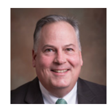
529 Plans and More: Smart Strategies to Help Pay for Your Grandchild's College Education

Grandparents can select savings strategies and tools to make their gifts go further.



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KEY INSIGHTS

- One way grandparents can leave a legacy is by supporting their grandchildren's educational aspirations.
- The 529 college savings plans may offer particular advantages for grandparents. These accounts are typically invested in a diversified portfolio with potential tax-advantaged growth.
- When it comes to supporting your grandchildren's college plans, you have many options. The right choice for you likely depends on your financial situation.

As a grandparent, you may feel it's important to leave a legacy of shared values, hopes, and wisdom for future generations. One way you can achieve these goals is to support your grandchildren's educational aspirations. This support can offer benefits that are both practical (the cost of higher education is substantial) and emotional (you can contribute to your family's future success). "Contributing to a grandchild's college education can benefit the whole family," says Roger Young, CFP®, thought leadership director with T. Rowe Price. "Grandparents gain satisfaction from seeing their hard work benefit future generations, while parents and the students themselves get some relief from the burden of paying for college."

One option that may offer particular advantages for grandparents is a 529 college savings plan. These accounts are typically invested in a diversified portfolio with potential tax-advantaged growth. "Recent legislative changes have made 529s an even better tool for many grandparents," says Young. "If you have the means to support a grandchild's education, these accounts are well worth considering."

Factors to consider when saving for college

It's important to integrate college savings plans into your broader financial plans, including your estate planning needs.

When it comes to saving for college, you have several options available to you. These options include funding a 529 college savings plan, putting money into a custodial UGMA/UTMA,[1] or opening

[1] UGMA/UTMA named for the Uniform Gifts to Minors and Uniform Transfers to Minors Acts

a taxable savings or brokerage account earmarked for funding education, among others. To determine which college savings strategy could best fit your goals, consider how each is structured. For instance, you might think about factors including:

- **Control and ownership of assets.** Do you prefer to maintain control and ownership of the assets you're dedicating to your grandchild's education? Or would you prefer to contribute to an account that their parents have already set up?
- **Growth potential.** Have you considered savings or investment vehicles that could potentially grow the assets for college over time?
- **Tax efficiency.** How important is tax-free growth to you? Some account types offer the potential for tax-free growth. In addition, the state where you live may offer a state income tax deduction when you invest in its college savings plan.
- **Flexibility.** How important is the ability to redirect these assets if your grandchild's college aspirations or needs (or your own situation, for that matter) shift down the road?
- **Impact on financial aid.** Will need-based financial aid be part of your grandchild's college funding plan? Different vehicles have different effects on financial aid.
- **Time horizon.** How many years do you have to save before your grandchild enters college?

Approaches to saving for a grandchild's college education

After considering your preferences, think about how you'll fund this goal. Your options include:

- **Regular monthly contributions.** If you set up automatic contributions, this approach can streamline the process and enable you to save money gradually and consistently. In addition, continuing to invest through all types of markets can help you buy more shares when prices are low and fewer shares when prices are high—potentially maximizing the value of the account over time.
- **Annual contributions.** Consider making contributions on birthdays, holidays, or other special occasions.
- **Reinvesting your required minimum distributions (RMDs) from your retirement plan(s).** If you don't need your RMDs to support your current cash flow or future expenses, you could invest them into a fund for college expenses.
- **Large gifts (subject to limitations).** When you contribute to your grandchild's college savings account, the contributions are (with some exceptions) removed from your taxable estate and considered a gift to the grandchild. Consider the following approaches:
  - Each grandparent could use their $17,000 gift maximum (per recipient, per year) to gift money to their grandchildren under the gift tax exclusion. Any contributions beyond this amount will be counted toward the $12.92 million lifetime gift tax exclusion.
  - With five-year averaging, in a 529 plan you can frontload contributions to the plan without exceeding the annual gift tax exclusion. Grandparents can choose to make a one-time deposit of up to $85,000 (or $170,000 if you are a married couple filing jointly), per child, without incurring gift taxes. (In this case, the $17,000 gift maximum per year is considered to be spread out over a five-year period.)

The right choice for you likely depends on your financial situation. Be sure to make decisions about saving for a grandchild's education in the context of your other financial goals.

Ways to help pay for college

Grandparents have many vehicles available to save for college, including:

Accounts specifically for the benefit of the children:

- Funding a 529 college savings plan (either in your name or your grandchildren's parents' name)
- Putting money into a custodial UGMA/UTMA account for your grandchild

Additional ways to fund education:

- Opening a taxable savings or brokerage account earmarked for funding their education
- Paying tuition and fees directly
- Paying off student loans, which would include the borrowed amount plus interest, after graduation

Both 529 plans and UGMA/UTMA accounts offer some degree of control for grandparents. Here's how these accounts differ in several important ways.

