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2023 Estate and Gift Tax Conference

529 Plans: Too Cool for School and Estate Planning?

Thursday, March 9, 2023
8:30 am - 9:30 am

Speakers:

David Oh

Conference Reference Materials

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529 Plans: Too Cool for School and Estate Planning?

California Lawyers Association

March 2023

IRC Section 529 Qualified Tuition Programs

IRC section 529 provides that qualified program established and maintained by a State or eligible educational institution to fund qualified education expenses shall be exempt from tax.

Qualified education expenses include:

- Tuition, fees, books, supplies, equipment and room and board (if at least half-time) at an eligible college or university
- Tuition for elementary or secondary public, private or religious school up to \$10,000
- Expenses for fees, books, supplies and equipment for qualified apprenticeship program
- Payments of principal or interests on a qualified education loan of the designated beneficiary or a sibling up to \$10,000

Cost of Education

Institution	2021-22 Average Annual Budget for Full-Time Student
Private Nonprofit Four-Year (1)	\$54,800
Public Four-Year Out-of-State (1)	\$44,150
Public Four-Year In-State (1)	\$27,330
Private High School (Tuition Only) (2)	\$16,040

1. <https://research.collegeboard.org/media/pdf/trends-college-pricing-student-aid-2021.pdf>
2. <https://educationdata.org/average-cost-of-private-school>

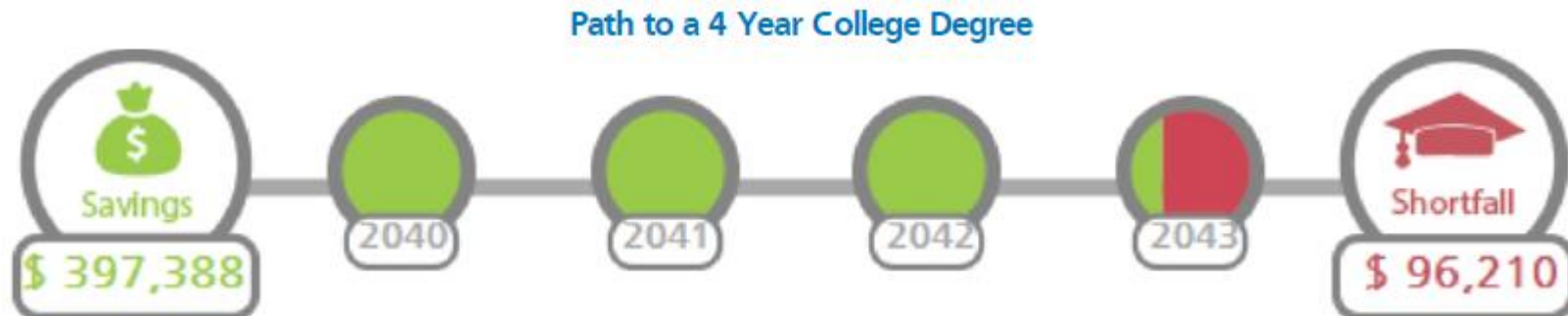
Example: No Educational Savings



Date of Birth:	January 1, 2022
Age to Begin College:	18
Current Annual College Cost:	\$50,000
College Inflation Rate:	5%

See Appendix I

Example: Taxable Account



Date of Birth:	January 1, 2022
Age to Begin College:	18
Initial Contribution:	\$160,000
Average Annual Return:	6.48%
Tax Rate:	20%
Total Savings:	\$397,388

See Appendix II

Example: 529 Plan



Date of Birth:	January 1, 2022
Age to Begin College:	18
Initial Contribution:	\$160,000
Average Annual Return:	6.48%
Tax Rate:	0%
Total Savings:	\$495,387

