THE WALL STREET JOURNAL.

http://online.wsj.com/articles/grandparents-can-make-early-529-gifts-1415048467

JOURNAL REPORTS | FAMILY FINANCE

The Way-Early '529' Gift

Grandparents Can Start a College-Savings Plan Before a Baby Is Born

PHOTO ILLUSTRATION BY JOHN WEBER

By **PETER S. GREEN**
November 3, 2014

So you just threw your daughter a big wedding. Now comes the not-so-obvious next step: setting up "529" plans for the future grandchildren.

If that seems like rushing things, think again. With the average four-year price of a private college nearing $165,000 and rising 3.7% a year, anxious families are looking at lots of strategies for helping future grandchildren get a college education. One strategy is to open a 529 college-savings plan and have it start growing years before the future student is even born.

After all, anyone can start a 529, which is funded with after-tax income; the fund's earnings and principal will be untaxed as long as the money goes to expenses that qualify as higher education. It makes particular sense for older parents with adult children to open a 529, as it helps get the savings ball rolling early. Moreover, if they later transfer ownership of the account to their grown children, both

JOURNAL REPORT

- Insights from The Experts
- Read more at WSJ.com/WealthReport

MORE IN INVESTING IN FUNDS & ETFS

- Yale Beats Harvard Again—in Market
- Investors Flee Active Stock Managers
- U.S.-Stock Funds Rise 2.7% in Month
- Tech Employees' Stock Mistake
- David Snowball Sounds Off on Funds

generations can benefit from some gift-tax exemptions.

Benefit Keeps on Giving

Jim Holtzman of Legend Financial Advisors in Pittsburgh explains: If a future grandparent starts a 529 whose beneficiary is the future parent, the grandparent can contribute tax-free up to $70,000—five years' worth of contributions at $14,000 a year—or up to $140,000 for two grandparents. When an infant arrives with his or her own Social Security number, the parents—or the grandparents who still own the account—can designate the newborn as the beneficiary. Such transfers will likely avoid taxes, though they will eat into the donor's lifetime gift allowance of $5.34 million.

In addition to increasing the amount of giving both sets of parents can do without owing gift tax, this can help wealthier grandparents reduce their estate below taxable level, particularly in states such as New York and Pennsylvania, where state estate-tax exemptions are far lower than the 2014 federal level, also $5.34 million.

Grandparents and parents can be tempted to maintain ownership of the account to help keep Junior on the straight and narrow. "The advantage of using a 529 is that the account-owner retains control, so when the kid graduates from high school, she's not going to buy a Harley," says Nancy Farmer, chief executive of the Tuition Plan Consortium, a group of 277 colleges in 39 states that lets parents (and grandparents) prepay tuition.

But if grandparents hang on to a 529 account, it can hurt a student's eligibility for aid. Distributions from a parent-owned or custodial 529 reduce federal financial aid by just over 5% of the distributed amount. But distributions from a grandparent-owned 529 can reduce eligibility by half the distributed amount, says Mark Kantrowitz, publisher of Edvisors.com, a website advising on funding college education.

And while grandparents' assets aren't considered in aid decisions by state schools, they do figure in some private-college aid grants, says Maura Griffin, a principal of Blue Spark Capital Advisors in New York.

Five Years Ahead?

When is the right time for prospective grandparents to act? Right now, says Cameron Casey, an estate-planning lawyer with Ropes & Gray in Boston. Waiting until a grandchild is born to start a 529 for them can mean years of lost earnings potential.

A 529 plan started with the maximum $14,000 initial gift, five years before a child is born, funded with $500 every month and earning interest at 3% compounded monthly, would yield $226,784 by the child's 18th birthday. The same plan started at birth would yield $167,336.

Of course, the future is unpredictable. If a future grandparent thinks he or she may not live to see a grandchild's birth, a will can provide for an executor or trustee to carry out 529 plans using assets in a revocable trust.

For grandparents concerned about what to do if the grandchild doesn't go to college or has sudden medical needs, a special trust might be a better vehicle, says Ms. Casey, as it will allow more flexibility. Using a 529's funds for something besides higher education will trigger a 10% penalty and make the earnings taxable.

If no grandchild ever arrives, it can be possible to reassign the account to a close relative without owing taxes or penalty.

Mr. Green is a writer in New York. He can be reached at reports@wsj.com.

Corrections & Amplifications

Law firm Ropes & Gray was misspelled as Ropes & Grey in an earlier version of this article. (Nov. 4, 2014)