Passive
CAPITAL MANAGEMENT

The Grandparent-Owned 529
A Terrific Way to Implement Multi-Generational Gifting

This is a note to new Grandparents. The birth of a grandchild is a joyous occasion. It often spurs a discussion of how grandparents can help the new generation. State-administered 529 plans are a great tool to accomplish this goal: they facilitate tax-advantaged, flexible, FAFSA-friendly savings to help fund the college education of your new grandchild. State 529 programs have been available for nearly 30 years, and over this time, they have become more user friendly: fees are lower, investment options have improved, and technology has made it easier to fund, manage, monitor, and ultimately disperse funds. State 529s are now a tool every grandparent can use!

529s in a nutshell. Created by Section 529 of the Internal Revenue Code in 1996, a 529 plan is a state-sponsored investment program that allows tax advantages for savings earmarked for qualified higher education (which include tuitions, room/board and many other related expenses). A 529 account has an owner (who sets up and manages the account) and a beneficiary (whose educational expenses the account is meant to pay).

529s have triple tax benefits. The basic principle of the 529 is to encourage education savings by granting tax advantages to the savers. Most 529 accounts are triple-tax-advantaged, and these benefits can really add up. Over a 20-year horizon, a triple-tax-advantaged 529 plan can yield roughly 30% more dollars available at tuition time compared to a taxable account!

- **Deduction for contribution**. Most (not all) state sponsored 529 plans offer state tax deductions on 529 contributions to their state-sponsored plans. For instance, in Maryland, Individual 529 contributors can deduct up to $2,500 per beneficiary, and joint filers can deduct up to $5,000 per beneficiary (how many Grandchildren do you have?!). In New York, the deduction is limited to $5,000 per Individual filer and $10,000 for joint filers.
- **Tax free earnings/appreciation**. The biggest tax benefit of a 529 accounts is that there is no tax on account income or realized gains. This is especially helpful to higher-earning grandparents that might find themselves subject to the Net Investment Income Tax (NIIT).
- **No tax on withdrawal when used for qualified Educational Expenses.** Large eventual distributions from these accounts for tuition will not trigger lumpy income or capital gains recognition.

Flexible Beneficiaries. 529 account owners CAN change beneficiaries on accounts and/or transfer dollars to other 529 accounts. This makes them very flexible to adapt as your needs change. You can save into these accounts in flexible amounts as your situation changes. Perhaps one branch of your family needs more help than another, or maybe your scholar/athlete won't need all the dollars you've saved! Often grandparents let excess or re-allocated dollars waterfall down into the youngest grandchild's 529. We recommend grandparents own their own 529 accounts (rather than contributing to their child's 529 account for the benefit of the grandchild) since it preserves this usage flexibility for the grandparent/owner.

In addition to beneficiary flexibility, excess 529 funds (up to $35,000) can now roll into a Roth IRA for the same beneficiary. This new rule change (enacted in 2023) gives the accounts additional flexibility to use for a grandchild's benefit.

Now FAFSA friendly. The new simplified Free Application for Federal Student Aid (FAFSA) forms being implemented in 2024 have important changes for Grandparents.   Previously, distributions from a Grandparent -owned 529 plan were reported as income to the student, impacting subsequent-year financial aid qualification. The new rules remove this reporting, so that Grandparent-owned 529 plan contributions for qualified education spending are much more FAFSA friendly. (a note here, the Grandparent-owned 529 account is still incorporated into the CSS profile that is used by many Colleges/Universities for non-federal financial aid)

Keep it simple. In most cases, you don't need to "overthink" a 529 strategy. You don't need to start a 529 for your yet-to-be-born grandchild. You don't need to "superfund" a 529 account or create a "Dynasty 529". Just open one for each grandchild at their birth. Contribute whatever amount you can each year. Over 15-18 years, you can create a substantial pool of funds for your grandkids' education. #bestgrandparentsever!

Considerations. All of these summary points come with nuance and details. Each State 529 plan can be a little different in taxes, fees, investment options. Qualified expenses, while broad, still have limitations after which 529 distributions can be penalized, and there are nits and nuances surrounding things like beneficiary transfers and Roth rollovers. However, none of these things should preclude you from considering a Grandparent owned 529.

Call us to discuss. At PCM, we do not manage 529 accounts for our clients, and we do not assess a fee on these assets. But we can help you evaluate 529 plans, set up your 529 account, pick investment allocations, fund it (hopefully annually), and eventually use it to support one of the greatest gifts you can give your kids and grandkids … a jump-start on college education and life. At PCM, we think this is always a good investment!

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