What Grandparents Should Know About Paying for College

More grandparents are starting to give during their lifetime instead of waiting to pass down their assets, experts say.

By Farran Powell | Reporter Nov. 2, 2016, at 9:00 a.m.

Families that received money from extended family or friends reported being given an average of $5,899 for college costs, according to a 2016 Sallie Mae survey. (E+ COLLECTION/GETTY IMAGES)

A growing number of grandparents aren't just interested in saving in their retirement, but are using their finances to support family members – which in some cases includes paying for a grandchild's college expenses.

"Grandparents in particular want to start giving in their lifetime and not wait until passing their assets on down to their heirs," says Wendy Moyers, a financial advisor and the founder of Linden Oak Wealth Partners in Kensington, Maryland.

A recent study by Age Wave and Merrill Lynch reports that 62 percent of adults ages 50 or older are providing some form of financial support to a family member. That study also found that 60 percent of those surveyed say it's better to pay down some assets now rather than waiting until the end of life.

"Not everyone is in a position to help. We're lucky that I was an only child and that she's done a really good job on planning her retirement," says Sabina Novoa, a mother of two from San Francisco, who receives money from her mother to pay for her kids' educational expenses. "She's just helping to ease the pain."

Novoa receives $1,000 every month in her checking account from her mother in San Jose, California to pay for sending her 19-year-old daughter to the University of Arizona.

"I'd say it's about $50,000 that we're paying for her collegewise, so it does help because it brings down our cost down to about $38,000 a year," says Novoa, who adds that her mother wanted to help now instead of later to see the results firsthand.

[Learn about tools that give you a tailored estimate of what you'll pay for college.]

For grandparents in a position to help fund their grandchildren's college costs, here are a few financial considerations to review.

1. A grandparent can give up to $14,000 a year to a child or grandchild without paying gift tax. That's according to IRS guidelines on gift exclusions. Grandparents who are married and file jointly can give up to $28,000.

Receiving $12,000 a year as a gift for college costs, such as in the Novoa family, qualifies as exempt since it's under the $14,000 threshold.

But experts say a monetary gift to a student counts as untaxed income to the student, which can reduce aid eligibility on the Free Application for Federal Student Aid. The FAFSA is used by many schools to determine financial aid awards – especially need-based ones.

"A gift from the grandparent to the parent is not reported as income on the FAFSA," says Mark Kantrowitz, publisher and vice president of strategy at Cappex.com, a college and scholarship search website. "It's better for the grandparent to give gifts to the parents, not the grandchild – even if the ultimate intention is to help the grandchild pay for college."

[Read 10 ways parents should plan for college financially.]

2. Grandparents can make payments directly to the educational institution to avoid gift taxes. The IRS allows a person to make direct payments to a medical and educational institution without it being counted as a "gift."

"If the grandparent paid the school directly in terms of tuition, then the grandparent has more flexibility to give money to the child using the annual gift tax exclusion," says Moyers from Linden Oak Wealth Partners.

But some colleges may treat this as cash support and reduce the student's eligibility for need-based aid, experts say.

For this reason, Kantrowitz from Cappex.com says unless the student doesn't qualify for need-based aid, "There's no real benefit for the grandparent making a payment directly to the college as opposed to giving the money to the parent."

3. A tax-advantaged 529 account is one way for grandparents to save and pay for college. "One of the most efficient and flexible methods to save for the cost of higher education is through a 529 savings plan," says Ashley Bleckner, a financial planner at California-based RS Crum, Inc., a financial planning and investment management firm.

Experts say a 529 plan that isn't owned by the parent or the student doesn't count toward the estimated family contribution – the figure calculated from the FAFSA that determines a family's ability to pay.

[Learn what you need to know about FAFSA changes.]

But distributions from a grandparent-owned account count as income to a student, Moyers says.

"Distributions from a grandparent-owned plan may reduce eligibility for need-based financial aid by as much as half of the distribution amount, while a parent-owned 529 plan reduces aid eligibility by as much as 5.64 percent of the asset value," the Cappex.com publisher says.

Under this circumstance, some financial planners advise grandparents with 529 accounts to hold off on distributions until it no longer hurts the student's chances at financial aid.

With the new FAFSA rules that use a different base tax year for calculations, financial advisors say there's more flexibility in planning distributions.

"The new rules say they will go back and look at the tax return from two years previously, not one year previously. This is beneficial for grandparents who own a 529 because the distributions could potentially start when the child is preparing for their junior year of college," Moyers says.

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