



Investment Planners, Inc.
Donna J. Hines, RFC, CEP
4 Brown Avenue
Weston, WV 26452
phone:(304) 517-1300
dhines@investment-planners.com
cell:(304) 476-5677

529 Plans and Estate Planning

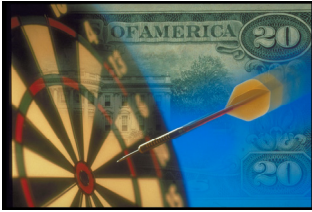


IPI Asset Management, Inc.
Integrity ★ Performance ★ Innovation

Strategic Lifestyle & Wealth Management

December 09, 2009

529 Plans and Estate Planning



Since their creation in 1996, 529 plans have become to college savings what 401(k) plans are to retirement savings--an indispensable tool for helping you amass money for your child's or grandchild's college education. That's because 529 plans offer a unique combination of benefits unmatched in the college savings world: availability to people of all income levels, professional money management, high maximum contribution limits, and generous tax advantages.

Yet 529 plans are increasingly being used for another purpose--estate planning. This estate planning use has emerged thanks to special tax rules surrounding lump-sum contributions to 529 plans, combined with the convergence of two powerful trends--boomer grandparents and soaring college tuition.

Estate planning framework

To fully appreciate how the estate tax laws favor 529 plans, you must first understand how these laws apply to other assets. Generally, assets that you own at your death (i.e., your estate) in excess of a certain amount (\$3.5 million in 2009) will be subject to federal estate tax (and probably some form of state estate tax as well). Reducing the size of your estate, then, will minimize these estate taxes. One way to reduce your estate is to make gifts during your life. However, lifetime gifts are generally subject to federal gift tax (and possibly state gift tax as well). Fortunately, there are some important exceptions.

First, every individual has a \$1 million lifetime exemption from federal gift tax. This means you can make gifts to anyone that cumulatively total \$1 million without incurring any federal gift tax liability.

Second, individuals are allowed an annual exclusion from the federal gift tax, which is currently \$13,000. This means you can gift up to \$13,000 per recipient per year gift tax free. And, a married couple who elects to "split" gifts can give up to \$26,000 per recipient per year gift tax free.

Gifts made to grandchildren (or anyone who is more than one generation below you) have special tax rules. These gifts are not only subject to gift taxes, but they're subject to an additional tax known as federal generation-skipping transfer tax (and possibly

state generation-skipping tax as well). However, there are exceptions for this tax too: a lifetime exemption (\$3.5 million in 2009) and an annual exclusion that's the same as for federal gift tax--\$13,000 or \$26,000 for married couples.

This is where 529 plans come in.

Special gifting feature of 529 plans



Under special rules unique to 529 plans, you can make a lump-sum contribution to a 529 plan in an amount equal to five times the federal annual gift tax exclusion (\$65,000 in 2009 or \$130,000 for a married couple)

per recipient, as long as you make a special election on your federal gift tax return that effectively spreads the lump-sum gift evenly over five years, and provided you do not make any other gifts to the same recipient during the five-year period.

Example: Mr. and Mrs. Brady make a lump-sum contribution of \$130,000 to their grandchild's 529 plan in Year 1, electing to spread the gift over five years. The result is they are considered to have made annual gifts of \$26,000 (\$13,000 each) in Years 1 through 5 (\$130,000/5 years). Because the amount gifted by each spouse is within the annual gift tax exclusion, the Bradys won't owe any gift tax (assuming they don't make any other gifts to their grandchild during the five-year period). In Year 6, they can make another lump-sum contribution and repeat the process. In Year 11, they can do so again.

Thus, 529 plans offer an opportunity for wealthy parents and grandparents to put hundreds of thousands of dollars away gift tax free to help their children and grandchildren with college costs, while paring down their estates and reducing potential estate tax liabilities.

There is a caveat, however. If the donor were to die during the five-year period, then a prorated portion of the contribution would be "recaptured" into the estate for estate tax purposes.

Example: In the previous example, assume Mr. Brady dies in Year 2. The result is that his total Year 1 and 2 contributions (\$26,000) are not included in his estate. But the remaining portion attributed to him in Years 3, 4, and 5 (\$39,000) would be included in his estate. However, the contributions attributed to Mrs. Brady (\$13,000 per year) would not be recaptured into the estate.

This estate planning use has emerged thanks to special tax rules surrounding lump sum contributions to 529 plans, combined with the convergence of two powerful trends--boomer grandparents and soaring college tuition.

Section 529 plan basics



Section 529 plans are governed by federal law (section 529 of the Internal Revenue Code, hence the name) but are sponsored by states and, less commonly, colleges. Each plan may have slightly different features, but each must conform to the federal framework. There are two types of 529 plans--college savings plans and prepaid tuition plans.

College savings plans are the more popular type; nearly all states offer one or more of these plans. A college savings plan functions like an individual investment-type account. You select one or more of a plan's investment portfolios, and you either gain or lose money, depending on how those portfolios perform (similar to a 401(k) plan). College savings plans typically accept over \$300,000 in maximum lifetime contributions, and these funds can be used for tuition, fees, room and board, books, and equipment at any accredited college in the United States or abroad.

By contrast, a prepaid tuition plan pools your contributions with the contributions of others, and in return you get a predetermined number of units or credits that are guaranteed to be worth a certain percentage of college tuition in the future (in effect, you are paying future tuition with today's dollars). Funds in a prepaid tuition plan can only be used to cover tuition and fees at the limited group of colleges (typically in-state public colleges) that participate in the plan. Prepaid tuition plans are generally limited to state residents, whereas college savings plans are open to residents of any state.