See Appendix III

529 Plan Relationship

Account Owner

- Designates beneficiary
- Makes investment choices
- Makes distributions

Contributor

- Makes cash gift
- Can be multiple people
- Does not need to be account owner

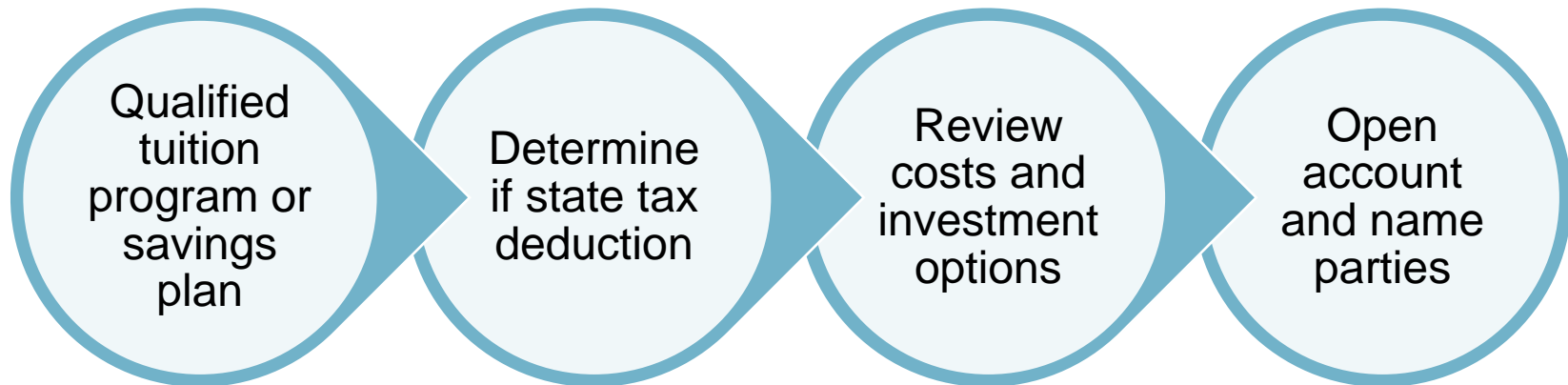
Beneficiary

- Has qualified expenses paid
- Must be an individual
- Can be changed to another family member



State Sponsor
Account Custodian
Investment Option Providers

Selecting a 529 Plan



529 Plan Account Set-up and Administration

Contributions

- Must be in cash
- Can be made by different people
- Limits apply after meeting threshold

Investments

- Options defined by plan
- Many offer target date funds
- Conservative to aggressive options

Distributions

- Distributions for qualified expenses can be made (1) direct to institution, (2) by check to both the designated beneficiary and institution, or (3) to beneficiary in reimbursement after substantiation or in advance with certification of application and substantiation within 30 days
- Distributions not for qualified expenses subject to income tax and 10% penalty

Tax Matters

<h2>Income Tax</h2>	<ul style="list-style-type: none"> • Contributions not deductible for federal • Contributions may be deductible for state • Earnings are exempt unless withdrawn for nonqualifying expenses • Additional 10% penalty • Distributions reported on Form 1099Q • Change of beneficiary is not an income tax event
<h2>Federal Estate Tax</h2>	<ul style="list-style-type: none"> • Not included in account owner's estate • Included in designated beneficiary's estate
<h2>Federal Gift Tax</h2>	<ul style="list-style-type: none"> • Contributions are completed gift • Qualifies for annual exclusion of \$16,000 • Ability to accelerate 5 years of annual exclusion • Gift splitting is permitted • No gift on change of beneficiary if family member at same generation
<h2>Federal Generation-Skipping Transfer Tax</h2>	<ul style="list-style-type: none"> • Contributions are subject to GST tax if beneficiary is a skip person • Qualified for GST tax annual exclusion

Trust Provisions

- Every trust should contain provisions that allow for the purchase or ownership of 529 Plans
 - The trustee may become a successor owner or may purchase a plan as an investment vehicle
 - Especially if the trust is created for educational purposes
- The following provisions should be included:
 - Authorization for a trustee to purchase a 529 Plan
 - Authorization to designate a beneficiary
 - Authorization to hold a 529 Plan as a successor owner
 - Authorization to roll over the plan for successor generations
 - Authorization to change designated beneficiaries
 - Authorization to manage the investments in the plan
 - Authorization to make both qualified and non-qualified distributions
 - Exoneration from liability for selecting one designated beneficiary in favor of another
 - Authority to make distributions among a class of beneficiaries to allow the Trustee to select a lower generation designated beneficiary for the 529 Plan from among the class

Trust Planning Issues

- Allocation of GST exemption to the trust
 - If the designated beneficiary is treated as making a gift to a lower generation designated beneficiary, the transferor for GST purposes will have changed and a new allocation will be necessary; however, if the new allocation is not made, GST can be avoided by naming designated beneficiaries who are no more than one generation below the prior designated beneficiary

Impact on Financial Aid

- 529 plan account owned by parent or student is considered
 - Treated as parent asset (5.64% counted)
 - Distributions do not impact aid
- 529 plan account owned by grandparent or other relative generally not considered
 - Distributions treated as student income (50% counted)
 - Income will impact aid

Alternatives to 529 Plans

- Direct tuition payments are gift-tax free
- IRA withdrawals for educational expenses are subject to income tax but not penalty
- Coverdell Education Savings Accounts
- UTMA accounts
- Crummey Trusts
- 2503(c) Minor Trusts

Planning Options

- Incentivized educational savings
- Tax-free family education-dedicated account
 - Trust as account owner for multi-generational governance and flexibility
- Accelerated gifting
- Pay-it-forward strategy for non-immediate family and friends
- Rollover into Roth IRA
- Bequest alternative to smaller trust
- Bad birthday/holiday gift alternative for relatives

