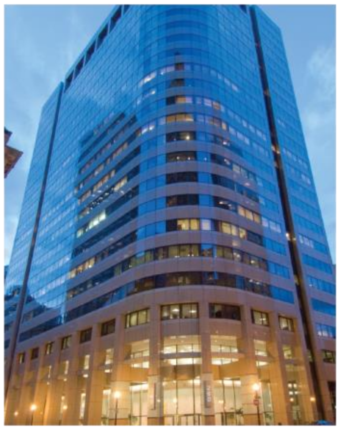
TFC FINANCIAL
The Financial Counselors

FINANCIAL PLANNING UPDATE
AUGUST 30, 2016

OUR VIEW



How Can Grandparents Help Reduce the Burden of Education Costs for their Grandchildren?

Within the traditional education system in this country, there are two key figures that have continued to increase over the past few generations: the absolute number of individuals receiving college or advanced degrees in the US and the cost of these degrees. The consequence of these two trends is that subsequent generations of students are graduating at a higher rate, but are doing so with higher and higher student loan debt. As PricewaterhouseCoopers reported this year in their Employee Wellness Survey, 11% of working Baby Boomers (ages 56–73 in 2016) reported still having outstanding student loans, compared to 26% of Generation Xers (ages 35–55) and a staggering 42% of Millennials (ages 21–34)[*].

For many people, living comfortably in retirement and not outliving their assets are their primary financial goals. For those fortunate enough to be able to think beyond sustainability, many want to help the next generations with their financial concerns and are looking for the best ways to do so. Helping to pay for education can be a rewarding choice for grandparents, their children and grandchildren.

A good place to start when deciding how to help is to think through the following questions:

- What is your timeline for gifting and how many years away from the education phase(s) are your grandchildren?
- Are you interested in gifting in a way that will be exclusively used for education?
- What phase(s) of education are you interested in funding? Primary/secondary school (pre-college) and/or post-secondary education (college and beyond)?
- Are you considering ways to reduce the size of your taxable estate either now or in the future?

11% of working Baby Boomers reported still having outstanding student loans in 2016, compared to 26% of Generation Xers, and a staggering 42% of Millennials[1].

Timeline Coordination

Depending on your financial needs and plans, you may be considering gifting now, sometime in the future, or both. The method by which you choose to give needs to align both with your timeline as well as be considered alongside the number of years before tuition payments will start for your grandchildren.

If your grandchildren are still many years away from the start of tuition, you have the advantage of time, where your gift can be invested in a savings vehicle and potentially grow in size. (How to choose between the different options will be addressed in the next section.)

If the time before tuition payments is short (within a few years), the benefits of growth in a savings vehicle may be reduced or eliminated when the costs of using these types of accounts are incorporated. If this is the case, consider making tuition payments directly to the institution. By paying directly to the institution, your payments fall under the IRS exclusion from federal gift taxes. Under this strategy, your gift will not be subject to gift taxes and the size of your gift is unrestricted.

[*] https://www.pwc.com/us/en/private-company-services/publications/assets/pwc-2016-employee-wellness-survey.pdf

Finally, if the student has completed their education, but has outstanding student loans, you can gift to them up to $14,000 per year as an individual (or $28,000 per year from a couple who is married and filing a joint tax return*) without any federal gift tax implications. If you choose to exceed these limits in a given year, you'll need to file a gift tax return. Over the course of your lifetime, you can gift up to $5,450,000 (in 2016) over the annual limit before you have to pay a gift tax. Also, you can consider becoming an authorized payer on your grandchild's student loans through their servicer to make payments directly.

Choosing a Savings Vehicle

If your timeline and goals allow you to take advantage of growth in a savings vehicle, the next important question to answer need to address the purpose of your gifts. There are savings vehicles available that are exclusively for education purposes (such as Section 529 Plans and Coverdell Education Savings Accounts (ESA)) and others that do not restrict how the funds are used by the student (such as Uniform Gift to Minors Act (UGMA) and Uniform Transfer to Minors Act (UTMA) custodial accounts, or other trust accounts set up for the benefit of a minor). The type of school you are interested in funding (meaning primary/secondary school (pre-college) and/or post-secondary education (college and beyond) also impacts your choices.

