Ways to Help Your Grandchildren
PAY FOR COLLEGE

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The annual cost of attending many of the most selective colleges and universities in the U.S. is well over $60,000 per year and tuition prices continue to increase faster than the overall inflation rate and the average family income. At a time when it has never been more important to your grandchildren's economic future to continue their education beyond high school, for many families it has never been so challenging to find the resources to pay for it. If you are fortunate enough to have investments or income which are not needed to meet your financial needs, consider the following ways you might be able to assist your grandchildren with college costs and maybe even help them to become more financially savvy along the way.

#1 529 College Savings Plan

A 529 college savings plan is a tax advantaged savings program which usually uses mutual funds as the primary investment vehicle. Contributions to 529 plans grow tax-deferred and earnings will be tax free when withdrawn if the money is used to pay for the beneficiary's qualified education expenses which include tuition, room and board and books and educational supplies. Grandparents can gift up to $14,000 annually ($28,000 for married couples) to each grandchild's 529. Many wealthy grandparents take advantage of the 5 year acceleration rule which allows 5 years' worth of annual gifts to be made in one year. For a married couple that means up to $140,000 could be transferred to a 529 plan for their newborn grandchild with the potential for 20 years of tax free growth!

In most cases we recommend the grandparents name themselves as the owner of the account with the grandchild as beneficiary. If Johnny or Suzie ends up getting a full academic or athletic scholarship and, therefore, don't need to use the 529, you can change the beneficiary to another grandchild. In some cases, we set up a single 529 plan for a family with many children who intend to go to college. The goal being to change the beneficiary to the younger children if the older children no longer need it; this would maximize and extend the tax-free growth potential.

I encourage clients to bring their grandchildren into our office for a meeting to review their 529 plan when they reach about age 10. It can be a valuable experience for the grandchild to learn about the magical power of compound interest and learn a little bit about what factors determine the value of the investment their grandparent has set aside to pay for their college education.

#2 Coverdell Educational Savings Accounts

Like money invested in 529 plans, Coverdell education savings accounts grow tax deferred. Withdrawals are not taxed as long as the money is used for qualified educational expenses. Coverdells typically allow for more investment choices but have a much lower maximum annual contribution of $2,000 per year. To be eligible to contribute you must have a modified adjusted gross income of $110,000 if you are single or $220,000 if you are married and filing jointly.

Most Coverdell account agreements require that the child's parent or guardian be named as the individual responsible for the account. One primary advantage of a Coverdell is that gains are tax free if used to pay for qualified K-12 educational expenses like private boarding schools/prep schools. Therefore, some financial advisers recommend the first $2,000 annually be invested in the Coverdell with any remaining amounts allocated to the 529 plan.

#3 Roth IRA

You can contribute up to $5500 if you are under 50, and $6500 if over. Contributions to Roth IRA's are tax free when withdrawn if held in the account for more than 5 years. Gains are tax free if withdrawn after 59 ½ and generally taxable and subject to an early withdrawal penalty before 59 ½ . There are a couple of creative ways we have had clients use Roth IRA's for their grandchildren:

A few years back I met with a client and her 15 year old granddaughter who had just started a summer job earning $5,000. She wanted to help her granddaughter pay for college but also provide her with money to be used for her first home, and in general connect with her in a powerful way on the value of saving money. She set up a custodial Roth IRA for her and agreed to match her granddaughter's contributions to the plan on a two-for-one basis. The granddaughter agreed to contribute $1500 so her contribution was matched by her grandmother with $3,000. When it came time for college, some of the contributions were available to help with tuition and when the granddaughter purchases her first home some of the gains will be withdrawn tax free for the down payment.

#4 Pay tuition directly to the college or university

Paying tuition directly to the institution can be an effective strategy for a wealthy grandparent who has a grandchild who is not eligible for financial aid. If the grandparent's estate is large enough to be concerned about state and federal estate taxes, a payment made directly to the college is not considered a taxable gift and it effectively reduces the value of the estate and provides a valuable benefit to both the grandchild and his/her parents.

I have had some grandparents structure their gifts like merit scholarships with the annual gift amount determined by the grade point average (GPA) of the grandchild. The better the GPA, the larger the gift and, in some cases, no gift if the GPA was below a 2.0. Done correctly this can be a powerful and sometimes even painful way for your grandchild to learn the proper balance between fun and academics in college!

#5 Pay student loans after college

For a grandchild who is eligible for subsidized low interest student loans, a grandparent could surprise them at graduation with a pledge to pay all or some of the monthly payments on the student loans. There are no gift tax consequences if the annual amount is less than $14,000 for a single grandparent or $28,000 for a married couple.

These are some of the most popular and effective ways we have used with our clients to help them pay for their grandchildren's college education. Many times the most critical first step is to have a conversation with the parents to get a sense of how financial aid will affect their share of the cost of college, if at all, and to discover what funds they have set aside for college, if any. In my experience, families don't talk about money nearly enough and any opportunity for a grandparent to connect with their children and grandchildren to discuss both the value of education and how to pay for it should be made a family priority. I have had meetings attended by our client, her daughter, and middle school aged granddaughter, to discuss how the family will pay for the granddaughter's education. Family meetings to discuss major financial purchases like college education can have a lasting impact on a grandchild who dreams of getting a great education and using it to make the world a better place for her and her family. Consider investing in your grandchild's education, there are few investments which offer the potential for such great returns for your family.

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Prior to investing in a 529 Plan investors should consider whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary. Non-qualified withdrawals may result in federal income tax and a 10% federal tax penalty on earnings. Please consult with your tax advisor before investing.

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