HOW GRANDPARENTS CAN HELP GRANDCHILDREN WITH COLLEGE

Information on ways to help your grandchild with college tuition.
As the cost of a college education continues to climb, many grandparents are stepping in to help. This trend is expected to accelerate as Baby Boomers, many of whom went to college, become grandparents and start gifting what’s predicted to be trillions of dollars over the coming decades.

Helping to pay for a grandchild’s college education can bring great personal satisfaction and a beneficial way for grandparents to pass on wealth. So what are some ways to accomplish this goal?

**Outright cash gifts**

A common way for grandparents to help grandchildren with college costs is to make an outright gift of cash or securities. But this method has a couple of drawbacks. A gift of more than the annual federal gift tax exclusion amount, $15,000 for individual gifts and $30,000 for gifts made by a married couple, might have gift tax and generation-skipping transfer (GST) tax consequences. (GST tax is an additional gift tax imposed on gifts made to someone who is more than one generation below you.) A drawback is that a cash gift to a student will be considered untaxed income by the federal government’s aid application, the FAFSA, and may impact the student’s financial aid eligibility.

Grandparents can give the cash gift to the parent instead of the grandchild, because gifts to parents do not need to be reported as income on the FAFSA. Another solution is to wait until your grandchild graduates college and then give a cash gift that can be used to pay off school loans.
Pay tuition directly to the college

Under federal law, tuition payments made directly to a college aren’t considered taxable gifts, no matter how large the payment. So grandparents don’t have to worry about the annual federal gift tax exclusion. But payments can only be made for tuition; room, and board, books, fees, equipment, and other similar expenses don’t qualify. Paying tuition directly to the school helps to ensure your money will be used for the educational purpose you intended. A grandparent can still give a grandchild a separate tax-free gift each year up to the $15,000 limit ($30,000 for joint gifts).

A college may often reduce a student’s institutional financial aid by the amount of the grandparent’s payment. So before sending a check, ask the college how it will affect your grandchild’s eligibility for college-based aid.

529 plans

A 529 plan can be another option for grandparents to contribute to a grandchild’s college education. Contributions to a 529 plan grow tax deferred, and withdrawals used for the beneficiary’s qualified education expenses are completely tax free at the federal level (and generally at the state level, too).

There are two types of 529 plans: college savings plans and prepaid tuition plans. College savings plans are individual investment-type accounts offered by nearly all states and managed by financial institutions. Funds can be used at any accredited college in the United States or abroad. Prepaid tuition plans allow prepayment of tuition at today’s prices for the limited group of colleges, typically in-state public colleges, that participate in the plan.

Grandparents can open a 529 account and name a grandchild as beneficiary (only one person can be listed as account owner, though) or they can contribute to an already existing 529 account. Grandparents can contribute a lump sum, with certain restrictions, to a grandchild’s 529 account, or they can contribute smaller amounts regularly.

If grandparents want to open a 529 account for their grandchild, there are a few things to keep in mind. If you need to withdraw the money in the 529 account for something other than your grandchild’s college expenses, for example, for personal medical expenses or emergency purposes, there is a double consequence: the earnings portion of the withdrawal is subject to a 10 percent penalty and will be taxed at your ordinary income tax rate. Also, funds in a grandparent-owned 529 account may still be factored in when determining Medicaid eligibility, unless these funds are specifically exempt by state law.
Colleges treat 529 plans differently for purposes of distributing their own financial aid. Generally, parent-owned and grandparent-owned 529 accounts are treated equally because colleges simply require a student to list all 529 plans for which he or she is the named beneficiary.

An additional consideration is that any withdrawals from a grandparent-owned 529 plan will count as income to the student when filing for financial aid. However, if the 529 plan account is used in the final year of college, the income rule would not generally apply.

**Private elementary/secondary school**

If you’re interested in contributing to your grandchild’s private elementary or secondary school education, you have two options. First, you may withdrawal up to $10,000 annually per beneficiary. Example: Parents and grandparents both have a 529 plan for the same beneficiary. They could not both take out $10,000 for the same beneficiary, but $5,000 from each would be fine.

The second option is a Coverdell education savings account (ESA). You can contribute up to $2,000 per beneficiary each year to a Coverdell ESA. Like funds in a 529 plan, money in a Coverdell ESA grows tax deferred and is tax-free at the federal and state level if used to pay the beneficiary’s qualified education expenses, which includes college along with private elementary and secondary school. However, there are income limits on who can contribute to a Coverdell ESA; married couples with a modified adjusted gross income over $220,000 ($110,000 for individuals) can’t contribute.