529 Plans – Great for Grandma & Grandpa

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Education is not preparation for life; education is life itself. - John Dewey

Education is perhaps the greatest gift one generation can give to another. Aside from the education itself there are additional benefits provided when a grandparent helps fund a grandchild's education. It is a way to relieve the parents of some of the stress of paying for a child's education and for the older generation to instill the value of education on the younger generation.

A 529 plan is a tax-advantaged savings plan designed to encourage saving for higher education. These "qualified tuition plans," are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code.[1]

Grandparents can enroll in a 529 Plan directly with a program provider or through a financial advisor. Once enrolled the grandparents can make gifts to the plan, allowing the funds to grow tax free until needed for educational expenses. The tax free growth makes it advantageous to start these accounts as early as possible. Accounts can be opened for a beneficiary as soon as they have a social security number.

529 Plans provide many advantages for grandparents. As owner of the account they retain control of the assets, making all the investment and distribution decisions. Additionally, if needed the funds can be withdrawn in case of an emergency. The earnings would be subject to income tax and a 10% penalty for non-qualified withdrawals. There are estate planning benefits as well, once assets are placed inside the plan they are no longer considered part of the account owner's estate.

Here are the answers to some common questions:

How much can be contributed per year?

- Contributions of $14,000 ($28,000 for joint gifts) a year or less qualifies for the annual federal gift tax exclusion. [2]
- Under special rules unique to 529 plans, you can gift a lump sum of up to $70,000 ($140,000 for joint gifts) and avoid federal gift tax, provided you make an election to spread the gift evenly over five years.[2]

Are 529 Plan contributions tax deductible?

- There is no Federal deduction offered but some states do offer a tax deduction for contributions to the state sponsored 529 college savings plan. In New York State for instance, up to $10,000 is deductible annually from taxable income for married couples filing jointly ($5,000 for single taxpayers). Unfortunately, high income tax states such as New Jersey and California are not among the states offering tax benefits.

What is considered an eligible educational institution?

- Generally, any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.[2]

What is considered an eligible education expense (qualified withdrawal)?

- A 529 account can be used only to pay for expenses that are required by the college or other post-secondary training institutions. These expenses include: tuition and fees, allowance for room and board, textbooks, supplies, computers and related equipment.

What happens if the child receives a Scholarship?

- Three options are available for this scenario:
    a. The child can use the 529 funds for some future education expense such as graduate school. [3]
    b. The account can be directed to another family member, such as a sibling or cousin. The account could even be transferred to yourself, your child or the beneficiary's child.[3]
    c. Withdraw the extra funds up to the amount of the scholarship. The earnings will be subject to income tax but the 10% penalty is waived.[3]

What is the impact on Financial Aid?

- Owning a 529 account for your grandchild will not affect your grandchild's eligibility for need-based financial aid, but taking distributions could have a negative impact in the subsequent year. The value of assets owned by a grandparent is not reportable on the FAFSA financial aid application. In comparison, parental assets are reported on the FAFSA form and reduce aid by 5.64% of the assets value. Distributions from a 529 plan owned by grandparents are reportable on the following year's FAFSA as student income and reduce aid by 50% of the income amount. The financial aid formula counts student income just as it counts student assets (although the assessment percentages and allowances are different).[4]

- One strategy to maximize the impact of the grandparent owned 529 account is to only pay for the final year of college, then the income rule would not matter since the student would not be applying for financial aid for the following year.

The 529 Plan is a great tool for education funding but it should be used in coordination with your financial and estate plan. You should also take steps to make sure you use the plans correctly to avoid withdrawal mistakes. Talk to your Massey Quick advisor to see if this is the right tool for you.

1. https://www.sec.gov/investor/pubs/intro529.htm
2. https://www.irs.gov/uac/529-plans-questions-and-answers
3. http://www.savingforcollege.com
4. https://studentaid.ed.gov/sa/fafsa/estimate

Disclaimer

It is important to note that earnings on a distribution not used for qualified expenses may be subject to income taxes and a 10% federal penalty. The availability of tax or other benefits may be conditioned on meeting certain requirements such as residency, purpose for or timing of distributions or other factors as applicable.

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