as early and as often as possible, which gives money extra time to compound. If parents can afford it, they also should put the maximum amount into retirement accounts because those assets are not counted, for federal aid purposes, toward aid contributions. Other tips include paying down a house mortgage or credit card debt, because that could reduce available assets that would be expected to pay for college.

Specialists universally discourage shifting money from stocks to life insurance annuities in an effort to hide assets because some colleges may ask about those investments as well.

What is more, advisers suggest not selling stocks to pay for college in the year that one is applying for aid because that money will be considered income, and income is assessed by financial aid providers at a higher percentage than savings are. If stocks must be sold to pay for college, the sale should be done by early in a child’s junior year of high school — the year before the aid application — so the proceeds are not considered income.

Some states, including New York, allow parents who live in the state to take tax deductions on contributions regardless of withdrawal date.

“A lot of states offer state income tax deductions for your contribution, no matter how old your child is or how soon you may need to pay for college,” said Joseph Hurley, founder and chief executive of savingforcollege.com, an independent Web site providing information on 529s and other ways to save for college. His site offers a calculator that forecasts college costs.

Families should not fear that years of saving and living frugally will be held against them when they apply for aid, said Rita Robbins, president of Invescor Advisory Services, which trains independent financial advisers. Parents' savings are assessed at 5.6 percent, under financial aid guidelines, whereas they may be expected to contribute almost half of their adjusted gross income (gross income less state, local and federal taxes and Social Security).

"Most people worry they are going to grab all of your savings. They're not — they're going to grab all of your income," said Ms. Robbins, who urged people to control costs and save long before they need to apply for the aid.

"People don't set aside enough money because parents, based on their lifestyle, don't make accommodations for this," she said. "This standard of living they've been accustomed to has left them no room for adequate planning for their children's higher education cost."

A version of this article appears in print on , on page C6 of the New York edition with the headline: Cracking the Books for Financial Aid to College.