What Grandparents Should Know About 529 Plan Impact on Taxes, MassHealth Eligibility

By: Brandon C. Walecka, Esq.

Walecka Law, P.C.

774-203-9003

Brandon@WaleckaLaw.com

Grandparent 529 plans are becoming a popular way to save for college – and for good reason. With a 529 plan, you can build an educational legacy for your grandchild while taking advantage of tax and estate planning benefits.

One potential drawback of grandparent 529 plans, however, was that they could affect financial aid eligibility. But, thanks to upcoming changes to the Free Application for Federal Student Aid (FAFSA), beginning in the 2024-2025 school year, contributions you make to a 529 plan need not be reported on the student's FAFSA application, and therefore will not count against the student's eligibility for federal financial aid. This change alleviates a fear that a grandparent helping their grandchild by using their own 529 plan would interfere with their getting financial aid.

Brief Explanation of 529 Plans

A 529 plan is a tax-advantaged plan that can be used to pay for educational expenses, for both higher education and grades K-12. Legitimate expenses include tuition, supplies, room and board, books, etc. Since 2019, the funds may also be used for student loan payments. There is no tax on gains or withdrawals so long as the money is used for legitimate educational expenses.

Every state has its own 529 plans, but you are not limited to your own state's plans. Each plan has its own investment options. You have complete control over the account, and can make withdrawals if you wish – although if the withdrawal is not for a legitimate educational expense, the earnings are taxed and you will incur a 10% penalty.

You can also change beneficiaries, so long as the new beneficiary is a relative of the originally chosen beneficiary. A 2019 ruling widens the net of possible beneficiaries to include a first cousin of the original beneficiary.

Estate Tax Advantages

The current (2022) federal unified estate and gift tax exemption is $12.06 million per person. Massachusetts estate tax exemption is $1,000,000. These figures are the total amounts you can give away, both during your lifetime as gifts, and at death, without those funds being subject to estate tax. However, in 2026, the federal unified estate and gift tax exemption will drop down to approximately $6 million per person.

If you have a taxable estate (or are likely to have one), setting up a 529 enables you to reduce the size of your estate and therefore put more tax-free money into the hands of your heirs. In 2022, you may contribute up to $16,000 (the annual gift tax exclusion) to a 529 Plan without paying tax. Moreover, there is a special feature that comes with a 529: you can load the account up front with 5 years' worth of estate tax exclusions ($80,000).

Potential Disadvantage: MassHealth Eligibility Jeopardized

The funds in your 529 account are considered YOUR assets. You control them. Thus, the funds will be considered an asset by Medicaid (MassHealth in Massachusetts) and will count against your MassHealth eligibility if you ever apply for MassHealth benefits for long-term care. MassHealth has a five-year look-back period for gifts. Moreover, the disbursements made for your beneficiary's educational expenses could be considered a gift and also count against eligibility if disbursements are made within the look-back period.

Talk to a qualified elder law attorney to explore how to best help your grandchild pay for their education and still protect your own MassHealth eligibility. To explore the details of various 529 plans, talk to a financial advisor who has experience with these plans.

Do you have a suggestion for a future article topic for Attorney Walecka? Reach out to him directly with a question or topic you think would be helpful to readers.

The information contained in this article is not intended to make you an expert on estate planning nor is this article intended to replace the need for the advice of a professional. Rather, this article is simply intended to provide a basic understanding of why estate planning is important for everybody and a basic understanding of some of the more common estate planning tools. This article does not constitute legal advice.