

# The Grandparent's Guide to Education Contributions



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Becoming a grandparent is exciting and provides unique perspectives as you participate in your children's and grandchildren's lives in new and different ways. Having endured the early years of parenthood yourself, you understand the challenges parents can face – from sleepless nights with a newborn to worries about the financial responsibilities of raising a child. However, in this phase of your life, you may be able to support your children in ways that you perhaps couldn't in the past – investing in the education of your grandchildren.

With education being such an important part of a child's future, many grandparents consider the gift of education – an investment in their grandchildren's future. Tuition costs are rising at an unprecedented rate, so financial support from grandparents to supplement or fully finance grandchildren's education, is most often welcomed by parents.

There are several ways you can contribute to a grandchild's education, and each has some financial considerations, including taxes, deductions and limits, that you may want to consider before choosing your preferred method.

## 529 College Savings Plan

A 529 plan is designed to encourage saving for future education costs. Traditionally it could only be used as a college account, recent reform allows for up to \$10,000 to be withdrawn on behalf of tuition for primary and secondary private education. After private education costs are completed, the 529 can then continue as a fund for the grandchild's college education.

In 34 states, grandparents can claim the state income tax deduction for 529 contributions. Rules vary by state whether one must own the account, or whether one can contribute to an already existing account to receive the deduction. There is no limit to the number of 529 accounts that can be opened for one beneficiary, so there is no concern if multiple relatives open and contribute to accounts.

If you need to withdraw the money within the account for something other than college expenses, you will face taxation at your ordinary income tax rate in addition to a 10 percent penalty on the earnings portion.

It's important to note that, in some states, funds in a grandparent-owned 529 may be factored in when determining Medicaid eligibility.

## Outright Gift

Grandparents often contribute to a grandchild's education with an outright gift of cash. As of 2018, a gift of less than \$15,000 per person (the annual federal tax exclusion amount), or \$30,000 for a couple, is tax-exempt.

While an outright gift may seem like the easiest way to help finance your grandchild's education, there are some details to consider. Any gift of more than \$15,000 may have gift tax and state generation-skipping transfer (GST) consequences. GST is an additional gift tax imposed on gifts made to someone who is more than one generation below you. It is intended to compensate for the estate taxes that are avoided from skipping the parent's generation.

Another consideration is that a cash gift will be considered untaxed income and may impact the student's financial aid eligibility. One way to avoid this is to give the cash gift after your grandchild graduates, at which time the money can be used to pay off student loans.

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## Direct Payment

Under federal law, tuition payments made directly to a college are not considered taxable gifts, no matter how large. This type of payment is a “qualified transfer,” meaning any amount paid on behalf of an individual for tuition or medical care is exempt from the federal gift tax exclusion limit.

Additionally, paying directly to the school ensures that the money will be used for the educational purposes you intended.

Something to remember with direct payment is, as with an outright gift, a college or private primary/secondary school may reduce a student’s financial aid by the amount of the grandparent’s payment.

Finally, only funds paid to institutions qualified as schools will be considered as tuition, so a direct payment to preschool may be tax-exempt, but daycare is not. And, if you decide to pay for your grandchild to attend camp, it is considered an outright gift, even if the camp is educational, making it subject to the \$15,000 limit.

## Coverdell Education Savings Account

Coverdell Education Savings Account (ESA), formerly known as an Education IRA, is designed for private primary and secondary schools. It is a federally-sponsored, tax-advantaged trust or custodial account set up to pay for qualified education expenses. Grandparents, parents, relatives, corporations and friends can all contribute to a Coverdell ESA.

While contributions are not tax deductible, amounts deposited grow tax-free until withdrawn. The annual contribution limit is \$2,000 per beneficiary, but because the income limit is \$110,000, it is not ideal for high-salary individuals.

Before making any contribution toward a grandchild’s education, it is important to consider how it will affect both you and your grandchild in the long run. However, no matter which method you choose, one thing is certain – your generous gift will have a positive and lasting impact long into the future.

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ATLANTA, GA  
770.226.5333

GREENSBORO, NC  
336.217.0151

MEMPHIS, TN  
901.761.7979

NASHVILLE, TN  
615.386.7302

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