529 college savings plans

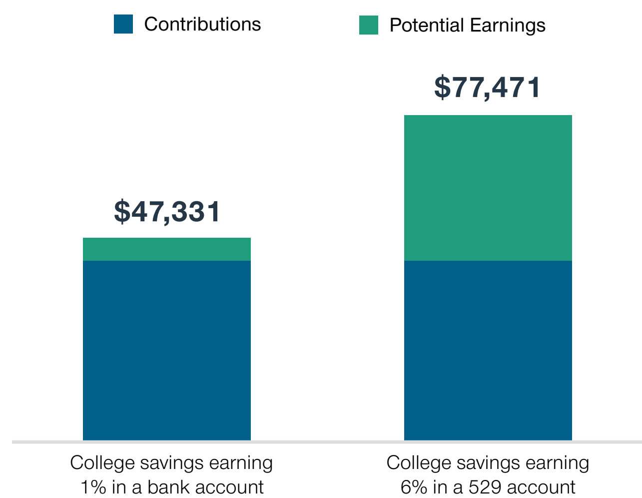
529 plans are flexible savings vehicles that are typically invested in diverse portfolios, often based on the beneficiary's projected college attendance date. They have the potential for significant tax advantages and may provide greater growth potential than regular savings accounts. (See "529 Plans Offer the Potential for Higher Returns.") Some 529 plans also offer cash incentive programs that can help boost your savings on behalf of your grandchild.

With a 529, grandparents have the option of opening their own accounts or contributing to an account that the parents have already established. When you are the account owner, you maintain control of the assets for the life of the account and can ensure that the money will be used for its intended education-related purpose.

Assets in a 529 account, including any growth over time, can be withdrawn

529 Plans Offer the Potential for Higher Returns

If you consider saving $200 per month in a bank account versus investing that same amount in a 529 plan over the course of 18 years, it could mean over $30,000 more in funds for education.*



Assuming approximate earnings of 1% interest in a bank account versus 6% earnings with a tax-deferred investment account, like a 529 plan. This representation demonstrates the difference between hypothetical rate of returns in a bank account and a 529 college savings plan account, compounded monthly, but not between any two specific products. This example doesn't represent the return on any particular investment, and these rates are not guaranteed.

*Unlike a traditional bank account that offers Federal Deposit Insurance Corporation (FDIC) protection, investments in 529 plans are generally not guaranteed, and you could lose money, including your principal, by investing in them. There may be other material differences between savings accounts and 529 college savings plan accounts that should be considered prior to investing.

tax-free for a range of education-related expenses, including tuition and room and board, among others, at eligible schools across the U.S. and internationally. These funds can also be used for trade school or apprenticeships. You can even take distributions of up to $10,000 per beneficiary each year for K–12 tuition at private, public, and religious schools.[2]

Additionally, starting in the 2024–2025 school year, distributions from a grandparent-owned 529 account will no longer count as income to the student on the Free Application for Federal Student Aid (FAFSA®).

If something changes, you can access the money; however, there may be taxes and penalties.[3]

UGMA/UTMA accounts

These custodial accounts allow you to give money to a grandchild and maintain control over how those assets are invested and spent until the child reaches the age of majority—typically 18 or 21, depending on the state where your grandchild lives. Gifts to an UGMA/UTMA are irrevocable, and the funds in the account must be spent to benefit the child.

When the custodianship terminates, the assets must be turned over to the named beneficiary, who can then use the funds as they see fit. Withdrawals, along with investment income and capital gains, from an UGMA/UTMA above a certain level are taxed at either the child's or the parent's rate. In addition, student assets in an UGMA/UTMA are likely to reduce eligibility for need-based financial aid.

Three key recommendations for grandparents

After deciding to support your grandchild's college education, you'll want to be sure to make the most of your money. The following strategies may help:

1. **Start early.** Setting money aside when your grandchildren are young provides time for those assets to benefit from tax-advantaged potential growth. Using an investment account, such as a 529 account, rather than a savings account may provide more growth potential over the long run—an important factor, given that T. Rowe Price recommends saving enough to cover 50% of the published cost of college.
2. **Be tax savvy.** Any growth in a 529 account is tax-free for qualified withdrawals. Unlike a Roth IRA, 529 accounts do not have income restrictions or annual limits for contributions. In addition, many states let you deduct some of your 529 contributions when calculating your state tax bill.
3. **Stay flexible.** If your original beneficiary decides not to pursue higher education or receives substantial college scholarships, you can easily transfer the assets in their 529 account to another family member without penalty. What's more, if your own retirement plans need shoring up, you can pull back some or all of the 529 assets as long as you remain the account's owner. Note that taxes and penalties will apply.

When it comes to supporting your grandchildren's college plans, you have many options. "Take time to consider which strategy best supports the goals you wish to achieve for your family and yourself," says Young. "Regardless of which approach you choose, you'll be providing a gift that will last a lifetime."

[2] While distributions from 529 college savings plans for elementary or secondary education tuition expenses are federally tax-free, state tax treatment will vary and could include state income taxes assessed, the recapture of previously deducted amounts from state taxes, and/or state-level penalties. You should consult with a tax or legal professional for additional information.
[3] When using 529 funds for nonqualified expenses, you would face a withdrawal penalty of 10% on any earnings as well as income taxes.

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