A New Type of Present for Your Grandchildren

- By Max Pauly

The birth of a grandchild is an exciting time for any grandparent; and, there is no time like the present to begin saving if you plan to help pay for their higher education. According to the U.S. Bureau of Labor Statistics, college tuition experienced an average inflation rate of 5.2% per year between 2000 and 2018. With skyrocketing costs, the goal of helping send children to college is becoming an entire family affair. According to a 2014 survey by Fidelity, 53% of grandparents are currently saving, or are planning to save, to help pay for their grandchildren's college education. In addition, 72% feel an obligation to help fund their grandchildren's education. The grandkids may not appreciate this gift today as much as the newest video game, but it will be very meaningful to them in the long run and may very well benefit the grandparents and their estate planning. With that in mind, below are some potential benefits and challenges associated with grandparents contributing to their grandchildren's education.

Benefits

1. Grandparents Retain Control of the Assets

   The 529 account owner (grandparents) will maintain control of the assets until it's time for college. This will ensure the money is used for the intended purpose (education). In addition, the grandparents can make contributions to the parent's 529 accounts (for the benefit of their grandchildren), where the parent will maintain control of the assets. Grandparents should be sure to name their children as successor owners on any 529 accounts they open to avoid additional legal headaches in the event of their death.

2. Direct Payment to the College/University

   Is your grandchild already in college, or about to begin college? If so, grandparents can make direct tuition payments to the institution without the payment being considered a gift. This can be a great way to help pay for your grandchildren's education if you did not set up a 529 account for them when they were younger. The direct deposit will reduce potential estate tax exposure and may help to ease the burden on parents who are paying for their children's education. However, some colleges may reduce your grandchild's eligibility for need-based aid if this strategy is utilized. We will discuss this challenge in more depth later.

3. Reducing Potential Estate Tax Exposure

   In 2018, a grandparent can make gifts of up to $15,000 to each grandchild without having to account for the gift on their tax return. A great receptacle for this gift is a 529 plan. Another option involves frontloading up to $75,000/beneficiary into a 529 plan without generating a taxable gift; this would necessitate the filing of Form 709 with your tax return. Each grandparent could make this contribution bringing the total to $150,000. If a grandparent frontloads the contribution they are not allowed to make any additional gifts to that beneficiary for the next five years. These gift amounts can significantly decrease your taxable estate.

4. <u>Deducting Contributions on Grandparent's State Income Tax Returns</u>

   Some states will offer tax breaks for residents who contribute to their home state's plan. For example, Ohio recently raised their state tax deduction on contributions from $2,000/year to $4,000/year per beneficiary. Other states also provide tax deductions in varying amounts for contributions to their plan, while some states provide a tax deduction for contributions to any state's 529 plan. These deductions can be used to offset income resulting from required minimum distributions.

   In addition to the benefits listed above, please reference this article we published earlier this year related to additional information on 529 Saving Plans:

   http://www.jdovich.com/wp-content/uploads/2018/02/New-Opportunities-for-529-College-Savings-Plans.pdf

<u>Challenges</u>

1. <u>Impact on Needs-Based Financial Aid</u>

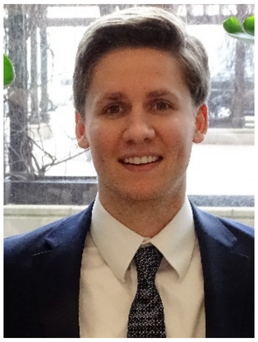
   If a 529 Savings Plan is owned by a grandparent, it is not reported on the Free Application for Federal Student Aid (FAFSA Form). This results in distributions counting towards untaxed income for the beneficiary. The distributions can reduce your grandchild's eligibility for need-based aid by as much as half (50%) of the amount of the distribution, while a parent making distributions will only reduce eligibility for need based aid by 5.64% of the asset value.

   Let's walk through an example:

   $5,000 in a 529 plan owned by a grandparent and a subsequent distribution of the same amount will reduce aid eligibility by up to $2,500 dollars. Compare that to a $5,000 distribution from a parent-owned 529 plan that will only reduce aid by up to $282 dollars.

   There are a few different workarounds for grandparent-owned 529 plans to resolve the issue highlighted above. We mentioned previously direct payments to the college or university; another option involves the grandparent changing the account owner to the parent (if the 529 plan allows them to) or making the gift directly to the parents instead of the grandchild. However, in this event, this may result in your state recapturing previously taken state income tax deductions.

With the large increases in higher education expenses, families may need to work together to help pay for college. In addition to contributing to a 529 plan, there are other more sophisticated ways to fund education through trusts, which we did not touch upon in this article. If you are interested in either of these options, we would be happy to discuss and create a plan that will provide a benefit to your grandchildren's education, as well as your own financial plan.



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Gifting Grandparents Study – A Holiday Tale:

https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Fidelity-529-Holiday-Gifting-eBook.pdf

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