Grandparent-Owned 529 College Plans

The Key to Maximizing Financial Aid

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" AN INVESTMENT IN KNOWLEDGE PAYS THE BEST INTEREST."
— Benjamin Franklin

MANY GRANDPARENTS CHOOSE to contribute to their grandchildren's future by helping pay for their college education. Helping them earn a degree without piling up mounds of burdensome college debt will deliver long-term benefits. It's a gift sure to be greatly appreciated, by both the students and their parents.

Today's most popular way to provide college funds is through a state-sponsored 529 plan. Plan earnings grow tax-free, and in most states contributions receive favorable tax treatment. But the grandparent's gift in the form of a 529 plan can wind up costing their grandchild and their child by leaving them less qualified for federal student aid. To ensure the best outcome for good intentions, grandparents need to plan how and when the 529 funds will be used.

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Applications for federal aid under the Free Application for Federal Student Aid (FAFSA) program are considered on the basis of assets and income. As such, a 529 plan owned by the student's custodial parent or parents — is considered an asset and can reduce the need-based aid by up to 5.64 percent. For example, a $20,000 529 plan in the parent's name could reduce the student's (grandchild) federal aid by as much as $1,128. If the 529 plan is in the name of the grandparent, it doesn't show up as an asset on the student's application.

Generally speaking, putting money in a 529 plan in the name of a grandparent sounds like a good idea in regard to the asset-based test of the FAFSA form. However, taking the money out most efficiently, that is, avoiding the income test on the FAFSA form, is another matter that requires some strategic planning.

Some options for distributing grandparent-owned 529 plan contributions and earnings efficiently include:

If the 529 plan is in the name of the grandparent, it doesn't show up as an asset on the student's application.

OPTION 1

Once the student starts using the grandparent-owned 529 funds, the money becomes income and the student's federal aid can be reduced by up to 50 percent of that income. However, FAFSA looks back to the previous two years to make their calculations, so if the student waits to use the funds until their final two years in college, they will not be penalized by any of that income. Keeping the plan funds in the grandparent's name also allows them to maintain control over those funds, improving the odds they will be used as intended.

OPTION 2

The grandparent can transfer ownership of their 529 plan to their child, the student's parent. It will count as an asset on the federal aid application but not as income to the student, avoiding the trap above.

OPTION 3

Rollover one year's worth of funds each year to a parent-owned 529 plan. If the funds are rolled over after the FAFSA application date and they are spent during that year, they won't show up as either an asset or student income the following year.

OPTION 4

The Setting Every Community Up for Retirement Enhancement (SECURE) Act also provides a new benefit for distributions made after December 31, 2018. This new act allows 529 plan owners to make a tax-free distribution towards a qualified education loan that will be considered a qualified 529 plan expense. A few drawbacks of this option include an aggregate lifetime limit of $10,000 in qualified student loan repayments per 529 plan beneficiary and $10,000 per each of the beneficiaries siblings. Another drawback of this method is that the portion of the student loan interest that has been paid with the 529 distribution is not eligible for the student loan interest deduction.

As all 529 plans are state-sponsored, each state designs its own plan structure and sets its own rules. As well, colleges have their own guidelines to qualify for aid. As such, financial aid qualification differ from college to college and 529 plan distributions will be governed by many and disparate rules, which makes meeting with your financial advisor a must to ensure the most efficient distribution of those funds.

We're here to help. For more information on 529s or with any of your college savings planning questions or concerns, contact me at zallegretti@HBKSwealth.com. Or schedule an appointment by calling 814-836-5776.

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Zach Allegretti is a financial advisor in the Erie, Pennsylvania, office of HBKS® Wealth Advisors. Zach comes to HBKS® with experience in both the insurance and financial advisory fields, having been employed with Nationwide and AXA Financial.

An honors graduate of The Behrend College of Penn State University, Zach earned his Bachelor of Science degree in finance prior to accepting his current position with HBKS®.