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Beyond the Portfolio – Launching Your Graduate

Pratik Patel:

Hi everyone. I'm Pratik Patel, US Head of Planning for BMO Wealth Management and this is Beyond the Portfolio. I'm excited to be here for an episode that's near and dear in my heart and at least up until this point in their lives, touches on your kids' greatest transition and that, of course, is college. Going away for school and living away from home in most instances is some combination of exciting and terrifying and honestly that statement applies whether you're talking about the child or the parent. But since we're in wealth management, we're going to focus today's conversation on helping parents with what lies ahead from a planning and financial perspective.

We are here to discuss resources to be used as well as documents to get in order for your graduate leaving the nest. To that end, I wanted to bring someone in who recently went through the experience to share some insight as to his family journey and the moves parents can make during this time. Jay Gleason leads our planning team in the family office. He is an attorney with an LLM in tax. After almost 10 years in private practice, he spent the last 15 years in the financial services world first as a trust officer and for almost a decade in wealth strategies and planning. Jay, welcome to the program.

Jay Gleason:

Thanks, Pratik. Excited to be here.

Pratik Patel:

Jay, everything in this space feels nuanced including gifting. Can you talk a bit about the mechanics around gifting when it comes to school tuition?

Jay Gleason:

Yes. So first of all, on the baseline, we have to understand that everybody has an annual exclusion where one can give another individual \$19,000 per year. There are two exceptions that you can go beyond that annual exclusion and it doesn't count either on the annual end or the lifetime exemption. Those two are medical gifting and gifts of tuition. So to the extent that parents or grandparents can make gifts of tuition on behalf of their student, they should do so first. Two rules, the gift can only be for tuition, not room and board, or equipment. The second rule is that the gift has to go directly to the institution. Do not let it hit the hands of your student.

Pratik Patel:

Yeah, thanks, Jay. And obviously for most people, a large gift like this isn't an option. We wish it was, but it isn't always an option. College is something that requires saving over the child's entire life. Can you discuss how a family might go about tackling this immense expense?

Jay Gleason:

Yeah, absolutely. Our family was in this camp. Our daughter, when she was born, we immediately started a 529 plan for her benefit. Now, a 529 plan, I look at it as akin to an educational Roth. It qualifies for the annual exclusion and you can front load it by five years. So for grandparents that can afford to do so, they should consider this when a grandchild is born. If both are alive and able, meaning the grandparents, they can gift up to \$190,000 to the 529 plan, which is a really good head start towards that college education, even with the cost of education going up. They would just need to file a gift tax return, check a box saying that we're using a front load of those next five years.

Pratik Patel:

Yeah, what a headstart that would be for the kids. So let's fast-forward a bit. Now that the parents are getting to the point where they need the resources, how does the 529 plan work with distributions?

Jay Gleason:

Yes. So the parent has to be able to track the expenses. In our case, we would make a withdrawal from the 529 plan into our account and the next day make the same exact payment to the university. That would cover in our daughter's case, not only tuition, but room and board. For years three and four, you have to consider what the out-of-pocket costs are if your child is living off campus like ours has. You have to look at the cost of off-campus housing that is allowed at the given university. So they look at the cost of attendance where the student is attending. And these out-of-pocket or out-of-cost expenses will also be considered against the annual exclusion.

Pratik Patel:

Oh, interesting. I didn't know that. Now we hear more about some of these new benefits with the 529. Can you talk a little bit about some of the additional benefits of these plans outside of just paying for college expenses?

Jay Gleason:

Yes. There are benefits which can be used prior to college, so K through 12 tuition. So if your child goes to a private school, college prep exam fees, the SAT, ACT, tutoring, special needs expenses. For those not attending college, they can use those expenses to pay for trade school. 529 plans can be used to pay off up to \$10,000 in student loan debt. So let's say that you have a 529 plan and you have a student, maybe not your child, maybe a niece or nephew, although it could be your child who applied for a student loan that you didn't know about, you can use that 529 plan to alleviate up to \$10,000 worth of debt. And if there are amounts that are left over, the beneficiary of the 529 plan can also roll over up to \$35,000 to a Roth IRA for his or her benefit. Now that rollover is still subject to the annual contribution limits, so it may take five years to complete the distributions, but you can do it a chunk at a time.

Pratik Patel:

So what if a client or a child doesn't have a 529 client established? We're talking about all these things and these are best case scenarios, but the child did have savings either in their name or in the name of a trust. How would that operate to help with the expenses of college?

