MANAGING YOUR FINANCES

Roth IRA or 529 for **Grandkid's College**

ROTH IRAS AND STATE 529 COLLEGE-SAVINGS PLANS have a lot in common for grandparents who are looking for tax-advantaged ways to help pay their grandchildren's college costs. Both are funded with after-tax money. You don't get a federal tax break when you put the money in, but the accounts grow tax free.

But Roth IRAs and 529 plans differ in several ways. And one may be a better option than the other depending on the grandparent's age and financial picture.

■ **Flexibility.** The Roth is a better choice if you think you may need the money one day to pay for unforeseen retirement expenses. You can withdraw your contributions tax free whenever you want, and you can take out earnings free of tax and penalties once you turn age 59½ (as long as you've had a Roth for at least five years). "If you change your mind for any reason, so be it," says Jeffrey Levine, IRA technical consultant with Ed Slott and Co. With a 529, you'll pay income tax and a 10% penalty on any earnings when you withdraw the money for noneducational purposes.

■ **Contributions.** You can contribute a lot more at a time to a 529 plan than to a Roth. Depending on the state plan, you can make a lifetime contribution for each beneficiary of $250,000 to $400,000—and all at once.

Roth contributions are limited to $6,500 a year for someone who is 50 or older, and you need to have earned income to contribute. Another disadvantage is that you can't contribute to a Roth if your adjusted gross income exceeds certain thresholds. There are no income limits for 529 plan contributions, nor do you still have to be working in order to contribute to the account.

You can convert money from a traditional IRA to a Roth IRA. But expect a big tax bill if you convert a large sum to help pay college expenses for several grandchildren. And if your grandkids plan to attend college soon after a big conversion, "it doesn't make sense to convert," says Deborah Fox, who runs Fox College Funding, a financial planning service, in San Diego. "You need enough time to accumulate tax-free earnings to make the conversion worth it."

■ **Taxes.** Most states offer tax deductions or credits for at least part of a 529 plan contribution. (For information about your state's plan, go to Savingforcollege.com.)

Roth account holders do not get any tax breaks for their contributions.

If you're looking to reduce your taxable estate, a 529 plan beats the Roth. Deposits of up to $14,000 a year ($28,000 for a couple) for each grandchild can qualify for the annual gift-tax exclusion. And if you want to reduce the size of your estate quickly, you can deposit five years' worth of contributions in a single year without having to file a gift-tax return.

Tuition payments you make directly from the Roth to the college won't count toward the annual gift-tax exclusion. However, if you die before you pay for college expenses, your Roth assets will be subject to estate tax.

■ **Financial aid.** Either option can blow your grandkid's eligibility for financial aid. Neither a 529 plan nor a Roth IRA held by a grandparent is reported as an asset on the student's application for federal financial aid. But 529 distributions are reported on the following year's application as student income, reducing aid eligibility the next year, says Steve Stanganelli, a certified financial planner with Clear View Wealth Advisors, in Amesbury, Mass. A Roth distribution to pay college bills also will be considered student income.

Stanganelli says one way to avoid this is to hold off on 529 plan distributions and tuition payments from the Roth "until the child has filed the last financial aid form." If the money is needed earlier, grandparents who own a 529 plan can transfer ownership to the parents. Distributions from a grandparent's plan have a much more severe impact on aid eligibility than a 529 plan owned by a parent. **K SUSAN B. GARLAND**

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