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PARTICIPANT PERSPECTIVES

HOW TO SET UP A COLLEGE SAVINGS PLAN FOR A GRANDCHILD

A Section 529 plan offers one tax-advantaged way to help fund the cost of college. Here's what you need to know about setting up a plan for a grandchild.

A four-year college education is expensive. According to research from the College Board,* the average published yearly cost of tuition and fees for 2021-2022 at a four-year private college was $38,070, and $10,740 for in-state students at a four-year public school; room and board represent an additional fee. And if history is any guide, college costs are unlikely to fall.

If you have grandchildren and would like to help them get a good start in life, what better gift than the opportunity to graduate from college with few, if any, student loans? A Section 529 plan provides one tax-advantaged way to help fund the cost of college. Here's what you need to know about establishing a plan for a grandchild.

WHAT THEY ARE, HOW THEY WORK

Most Section 529 plans are state sponsored and come in two varieties: prepaid tuition plans and college savings plans. You can set up a separate Section 529 plan for as many beneficiaries as you wish and fund each plan by investing a lump sum or by making regular contributions. You can contribute to a Section 529 plan regardless of your annual income or age. Moreover, if you don't like some of the features of your state's plan, you can participate in another state's plan.

The money in a Section 529 plan grows on a tax-deferred basis, and distributions for qualified educational expenses are free from federal income tax. Many states offer Section 529 plan tax benefits for their residents as well. To avoid federal gift taxes on your plan contributions, you can limit them to the gift-tax annual exclusion amount ($16,000 per beneficiary in 2022; $32,000 if you and your spouse contribute) or elect to treat a larger contribution as though the gift was spread out over five years. By contributing, you are generally also removing the gift amount from your estate for federal estate tax purposes.

Another key advantage to opening a Section 529 plan on a grandchild's behalf is that grandparent-owned Section 529 assets are not factored into the Free Application for Federal Student Aid (FAFSA), which helps determine a student's eligibility for grants, work-study programs, and loans. However, just be aware that up to 50% of any distribution made from a non-parent-owned Section 529 plan may be counted as income on a student's future financial aid applications. It may be possible to avoid this situation by delaying distributions from non-parent-owned accounts until the final two years of a grandchild's college career.

It can be advantageous to open an account when a child is still very young. Thanks to the power of compounding, the earlier you begin the greater the potential sum by the time your grandchild enters college.

In addition to Section 529 plans, there may be other options you can explore if you want to contribute toward a grandchild's education. The guidance of a financial professional can help you determine what approach is best for your circumstances.

* Trends in College Pricing 2021, The College Board.

Investing in Section 529 plans involves risk, including loss of principal. Before you invest in a Section 529 plan, request the plan's official statement and read it carefully. The official statement contains more complete information, including investment objectives, charges, expenses, and the risks of investing in a Section 529 plan, which you should carefully consider before investing. You should also consider whether your home state or your beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's Section 529 plan. Section 529 plans are not guaranteed by any state or federal agency. By investing in a Section 529 plan outside of the state in which you pay taxes, you may lose the tax benefits offered by that state's plan. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary.

DISABILITY INSURANCE HELPS PROTECT YOUR EARNING POWER

Disability insurance may be a helpful way to protect your financial health if you are unable to work for an extended period.

Your ability to generate income is your most important asset. But, have you taken any steps to protect your earning power?

Consider this: A serious illness or an accident could potentially sideline you from work for an extensive period. If you were to become disabled, could you still make payments on your mortgage and other loans and meet everyday expenses? Whether you are an employee, self-employed, or own a small business, you may be forced to tap into your savings and investments to pay personal and business expenses. Over time, the assets you have spent a lifetime acquiring could be quickly depleted.

PROTECTING YOUR FINANCIAL HEALTH

Disability insurance protects your financial health by helping to make up for the loss of a regular income. Employer-provided disability insurance can be short-term, long-term, or both:

- Short-term policies generally pay a percentage of your salary for a limited period.
- Employer-provided long-term disability policies typically pay up to 60% of your salary.
- An individual disability insurance policy may be another option worth considering, even for those with employer-provided coverage.

SELECTING THE RIGHT FIT

There are various ways to purchase disability insurance. You can buy a policy through a broker or an insurance company that specializes in disability insurance, or through a professional association. Policies can generally be customized to suit your needs and your budget. You select the amount of coverage you need, the waiting period, and the length of time that benefits will be paid to you. The cost of a policy will depend on a variety of factors, including:

- Your age
- Your health
- Your gender
- Whether you are a smoker
- Your occupation
- The length of the waiting period before benefits begin
- How long benefits will be paid out
- Your income
- How the policy defines a disability
- Any additional features in the policy, such as a cost-of-living adjustment

ANOTHER IMPORTANT CONSIDERATION

If you are unable to perform your job, but could potentially engage in other types of work, certain disability policies will pay out very limited — or no — benefits to you. Other disability policies pay out full benefits if an an injury or illness prevents you from working, even if you could do other types of work.

Protecting your financial health requires a multifaceted approach. The input of an experienced financial professional can be very helpful in identifying areas of your finances that need attention.

HOW TO HANDLE A FAMILY LOAN

Consider these issues before lending money to or borrowing money from a family member.

When lending money to (or borrowing from) a family member, it's important to proceed with caution. Family loans have the potential to create disharmony within the family. Before any money changes hands, be sure to address several important issues.

CLARIFY THE PURPOSE OF THE LOAN

Begin by considering what the loan will be used for. Will it help pay for a new car, graduate or professional school, a new home, or to help fund a new business's startup expenses? It's important to know the purpose of the loan since some loans may carry a higher risk of non-repayment than others. For example, the risk of not being paid back by an adult child for a house down payment may be lower than loaning money to a relative to help start a business.

PUT IT IN WRITING

Keep it businesslike and draw up a written loan agreement that specifies the interest rate and other terms of the loan. Both lender and borrower should sign and date this agreement. By putting the loan provisions in writing, you avoid the potential for misunderstanding or ambiguity and possible intra-family strife.

REVIEW BUSINESS LOAN REQUESTS CAREFULLY

It is important to carefully evaluate requests for loans to fund a new business. Try to determine if the business concept makes sense, if there's a market for the product or service, and if the borrower has the skills and work ethic to succeed. If you do not feel confident in making that evaluation, seek the advice of an experienced professional, such as an accountant or a financial professional.

If you agree to help fund a business, the loan agreement should be structured so that it conforms to standard business practices in relation to late payments and fees. Clarify responsibilities — will you have any say in how the business is operated? If so, how much will you have?

DON'T BE AFRAID TO SAY "NO"

Be careful not to let family bonds blind you to certain realities. For example, if making the loan will strain your budget, now or in the future, then you should decline. If you have doubts about the likelihood of a family member repaying the loan, then say no — likewise if you are concerned with the viability of a planned business you are being asked to help fund.

For objective advice on how best to handle a request for a large loan or help on any other financial matters, consider contacting a financial professional.

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