

College Financial Aid Planning for Farm Families

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October 20, 2000



One of the biggest expenses many farm families face is the cost of a college education for their children. Because farm families have some ability to plan their taxable income through the timing of income and expenses, they have an opportunity to optimize the need-based financial aid their children will receive. However, planning what income level will optimize financial aid is a very complex process, which I will endeavor to shed some light on.

The majority of post-secondary institutions calculate financial aid by first calculating the “cost of attendance,” then subtracting the “expected family contribution”, and finally subtracting other types of financial assistance, such as scholarships. The resulting financial aid can take the form of state and federal grants, work-study programs, and subsidized and non-subsidized loans. Thus, planning to attain a relatively low “expected family contribution” will increase the amount of aid and the likelihood of qualifying for grants, which need not be repaid.

“Expected family contribution” (EFC) is generally calculated by a series of formulas that use information derived from the “Free Application for Federal Student Aid” (FAFSA), a form with which parents of college bound children are familiar. There are four formulas for students and their parents that are combined to calculate EFC.

They are:

1. A contribution from the parent’s income
2. A contribution from the parent’s assets
3. A contribution from the student’s income
4. A contribution from the student’s assets

These formulas are updated annually.

Dependant students are expected to spend about one half of their after-tax income in excess of \$2200 toward their educational expenses and about 35% of their assets annually.

Parent’s assets that are used in the calculation include savings, stocks, bonds, real estate, and other investments that are not in a retirement fund, such as an IRA, Keogh, or Roth IRA. Not included are farm assets, if you are an active farmer, and your home. The formula expects you to contribute approximately 12% annually of those assets that are not sheltered from the formula toward college expenses, although the formula allows parents to protect a portion of these investment assets based on their age. Since most farm families have the majority of their money invested in their farming operation, which is not used in calculating the parent’s contribution from assets, contribution from parent’s income is usually the most important formula for planning purposes.

The parent’s contribution from income is calculated as follows:

1. Start with “adjusted gross income” from Line 33 of Form 1040

2. Add additional untaxed income; earned income credit and contributions to retirement funds are the most common additions.
3. Subtract federal income tax paid.
4. Subtract an allowance for state taxes paid; in Minnesota this is 9% of total income below \$15,000 and 8% of total income above \$15,000.
5. Subtract mother and father's social security taxes paid. This is always 7.65%, even if one or both of the parents pay self-employment tax, unless either income earned from work is above \$72,600.
6. Subtract an "income protection allowance," which is derived from a table. A family with two children, one of whom is in college, could protect \$19,140 for the 2000 school year. This table is reprinted below.

Income protection allowance table, 2000-01 (Used to calculate EFC for parents of dependent student)					
Number in parents' household including student	Number of college students in household Exclude parents from number in college.				
	1	2	3	4	5
2	12,450	10,320			
3	15,500	13,380	11,250		
4	19,140	17,010	14,890	12,760	
5	22,580	20,450	18,340	16,120	14,090
6	26,420	24,290	22,170	20,040	17,920

For each additional family member, add \$2980. For each additional college student, subtract \$2120.

7. Subtract an "employment expense allowance," which is 35% of the lowest income in two-parent families, both employed, or 35% of income for a one-parent family, or \$2800, whichever is less. (=0 if only one working parent in a two-parent family)
8. The result is called the "available income allowance (AAI)." This figure, when added to the contribution from assets, is compared to a table which is used to calculate "expected parent contribution." The table is reprinted below. Parents with more than one child in college contribute a proportional share of "the expected parent contribution" to each student.

Parents' contribution from AAI table, 2000-01 for parents with dependent student	
If parents' AAI is --	The parents' contribution from AAI is --
Less than -\$3,409	-\$750
-\$3,409 to \$11,100	22% of AAI
\$11,101 to \$14,000	\$2,442 + 25% of AAI over \$11,100
\$14,001 to \$16,800	\$3,167 + 29% of AAI over \$14,000
\$16,801 to \$19,600	\$3,979 + 34% of AAI over \$16,800
\$19,601 to \$22,500	\$4,931 + 40% of AAI over \$19,600
\$22,501 or more	\$6,901 + 47% of AAI over \$22,500

The expected family contribution (EFC) is the combination of the parents' expected contribution and the students.

Example:

The “expected family contribution” (EFC) for a farm family of four, with a \$25,000 farm income, \$15,000 income from spouse’s off-farm job, less than \$2,000 income earned by the college student, no student financial assets, one child in college, and no financial assets other than farm assets and farm home, would be calculated as follows:

1. Expected student contribution would be 0	
2. Parents’ adjusted gross income (Line 33 Form 1040)	\$38,234
3. Add untaxed benefits =	0
4. Subtract federal income tax =	3,004
5. Subtract state tax allowance =	3,209
6. Subtract father’s social security tax (.0765 X 25,000) =	1,913
7. Subtract mother’s social security tax (.0765 X 15,000) =	1,148
8. Subtract income protection allowance =	19,140
9. Subtract employment expense allowance (.35 X 15,000 or 2800) =	2,800
10. Available income =	7,020
11. Add contribution from assets =	0
12. Available income allowance =	7,020
13. Expected parent contribution (from table) =	1,544
14. Expected family contribution (line 1 + line 12) =	1,544

Strategies for college planning

Keeping assets out of college children’s names is an important strategy for optimizing financial aid.

An “expected family contribution” of close to zero is needed to be eligible for a pell grant. The adjusted gross income that will produce this result varies depending on family size, whether both parents work, and how many children attend college. In the above example the family would qualify for a partial pell grant, assuming college costs are in excess of \$1500 per year.

Income can be planned to optimize financial aid. Income earned in the year the child enters the 12th grade would be the income counted for most college freshmen. Income earned the year the child enters their freshman year in college will be used for determining aid in the second year of college.

Remember, if tax planning is used to defer taxable farm income, at some point the deferred income must be reported and the taxes paid. However, income averaging is available to farmers to help soften this blow somewhat. Thus, a strategy may be to reduce taxable farm income while the student is in college, then report the deferred income in a year after the student graduates or leaves school, using income averaging to reduce the tax.