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How and when to fund a 529 Plan

Q. I have a few questions concerning 529 plans for my grandkids. I've waited too long but I'm ready to start now. First, can I start a 529 by transferring stock into an account? There would be no sale and no capital gains, right? And when a kid has a 529, does he/she have to declare it on college financial aid forms? And, if so, does this appear to affect the likelihood of getting financial aid?

A. You've got some lucky grandkids!

If by saying you've waited too long, you mean your grandchildren are just about to start college, you may be better off making a direct contribution towards their college tuition, room and board bills rather than trying to start a 529 plan now, said Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge.

"Generally, a 529 plan will become more conservatively invested—more bond funds and cash as a child nears college age, so the opportunity for the investments to grow through stock market appreciation are minimal as they get older," she said. "This adjustment is made to reduce the risk of loss of principal should the stock market fare poorly just when the student is going to need the funds."

You're out of luck on your idea of funding a 529 Plan with stock, though. All deposits to 529 Plans must be made in cash, so you would not be able to transfer the stocks into the account for your grandchildren.

Mott said you should consider either liquidating the stock and gifting the cash to the parents to fund the 529, or gifting the stock to the parents for them to sell.

"For gift tax purposes you could gift up to $14,000 per parent or child before needing to file a gift tax return," Mott said. "Understanding the tax impact to both parties that might result from capital gains would be important before making the decision."

If you go the 529 Plan route, it's important to understand how the plan's owner will impact financial aid.

"The good news is that 529 Plans that are owned by a student who is considered to be a dependent of their parents is reported as parental assets, which counts less towards determining the amount of contribution that a family should make," said Howard Hook, a certified financial planner and certified public accountant with EKS Assoc. in Princeton.

If the student is not a dependent of the parents, then the assets are considered student assets and would count more towards determining the amount of contribution that a family should make, Hook said.

You might be tempted to start a 529 Plan and list yourself as an owner, hoping to avoid reporting the funds on financial aid forms, but it's not so simple.

A 529 savings plan is included on the financial aid forms known as the FAFSA and CSS Profile and it is considered when colleges determine the amount of financial aid, Mott said.

A parent-owned 529 plan receives more favorable treatment on these applications, she said. The value of the account must be included as an asset, but parents are only expected to contribute up to 5.64 percent of their assets compared to 20 percent for children's assets.

If a grandparent owns the account, it's true that it wouldn't be reported on financial aid forms, but any withdrawal from the account on behalf of the child will be considered untaxed income for the child on the following year's financial aid form.

"Up to 50 percent of that figure can affect eligibility for financial aid," Mott said. "So using a grandparent-owned 529 should be reserved for the last year of college to avoid having the withdrawal treated as income the following year."

Email your questions to moc.pleHyenoMJN@ksA.

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