PERSONAL FINANCE

Use the 529 Grandparent Loophole to Maximize College Savings

The 529 grandparent loophole can fund a grandchild's education without impacting their financial aid eligibility.

A 529 plan is one of the smartest ways to save for your grandkids' college education. And thanks to recent changes, it's now easier than ever to pair it with financial aid. Thanks to the FAFSA Simplification Act, the notoriously frustrating process of applying for student aid is less frustrating and more streamlined due to the removal of more than two-thirds of the questions on the FAFSA form (PDF).

Better yet, the FAFSA now lets grandparents with 529 accounts take advantage of the grandparent loophole to fund a child's education without derailing their financial aid application.

Not many people are taking advantage of this powerful back-to-school savings strategy. The most recent data from a 2025 Edward Jones survey show that 52% of Americans say they're unfamiliar with 529 plans, and only 14% of survey respondents currently use or intend to use a 529 plan for education savings.

Unfortunately, as so many people don't know about these tax-advantaged savings options, it can hinder both college goals and bigger financial dreams down the road. Two of the many benefits you could be missing include tax-free growth and the opportunity to roll over unused funds into a Roth IRA.

You could also be missing out on the **grandparent loophole** to fund a grandchild's education without impacting their financial aid eligibility.

What is the 529 grandparent loophole?

A 529 plan allows a contributor to prepay a beneficiary's qualified higher-education expenses at an eligible educational institution or to contribute to an account for paying those expenses. While 529 contributions must be made with after-tax money, the contributions grow free from federal or state tax.

How can the loophole benefit both you and your grandchildren?

Previously, distributions from a grandparent's 529 plan were reported as untaxed student income, which could reduce a student's eligibility for aid by up to 50% of the distribution amount — a significant penalty. Under the old rules, a $10,000 529 plan distribution could reduce your grandchild's aid eligibility by $5,000.

The good news is that with the new streamlined FAFSA (which took effect starting with the 2024-2025 award year), distributions from grandparent-owned 529 plans are no longer reported as student income, giving grandparents a welcome advantage.

What's different on the 2026-2027 FAFSA?

On the 2026-2027 FAFSA, students aren't required to report cash gifts from a grandparent or contributions from a grandparent-owned 529 savings plan. Grandparents can now use a 529 plan to fund a grandchild’s education without impacting that grandchild's financial aid eligibility.

With the new FAFSA form, a student’s total income is only based on data from federal income tax returns from the IRS. Any cash support, no matter the source, will not have a negative impact on financial aid eligibility on the FAFSA.

Instead of the FAFSA, more than 200-plus private institutions use the CSS Profile to award financial aid. These plans take a more complete picture of your financial circumstances than the FAFSA does, and grandparent-held 529 plans will still be considered.

Gift tax thresholds

Additionally, 529 plans are subject to gift taxes when they exceed certain thresholds.

For 2026, the annual gift tax limits are $19,000 for singles or $38,000 for married couples filing jointly, unchanged from 2025. These limits apply to each person who is receiving a gift in a year.

This means that you can donate these amounts per grandchild each year without owing federal gift tax. However, your 529 contributions might trigger gift tax consequences. If you exceed the annual exclusion, you might need to file a gift tax return.

For example, if you have two students and two 529 plans, and you're a single parent, this year, you can contribute $19,000 each or $38,000 total in a year without reporting these contributions to the IRS.

However, any contributions above $19,000 each (or $38,000 each if you're married and filing jointly) must be reported to the IRS and will count toward your lifetime gift tax exemption of $15 million (up from $13.99 million in 2025) for individuals or $30 million (up from $27.98 million in 2025) for couples in 2026.

Give more than that limit, and you could incur a flat gift tax of 40% for the excess amount.

Tax-free rollovers to Roth IRAs

If you put money in a 529 for your grandchild and he or she didn't attend college or only spent a portion of what you saved, you can roll over funds from your 529 plan tax-free into a Roth IRA, as long as certain conditions are met.

Rolling over unused funds from a 529 account into a Roth IRA can help individuals avoid tax penalties that occur when withdrawing funds for non-education expenses.

There's a limit on how much money can be rolled over throughout the beneficiary's lifetime, and these rollovers are subject to Roth IRA annual contribution limits.

IRA contribution limits for the 2026 tax year are $7,500 for people under age 50 (up from $7,000 in 2025) and an additional $1,100 catch-up contribution for those age 50 and older (up from $1,000 in 2025).

Before you get too excited, there are several additional limitations from the SECURE 2.0 Act worth keeping in mind:

- Your 529 savings account must be open for more than 15 years before funds can be rolled into a Roth IRA.
- If the 529 beneficiary is different from the 529 holder, the Roth IRA must be in the beneficiary's name.
- 529 contributions made within the preceding five years cannot be rolled over.
- The beneficiary must have earned income for the year at least equal in amount to the Roth IRA contribution transferred from the 529 account.

NYSUT NOTE: Establishing a 529 plan for your grandchildren can set them on the right path toward adulthood, but that's just one piece of securing your assets for the future. The NYSUT Member Benefits Corporation–endorsed Financial Counseling Program can set the table for a stress-free future for you and the people you care about the most.

About the Author

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Erin pairs personal experience with research and is passionate about sharing personal finance advice with others. Previously, she was a freelancer focusing on the credit card side of finance, but has branched out since then to cover other aspects of personal finance. Erin is well-versed in traditional media with reporting, interviewing and research, as well as using graphic design and video and audio storytelling to share with her readers.

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