FutureScholar
South Carolina's 529 College Savings Plan

COLUMBIA THREADNEEDLE INVESTMENTS®

FAFSA update: Why grandparents now have greater incentive to own 529 accounts

Big changes to the FAFSA process mean grandparents can finally help pay for college without worrying about the "financial-aid trap." Because of pending changes to the Free Application for Federal Student Aid (FAFSA), students will no longer have to disclose cash support. That means effective for the 2025–2026 school year, grandparent-owned 529 accounts will no longer impact a student's eligibility to receive needs-based financial aid.

How the FAFSA determines financial need

Financial need is determined by:

School's cost of attendance
– student aid index (SAI)

= Financial need

	Parents	Students
Income	22% to 47% of available income[1]	50% of adjusted gross income over $9,410[2]
Assets	0% to 5.64% of assets[3] ■ Mutual funds ■ Securities ■ Bank accounts, CDs ■ 529 savings plans when parent or dependent student is account owner	20% of assets held in student's name[4] ■ UGMA/UTMA accounts not held in 529 plan ■ Minor trusts not held in 529 plan ■ Savings bonds (in student's name)

Say goodbye to the financial-aid trap

529 plans are generally considered the most effective way to save for education related expenses. But in the past, treatment of grandparent-owned accounts had been criticized and even garnered the term financial-aid trap from savingforcollege.com. Why? Because while families applying for aid aren't required to disclose grandparent-owned 529 account assets on the FAFSA, they are required to disclose any cash support the student receives. So, if distributions are taken from grandparent-owned accounts and used for education expenses, the student is expected to show the distribution as income on future FAFSA applications.

As the table above shows, up to 50% of annual student income can be deemed eligible for college use, which can have a big impact on needs-based aid eligibility. Meanwhile, parent-owned 529 plans, which are disclosed upfront on the FAFSA, are only evaluated as up to 5.64% available for college use (no more than any other nonqualified asset).

The new FAFSA questionnaire, which will be in effect for the 2025–2026 academic year, no longer requires students to manually disclose cash support on the FAFSA form. As a result of the Consolidated Appropriations Act of 2021, all student income will be taken from tax return data, using the IRS Data Retrieval Tool (DRT). So grandparents can finally contribute significantly to the cost of their grandchildren's education without impacting any needs-based financial aid eligibility.

[1] Available income is the amount of parental adjusted gross income after allowances for federal, state, local and FICA taxes, as well as an income protection allowance based on the number of people in the household.

[2] $9,410 is the income protection allowance for the 2025 –2026 academic year.

[3] Assets held in qualified retirement plans, such as IRAs, are not considered in determining eligibility for federal student aid. The percentage of other assets considered in determining SAI will vary based on the amount of assets, the age of the eldest parent and whether there are one or two parents.

[4] A UTMA/UGMA 529 account of a dependent student is reported as a parental asset on the FAFSA.

Source for 1–4: U.S. Department of Education and Federal Student Aid, 2025 –2026

What makes 529 plans attractive for grandparents

Even before this change was announced, 529 plans offered grandparents several advantages, including exclusive gifting and estate planning benefits. After all, many grandparents are either in their peak earning years or already retired. They're likely thinking about their financial legacy, putting them in a great position to enjoy all the benefits of 529 accounts.

Consider how 529 assets are treated in the Internal Revenue Code:

- Contributions to 529 plans are completed gifts and are removed from the contributor/owner's taxable estate, but the owner maintains control.
- Forward-gifting provision allows contributions in the amount of five times the annual exclusion — $95,000 for individuals ($190,000 for joint filers) — to be made in a single year without gift tax. This can be done for as many beneficiaries as the contributor desires.
- Access to tax-deferral with no time, age or income limits and with no required minimum distribution from 529 accounts for the owner or successor owner upon inheritance.

529 accounts also benefit grandparents because they're incredibly flexible. For example, if the beneficiary decides not to attend college, the account owner can easily change the beneficiary at any time. Equally important is the account owner's ability to transfer ownership. Grandparents can maintain control while the beneficiary is still years away from college, in case they unexpectedly need the account assets for their own use, then can transfer ownership to the beneficiary's parent when it's time to take distributions for college expenses.

Bottom line

529 plans have always been a powerful college savings tool and a smart vehicle for grandparents looking to take advantage of gift and estate tax benefits. But until now, even these highly regarded features, combined with tax-free qualified distributions, haven't always been powerful enough to overcome worries about potential impacts to financial aid. Thankfully, this is no longer a concern, and grandparents considering investing in a 529 plan to help send their grandchildren to college can now do so without fearing the financial-aid trap.

To find out more, call **800.426.3750**
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