Potential Abuse

- Using as retirement plan alternative or supplement
- Creating 529 plan accounts for multiple beneficiaries and consolidating
- Creating 529 plan account for yourself and gift to other generations

Additional Resources

www.collegesavings.org

www.savingforcollege.com

www.collegeboard.org

www.tuitionfit.org

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Appendix I: No Educational Savings

College Investments and Expenses - Child 1

Year	Beginning Value		Savings	College Cost	Grants/ Scholarships	Student Pays	You Want to Pay	Shortfall	Ending Value	
	529 Plan	Taxable							529 Plan	Taxable
2022	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2023	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2024	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2025	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2026	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2027	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2028	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2029	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2030	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2031	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2032	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2033	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2034	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2035	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2036	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2037	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2038	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2039	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2040	\$0	\$0	\$0	\$120,331	\$0	\$0	\$120,331	\$120,331	\$0	\$0
2041	\$0	\$0	\$0	\$126,348	\$0	\$0	\$126,348	\$126,348	\$0	\$0
2042	\$0	\$0	\$0	\$132,665	\$0	\$0	\$132,665	\$132,665	\$0	\$0
2043	\$0	\$0	\$0	\$139,298	\$0	\$0	\$139,298	\$139,298	\$0	\$0

Appendix II: Taxable Account

College Investments and Expenses - Child 1

Year	Beginning Value		Savings	College Cost	Grants/ Scholarships	Student Pays	You Want to Pay	Shortfall	Ending Value	
	529 Plan	Taxable							529 Plan	Taxable
2022	\$0	\$160,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$168,294
2023	\$0	\$168,294	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$177,019
2024	\$0	\$177,019	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$186,195
2025	\$0	\$186,195	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$195,848
2026	\$0	\$195,848	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$206,001
2027	\$0	\$206,001	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$216,680
2028	\$0	\$216,680	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$227,912
2029	\$0	\$227,912	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$239,727
2030	\$0	\$239,727	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$252,155
2031	\$0	\$252,155	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$265,226
2032	\$0	\$265,226	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$278,976
2033	\$0	\$278,976	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$293,438
2034	\$0	\$293,438	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$308,650
2035	\$0	\$308,650	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$324,650
2036	\$0	\$324,650	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$341,480
2037	\$0	\$341,480	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$359,182
2038	\$0	\$359,182	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$377,802
2039	\$0	\$377,802	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$397,388
2040	\$0	\$397,388	\$0	\$120,331	\$0	\$0	\$120,331	\$0	\$0	\$291,419
2041	\$0	\$291,419	\$0	\$126,348	\$0	\$0	\$126,348	\$0	\$0	\$173,629
2042	\$0	\$173,629	\$0	\$132,665	\$0	\$0	\$132,665	\$0	\$0	\$43,088
2043	\$0	\$43,088	\$0	\$139,298	\$0	\$0	\$139,298	\$96,210	\$0	\$0

Appendix III: 529 Plan

College Investments and Expenses - Child 1

Year	Beginning Value		Savings	College Cost	Grants/ Scholarships	Student Pays	You Want to Pay	Shortfall	Ending Value	
	529 Plan	Taxable							529 Plan	Taxable
2022	\$160,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$170,368	\$0
2023	\$170,368	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$181,408	\$0
2024	\$181,408	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$193,163	\$0
2025	\$193,163	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$205,680	\$0
2026	\$205,680	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$219,008	\$0
2027	\$219,008	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$233,200	\$0
2028	\$233,200	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$248,311	\$0
2029	\$248,311	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$264,402	\$0
2030	\$264,402	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$281,535	\$0
2031	\$281,535	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$299,778	\$0
2032	\$299,778	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$319,204	\$0
2033	\$319,204	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$339,889	\$0
2034	\$339,889	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$361,913	\$0
2035	\$361,913	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$385,365	\$0
2036	\$385,365	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$410,337	\$0
2037	\$410,337	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$436,927	\$0
2038	\$436,927	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$465,240	\$0
2039	\$465,240	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$495,387	\$0
2040	\$495,387	\$0	\$0	\$120,331	\$0	\$0	\$120,331	\$0	\$399,360	\$0
2041	\$399,360	\$0	\$0	\$126,348	\$0	\$0	\$126,348	\$0	\$290,704	\$0
2042	\$290,704	\$0	\$0	\$132,665	\$0	\$0	\$132,665	\$0	\$168,280	\$0
2043	\$168,280	\$0	\$0	\$139,298	\$0	\$0	\$139,298	\$0	\$30,859	\$0