CORNERSTONE

PARTICIPANT PERSPECTIVES

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IS THAT FINANCIAL AID TAXABLE?

> **Most forms of financial aid are not taxable, however, it's important that students and their families understand how the rules may apply to their situation.**

The college search process is an exciting but time-consuming process. After your child narrows down the colleges of their choice, you must figure out how to pay for tuition, room, and board. The reality is that a four-year college education is expensive. The College Board reported that the average annual published tuition and fees for in-state students at a four-year public college was $11,260 for the 2023–2024 school year, $29,150 for out-of-state tuition and fees at a four-year public college, and $41,540 per year for a four-year private college.[1] However, colleges typically offer scholarships or discounted tuition rates for students who are high achievers academically or distinguish themselves in sports, the arts, music, or other fields. Grants and work-study programs can also help reduce the final price tag of a college education.

STUDENT AID TRENDS

In 2022–2023, undergraduate students received an average of $15,480 in financial aid, including grants ($10,680), federal loans ($3,860), education tax credits and deductions ($850), and federal work-study ($90).[2]

FINANCIAL AID AND TAXES

If your child is awarded financial aid for college, you may be concerned that taxes will be due on that aid, but it depends on certain circumstances. In general, gift aid, including scholarships and fellowship grants that are paid to an individual to assist in the pursuit of study or for research, is not taxable if:

- The recipient is a degree candidate at an eligible educational institution—defined as one that has a faculty, a curriculum, and a regularly enrolled group of students.
- The funds are either designated for tuition and related expenses—required fees, books, supplies, and equipment—or are unrestricted and the amount does not exceed tuition and related expenses. Expenses for room and board do not count.
- The award is not payment for services such as teaching or research.

Excess aid is considered taxable income to the student. Nonetheless, a student's standard deduction may be enough to shelter any earned income from income taxes.

OTHER OPTIONS FOR PARENTS

Saving for college through a Section 529 plan delivers valuable tax benefits.[3] The money in a 529 plan grows on a tax-deferred basis, and distributions for qualified educational expenses are free from federal income tax. Additionally, many states offer some form of state income tax deduction or credit for contributions to a 529 plan.

WORK WITH A PROFESSIONAL

Deciding where to go to college is both an exciting and stressful decision for young people. Figuring out how to pay for it can cause parents many sleepless nights. That's why it can be helpful to obtain the input of a financial professional as early as possible. A financial professional may be able to offer unique insights and advice on how parents can afford a college education for their children.

Source/Disclaimer:

1. The College Board, "Trends in College Pricing and Student Aid 2023."
2. Figures are per full-time equivalent student.
3. Certain benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions and how they may be used. Before investing, consider the investment objectives, risks, charges, and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.

WHAT YOU SHOULD KNOW ABOUT CASUALTY LOSS DEDUCTION RULES

> **The IRS has very specific rules about claiming a casualty loss deduction on your federal income tax return. If you lose property after a natural disaster, you'll need to know what does and doesn't qualify.**

All too often, there are news stories about people losing property or homes to natural disasters such as fires, floods, storms and earthquakes. In these situations, taxpayers may be able to claim a casualty loss deduction on their federal income tax return. The IRS has very specific rules governing what qualifies for a casualty loss deduction and how much can be deducted.

NON-BUSINESS CASUALTY LOSS

The IRS emphasizes that an individual's property loss can be claimed only if the loss is sudden and attributable to a federally declared disaster. For example, the long-term deterioration of property does not qualify as a property loss. This means that if you suffered water damage to your roof's trusses due to a slow, progressive water leak, you would not qualify for a casualty loss deduction under the current tax rules.

The casualty loss tax deduction for personal-use property is limited to the lesser of (1) the taxpayer's basis in the property (which is usually its cost) or (2) the decline in the property's value (i.e., its fair market value (FMV) immediately before the casualty minus its FMV immediately afterward).

A few other rules apply when calculating the deduction. First, the loss must be reduced by $100. Second, the deduction is allowable only to the extent that it, combined with any other casualty loss, exceeds 10% of the taxpayer's adjusted gross income. Finally, casualty losses covered by insurance are not deductible unless the taxpayer files a timely claim for reimbursement and reduces the loss by the amount of any reimbursement or expected reimbursement.

Be sure to seek the advice of an experienced tax professional to help you navigate IRS regulations.

401(K) PLAN HARDSHIP DISTRIBUTIONS

> **It's important to consider the tax consequences when deciding whether to take a hardship distribution from your 401(k) plan.**

A 401(k) plan is designed to help employees accumulate savings for retirement. However, some plans allow participants to take money out of their plan accounts if they have an immediate and heavy financial need. These distributions, referred to as "hardship distributions," are limited to the amount necessary to satisfy the financial need.

Although plan terms can vary, many plans permit hardship distributions for the payment of certain:

- Medical care expenses
- Costs related to the purchase of a primary residence
- Post-secondary educational expenses
- Amounts necessary to prevent eviction from or foreclosure on a mortgage on a primary residence
- Funeral or burial expenses

- Expenses for repairing damages to a primary residence following a casualty event
- Expenses and losses incurred on account of a disaster declared by the Federal Emergency Management Agency (FEMA)

Hardship distributions are taxable and in addition to regular income tax, they may be subject to a 10% early withdrawal penalty if the participant is under age 59½. A plan may require participants to take available plan loans before applying for a hardship distribution. Loans can be a better option for participants who can afford to repay them since there are no immediate tax consequences.

Additionally, beginning in 2024, participants may take penalty-free distributions of up to $1,000 per year if the money is used to pay for unforeseeable, emergency expenses. Such emergency withdrawals are taxed as ordinary income, but the 10% penalty tax for distributions taken before the age of 59 ½—does not apply.

Before taking a hardship distribution, participants may want to talk with a financial professional to help identify other options to preserve their retirement security.

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