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## Helping Grandkids Pay for College — A Quick Course for Grandparents



With college tuition costs continuing to escalate, grandparents are taking a more active role in helping to fund a college education for their grandchildren via vehicles such as a tax-favored 529 savings plan. More than half — 53% — of grandparents are saving or plan to start saving to help pay for college costs, Fidelity reports in its recent 2014 Grandparents and College Savings Study. All told, those grandparents indicated they expect to contribute a median of \$25,000 in college education funds for all their grandchildren, with 35% anticipating contributing \$50,000 or more.

Given the financial ramifications of investing in a grandchild's education, it's important to accompany that from-the-heart generosity with careful planning, so grandparents and grandchild(ren) alike get the most from the investment. Here are a few suggestions to make the planning process go more smoothly:

- 1. First be sure the grandparents have adequate resources to contribute to a grandchild's college education.** From a budgetary standpoint, can they afford to make a contribution without negatively impacting their current financial situation or their retirement plans — “can they give and if so, how much?” explains **Jorge Padilla, a financial planner at the Lubitz Financial Group in Miami, Fla.**
- 2. Talk through the issues as a family — and with a financial professional.** Have a family discussion around college funding. Involve parents, grandparents and a trusted financial advisor (for insight and guidance from a professional) as well as the grandchild/grandchildren, if they're considered mature enough to take part in the conversation. It's important that everyone is clear on how much money the grandparents plan to put toward the student's college education, and about the intent,

values and expectations underlying the grandparents' contribution, says **Padilla**.

**3. Kick the tires on potential savings vehicles.** Grandparents have options for contributing to a grandchild's college education, including a **Coverdell education savings account**, a **custodial account** such as a UTMA or UGMA, and a **529 savings plan**. Tax considerations, and the limitations of the Coverdell (low contribution limits, for one) and the custodial account (assets may count heavily against eligibility for financial aid, for example) options make the 529 plan the most popular vehicle for grandparents to contribute to a grandchild's college education. Any earnings or gains in a 529 plan are exempt from federal and state taxes as long as the money is used to fund college tuition or room and board. The 529 structure, unlike that of a Coverdell or UGMA/UTMA, also affords the account owner control over the funds and the ability to change beneficiaries. What's more, money in a 529 can be used to attend school in any state as well as many universities abroad. And depending on where you live, contributions to an in-state 529 plan may earn a state income tax deduction.

**4.** If a 529 is the chosen vehicle, **select options wisely**. Here are several questions you'll likely need to answer:

- **Which state's 529 plan to use?** Grandparents who live in a state that offers an income tax deduction for contributions to that state's 529 plan should consider establishing a plan in their home state in order to take advantage of the tax break, even if their grandchild lives in another state, says **Padilla**. If such a tax break isn't offered by their home state, then shop around for an out-of-state plan that delivers the best combination of fees and fund performance (a financial advisor can help here, too). The bottom line here is net performance: how a 529 account performs when fees/commissions/costs are factored into the equation. The website [Savingforcollege.com](http://Savingforcollege.com) provides a list of states offering 529 income tax deductions, along with a range of other useful information, including rankings and side-by-side comparisons of state 529 plans in such key areas as fund performance and fees.

- **College savings plan or prepaid tuition plan?** The latter may limit the school the student may attend, which is why many people opt for the former.

- **What type of 529 account to choose?** Most states offer a range of plans, each with its own mix of investment funds tailored to investment horizon, goals, etc. The advice of a financial professional with 529 expertise can prove valuable here as well.

- **To contribute to an existing 529 account (such as one already established by the student's parents) or open a new one?** For simplicity, it can make sense to contribute to an already established 529 account that accepts third-party contributions. But for tax reasons (such as to take advantage of the state income tax break), setting up a new account may make more sense.

5. **Consider how a contribution may impact the student's access to financial aid.** Since in most cases money distributed from a grandparent-owned 529 plan is considered student income for tax purposes, it can affect a student's financial aid package. Here's yet another area where a financial professional can provide valuable direction, "because you don't want to put the grandchild at a disadvantage when applying for financial aid," **Padilla** points out. To find a certified financial planner in your area, visit the Financial Planning Association's national database at <http://www.fpanet.org/PlannerSearch/PlannerSearch.aspx>.

6. **Take the time to consider tax strategies.** From gift taxes to estate planning, a variety of tax strategies may come into play with contributions made by grandparents to a college savings plan. For one, an advance amounting to up to \$70,000 (\$14,000 per year for five years) is available to apply toward the annual gift tax exclusion for contributions to a 529 plan. Given the nuances of some of these strategies, it's worth consulting a financial planner with college planning and tax expertise for guidance. As a primer, the IRS offers an overview of 529-related tax issues and other general information about the program at <http://www.irs.gov/uac/529-Plans:-Questions-and-Answers>