Jay Gleason:

Yeah, so the first thing you have to recognize with money in the name of the child, this can be a Uniform Transfer to Minors Act account or a Uniform Gift to Minors Act account depending on the state, but the money is theirs. They can spend it however they want. If there's enough money in the account, this may discourage them from attending college. So that's why we really suggest to our clients looking at 529 plans or putting money in trust for the benefit so that the child doesn't take the money in another direction than was intended. For parents with the concern about that, they may create a gift trust and have the money transferred to that gift trust account while the child is still the age of minority. So under either 18 or 21 in certain states, California is 25. As the beneficiary of that account, the child does have a right of withdrawal when he or she attains that age.

So here in Illinois, if we had \$200,000 in our daughter's name, we could transfer that into a trust where she would have a window of time after she attained age 21 that she'd have a right to withdraw. Now that's for a designated period of time, let's say 30 to 60 days. If that lapses and she has not exercised that right of withdrawal, you can retain those assets in trust until age 25 or 30 when that child would be more mature. In practice, what I've seen is parents do this and then they make it clear to the child, you do have the right of withdrawal. However, if you exercise that right of withdrawal, mom and dad may not make additional gifts to you when you would need it down the line.

Pratik Patel:

So that's motivating for sure. So now that we've saved up enough for college, let's switch gears a little bit. Let's talk about some of the documents, and I'm talking about legal debt documents that your child or student should have in place before going off to college.

Jay Gleason:

Yeah. So powers of attorney, they are adults now able to handle their finances, able to handle their healthcare. You need to get those in place. So at the very least, you should have those in place before your child goes off to school.

Pratik Patel:

All right. So we talk about power of attorney, but there's different types. Can you talk about each one?

Jay Gleason:

Yes. So the power of attorney for property as a financial power, this will allow the agent to handle assets in the student's name as well as act on behalf of the student in financial affairs. This could be immediately or could be upon disability. This may be most important for tax filing. Maybe your child's not home between winter break and spring break and they need to have their income taxes filed. If you have a power of attorney, and there would be a separate form with the IRS, you could handle that on their behalf. Could be for contributions to IRAs or Roth IRAs, which we'll talk about later and it could be just for paying bills. Now, property for healthcare will allow the agent to make healthcare decisions on behalf of the student. This also allows access to the medical records in order to make those decisions if the student's unable.

Pratik Patel:

All right, Jay. So as a parent, help me understand why the healthcare power is so important.

Jay Gleason:

Yes. So you would think, "This is my kid. Why am I being denied this information that I need to be aware of?" And I think it's important to not look at the current relationship that you have with your child, but to reflect on where you were at college at that age. So I'll take aim at myself here. I left Omaha, Nebraska to go to Arizona State University. Needless to say, there were activities that maybe I didn't want my mom to know about immediately. Your kids are kind of in the same boat. They have that right to privacy. There may be things that they don't want to necessarily share with mom and dad and you need to have that specified that you can obtain that information including healthcare status.

Pratik Patel:

Got it. So as we get towards the end of this episode, we're in wealth management, so we want to talk about some of the financial decisions for our kids. Are there other financial decisions we as parents should consider for our students as they go through college?

Jay Gleason:

Yes. The ultimate goal of your child going through higher education is to get a career and start their own path to land a job. Many students work their way through college to help pay for the day-to-day costs. Even if tuition, room, and board and books are paid, why not establish a pattern of savings for your child before they get out into the real world? We opened a Roth IRA for our daughter. She worked a summer job and earned a decent amount prior to heading off to college. She's continued to work every summer when she's come back home. And personally, we made a deal with her that for every contribution she made to her Roth, mom and dad would match that contribution by 50%. We wanted to establish this savings pattern now prior to her earning a full paycheck when she left school. And we may be long gone by the time that she gets to enjoy those benefits in retirement, but I think we'll put her on a good pace to start that savings program and maybe she'll thank us later.

Pratik Patel:

I bet she will. I love that idea. All right, Jay. Any last words of advice for parents going through the experience of sending their child off to college?

Jay Gleason:

Yeah. So personally, the drop-off is one of the toughest things you'll ever do. You spend 18 years prioritizing this little person helping out on homework, play dates, worrying about them being bullied or possibly bullying others. The day it comes, you ask yourself, how did it happen so fast? There are probably a lot of tears from your child and all you can do is reassure them that they've got this. They can do this. You can allow yourself to melt down later, but you realize this is where they need to be. This is the next step in their lives and you've put them in a position to soar. Be proud of what they've achieved to get to this position and be proud of what you've done to give them this opportunity. Be excited for their journey. We have one more year until our daughter graduates and I personally can't wait to see what's next.

Pratik Patel:

Well, what a wonderful way to close. With that, I want to thank everyone for joining us today. I'm Pratik Patel, head of wealth planning for BMO Wealth Management in the US and this has been another episode of Beyond the Portfolio. Thanks again for listening and we'll see you next time.

Mike Miranda:

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