

## HELPING GRANDCHILDREN PAY FOR COLLEGE

BY JOSEPH ORSOLINI

Funding your grandchildren's education is among the noblest of endeavors, for it provides those youngsters a considerable advantage as they enter adulthood and begin competing for their livelihood. At the same time, it can reduce your taxable estate—and if you plan wisely, you'll avoid paying any gift tax on your educational contributions.

Helping a grandchild pay for college involves more planning, however, than simply writing a check and handing it over to the parents or to the student. If not handled correctly, your gift may actually reduce the amount of financial aid for which the student is eligible, and it may result in gift-tax liability. Moreover, suddenly giving an 18-year old access to a large sum of money can cause more harm than good if the teenager isn't highly disciplined.

You can choose among three methods of funding a grandchild's education: contributing to state-sponsored 529 college savings plans, making tuition payments directly to a college or university or helping the student pay off loans after he or she graduates.

The method (or combination of methods) you choose depends on two considerations: your grandchild's age and your personal financial goals.

### Grandchild Under 18

If your grandchild is still in high school or younger, and you wish to make contributions toward his or her education now, then establishing a 529 savings plan may be the best option.

Money that you put in these plans grows tax-deferred and is income tax free if used for college. These plans also have special gifting rules that allow a grandparent to make contributions of \$11,000 per year or a single contribution of \$55,000, which represents five years' worth of gifts under the \$11,000 exclusion. This removes

that total amount (and any gain for that amount) from your estate immediately. As the owner of the account, you retain control over the funds, with the ability to withhold the money for certain reasons, change beneficiaries or even get your money back if you choose.

Under current financial aid guidelines, these funds wouldn't affect a student's ability to receive financial aid at most colleges. That may not be the case after 2004, when the U.S. Department of

### AVOID CUSTODIAL ACCOUNTS OR TRUSTS

Traditionally, the most common way to transfer money to grandchildren was to establish custodial accounts, also known as UTMA or UGMA accounts. The advantage to these accounts is that the income is taxed at the child's tax rate.

However, any income tax advantages may be wiped out if the child attends college. Custodial accounts are weighed heavily in student aid formulas, and they will reduce the student's financial aid eligibility.

An additional area of concern is that custodial accounts transfer control of the underlying assets when the child reaches the age of majority, which in many states is 18. If your grandson decides to use the money in his custodial college fund to buy a motorcycle and follow his favorite rock band across the country for a year, there's nothing you can do to stop him once he gets control of the funds.

Trust funds can present similar problems. You can maintain control over funds in the trust and limit the grandchild's access to the principal balance, but trust funds magnify the financial aid problem because colleges' aid formulas count the entire trust fund as the student's asset even though the student may only have access to the income stream from the trust.

Education reviews the financial aid guidelines. Proceed with caution if financial aid is a possibility, and discuss this option with the child's parents.

### Grandchild Attending College

If you'd rather not be limited by the gift tax rules, you can pay all or part of your grandchild's tuition directly to the school. Checks made payable to the college or university aren't subject to the gift tax rules, so you may exceed the established \$11,000 yearly exclusion.

Some schools may treat these payments as an outside resource and may reduce the student's financial aid eligibility accordingly, so ask to review the school's policy on receiving outside payments before you choose this option.

### Help Repay Student Loans

If your primary concern is to avoid hurting your grandchild's financial aid eligibility, you may have to wait until your grandchild is ready to repay student loans and help with those payments. In some cases, this strategy will maximize the student's financial aid eligibility. But you may be constrained by the \$11,000 gift tax limit, and you need to be confident that you'll live long enough to get the estate tax benefits of this strategy (reducing the value of your estate by the amount of the contribution).

With forethought and planning, it's possible to reduce your estate taxes while funding your grandchildren's education, without sacrificing control of your money or reducing their financial aid eligibility.

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