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Best financial gifts for grandkids

By David Rodeck Kiplinger's Personal Finance

Your grandkids will probably say they'd like a toy or bicycle this holiday season, but their adult selves might prefer a financial gift with a long-term payoff. What's the best way to do that?

Cold hard cash is an option but hardly one that pays off long term, particularly when interest rates are too meager to keep pace with inflation. Here are five better financial gifts to give.

College savings accounts. Investments in a 529 college savings plan grow tax-sheltered, and withdrawals are tax-free if they're spent for college. You can contribute up to $15,000 per year per grandchild or even prepay five years — $75,000 — at once. The gift amounts double for married couples. A Coverdell ESA lets you spend the money on primary and secondary schools, too. The gift can only be $2,000 per year per grandchild, and to contribute, your adjusted gross income can't exceed $110,000 per year if you're single or $220,000 if you're married.

Both of these accounts are meant for educational spending. If your grandchild doesn't go to college, the balance can be transferred to another family member. Otherwise, withdrawals of investment gains not used for education are taxed as income and hit with a 10% penalty.

Roth IRA. Carlos Dias, founder of Dias Wealth in Orlando, Florida, says a Roth IRA is a great gift for a grandchild with earned income from a job, such as a paper route or babysitting. You can give up to the amount the child earns per year, subject to the annual IRA limit ($6,000 for 2021).

Custodial investment account. These accounts are a good way to teach a newcomer to invest. Although the investment is in your grandchild's name, you control the custodial account until your grandchild turns 18 or 21, depending on your state.

In 2021, the first $1,100 of the child's investment gains are free of tax and don't need to be reported. The next $1,100 of gains are taxed at the child's marginal tax rate and require filing a return. As the account custodian, you are responsible for taxes on any gains over $2,200 at your marginal income tax rate, not the lower rate for capital gains.

Municipal bonds. Not only are interest rates higher for muni bonds than EE savings bonds, but payments are free of federal income tax and, in some cases, state and local taxes, too. Be sure to look for creditworthy bond issuers. Investment-grade bonds should be at least BBB, with AAA the safest rating.

Gold. Collectibles like gold coins might catch your grandchild's eye, but Dias warns: "My dad was big into buying collectibles like rare coins. A lot of them turned out to only be worth what he paid for or less."

A better option: Buy your grandchildren gold exchange-traded funds or stocks in gold-mining companies to avoid the higher taxes of physical collectibles.

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