By paying tuition directly to the institution, your gifts are exempt from federal gift taxes.

The vehicle that has become most widely used for college and graduate school education savings is the Section 529 plan. These accounts have a variety of advantages including favorable tax treatment, ease of availability and use, and flexibility with investment and beneficiary options. Contributions to these plans will grow tax-free if they are used for qualified educational purposes and can be used to pay for tuition and other costs (including fees, books, supplies, and equipment needed, such as a computer). The contribution limits per year mirror the annual gift tax exclusion amounts ($14,000 or $28,000 in 2016), but these accounts also offer a front-loading option. You can contribute up to 5 years' worth of contributions ($70,000 or $140,000), assuming no subsequent contributions are made during that timeframe. A restriction on these accounts, however, is that they cannot be used to fund primary or secondary education (pre-college).

One option for specifically funding pre-college tuition costs is a Coverdell Education Savings Account (ESA) but these have some drawbacks. ESA's offer the same tax-free withdrawal advantages, but impose income restrictions on those interested in funding these accounts. If your income level is too high (see the IRS limits†), then you cannot contribute to an ESA. Additionally, the maximum you can contribute each year is $2,000. Paying school tuition directly to the institution may be the best option if you are interested in helping with pre-college costs specifically.

Savings options for funds that are not specifically restricted for education include UGMA/UTMA custodial accounts or other trust accounts set up to benefit a minor. You can make the annual exclusion gifts ($14,000 or $28,000 in 2016) to these accounts as well, but the main disadvantage for many donors is the loss of control of these assets. Gifts into an UGMA or UTMA account are irrevocable (meaning you cannot take back any of the assets once you have made a gift), and once the minor reaches the age of majority (18 or 21 depending on the state), the minor will be in full control of the assets. If you are specifically interested in funding education and want to ensure the purpose of funds, these accounts might not be a suitable option.

---

* In order to make the maximum exclusion gift of $28,000 for 2016, a couple must choose to split the gift and file a gift tax return (Form 709) to demonstrate spousal consent.

† Modified adjusted gross income (MAGI) must be below $110,000 for individuals or $220,000 for couples filing joint tax returns in order to contribute.

TFC FINANCIAL
The Financial Counselors

Estate Planning Strategy

Considering your estate planning goals is an important step to keep in mind. The contribution limits we refer to above may limit your ability to achieve your estate reduction goals in the near term. If your goal is to remove assets from your estate quickly, consider taking advantage of the Section 529 plan five-year funding option of $70,000 per individual (or $140,000 per married couple)*. You can do this for multiple beneficiaries in a given year.
Alternatively (if your timeline allows for it), the unlimited amount you can pay directly to a school for tuition is also another option to maximize reducing your estate over a short time period.

Utilize the school's financial aid office resources to better understand total costs and funding options.

Coordinate Your Gifting with the Family

A final point to touch on is the importance of coordinating the timing of any gifts you plan to make with the plans of the student and/or their parent(s). This includes payments made directly to institutions, distributions from accounts like Section 529 plans and other gifts.

If financial aid is a possibility for the student, it's important to be aware that the amount, timing and sources of any gifts can impact how financial aid awards are calculated. The most widely used financial aid form is the Free Application for Federal Student Aid (FAFSA®). In 2015, President Obama announced regulatory changes to the FASFA® that come into effect for the 2017-2018 application cycle. It's important that your family utilizes the resources of the financial aid office of the student's school to understand the total costs and funding options available.

Your TFC advisor can assist you in developing a gifting strategy that aligns with the goals and timeline of you and your family. As always, we welcome your comments and questions.

Sincerely,

Michelle A. Herd, CFP®
Senior Client Advisor

TFC Financial Management, Inc.
260 Franklin Street, Suite 1888, Boston, MA 02110
p 617.210.6700 | f 617.210.6750 | tfcfinancial.com

* If you use the five-year funding option and pass away before the 5th calendar year, the contributions that were allocated to the years after your death will be included in your taxable estate.