Each type of 529 plan has an account owner, who is the person who opens the account, and a beneficiary, who is the person for whom contributions are being made. The account owner has the flexibility to make contributions to the account, request withdrawals from the account, change the investment selections for the account (for college savings plans only), and change the beneficiary of the account.

Grandparents can open a 529 account and name their grandchild as beneficiary (only one person can be listed as account owner), or they can contribute to an already established 529 account.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

Grandparent as 529 account owner

A grandparent isn't required to be the account owner of his or her grandchild's 529 plan to make contributions to the account. But if the grandparent is the account owner, there are two additional benefits.

First, as account owner, a grandparent can retain some measure of control over his or her contributions by changing investment selections, authorizing account withdrawals for both education and non-education purposes, or even closing the account. A grandparent will have this control over these contributions even though they generally aren't considered



part of his or her estate--a rare advantage in the estate planning world. However, funds in a grandparent-owned 529 plan can still be factored in when determining Medicaid eligibility, unless these funds are specifically exempted by state law.

Second, a grandparent-owned 529 plan is not counted for purposes of federal financial aid, meaning that the value of the account won't have any impact on the beneficiary's ability to qualify for federal aid. Compare this to a parent-owned 529 plan, which is counted as a parental asset by the federal aid formula and may reduce the amount of federal aid a student is eligible to receive.

Did you know...

- If your grandchild doesn't go to college or gets a scholarship, you can name another grandchild as beneficiary with no penalty
- Many states offer income tax deductions for contributions to their 529 plan
- Assets in 529 plans are expected to grow to \$257 billion by 2011
- A recent survey of grandparents revealed that over half were, or planned on, contributing to their grandchildren's college education

(Source: Financial Research Corporation)

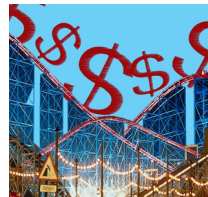
Tax consequences of 529 plans



The following chart summarizes the tax consequences of gifting to a 529 plan, and highlights the income tax ramifications.

Gift Tax	<p>All contributions to a 529 plan qualify for the annual federal gift tax exclusion--\$13,000 (\$26,000 for joint gifts).</p> <p>A special election for gifts up to \$65,000 (\$130,000 for joint gifts) can be made where the gift is spread evenly over a five-year period and no gift tax will be owed.</p> <p>Grandparents are subject to the generation-skipping transfer tax (GSTT) in addition to federal gift tax. Gifts of \$13,000 or less (\$26,000 for joint gifts) are excluded for purposes of the GSTT. Only the portion of the gift that results in federal gift tax will also result in GSTT.</p> <p>State laws may vary.</p>
Estate Tax	<p>Contributions made to a 529 plan generally aren't considered part of your estate for federal estate tax purposes when you die, even though you might retain control of the funds in the account (as 529 plan account owner) during your lifetime. Instead, the value of the account will be included in the beneficiary's estate.</p> <p>The exception to this general rule occurs when you elect to spread a gift over five years and you die during this five-year period. In this case, the portion of the contribution allocated to the years after your death would be included in your gross estate for tax purposes.</p> <p>State laws may vary.</p>
Income Tax	<p>Contributions grow tax deferred.</p> <p>Withdrawals from a 529 plan used to pay the beneficiary's qualified education expenses are completely tax free at the federal level.</p> <p>Withdrawals from a 529 plan that aren't used to pay the beneficiary's qualified education expenses (called a nonqualified distribution) face a double consequence--the earnings portion is subject to a 10% penalty and is taxed at the recipient's rate (in other words, the person who receives the distribution--either the account owner or the beneficiary--is taxed on it).</p> <p>State laws may vary.</p>

Estate tax--a moving target



If you're interested in using a 529 plan for estate planning purposes, be aware that the federal estate tax is scheduled to jump around over the next several years, according to provisions in the Economic Growth and Tax Relief Reconciliation

Act of 2001 (2001 Tax Act). The following table lists the increasing amounts that will be exempt from federal estate tax, along with the corresponding highest tax rate.

Year	Highest estate tax rates	Amount exempt from federal estate tax
2008	45%	\$2 million
2009	45%	\$3.5 million
2010	Federal estate tax scheduled to be repealed--no tax	Federal estate tax scheduled to be repealed--no tax
2011	Scheduled to revert to prior law	Scheduled to revert to prior law

Unless Congress takes additional action, the previous federal estate tax will be reinstated in 2011 under the sunset provisions of the 2001 Tax Act. Specifically, the top federal estate tax rate will be restored to 55%, and the federal estate tax exemption amount will return to \$1 million.

A trend that's here to stay



As the cost of a college education continues to climb out of reach for many parents, grandparents are stepping in to help. This trend is expected to accelerate in the coming years as

the baby boomers, most of whom went to college and want the same opportunities for their grandchildren, start gifting what is expected to be trillions of dollars over the next few decades. The benefit of using a 529 plan is twofold--grandparents can enjoy great personal satisfaction in helping their grandchildren with college costs, and they can do so in a way that pares down their estate and minimizes potential gift and estate taxes.



Investment Planners, Inc.
Donna J. Hines, RFC, CEP
4 Brown Avenue
Weston, WV 26452
phone:(304) 517-1300
dhines@investment-planners.com
cell:(304) 476-5677

Forefield Inc. does not provide legal, tax, or investment advice. All content provided by Forefield is protected by copyright. Forefield is not responsible for any modifications made to its materials, or for the accuracy of information provided by other sources.



IPI Asset Management, Inc.
Integrity ★ Performance ★ Innovation

Strategic Lifestyle & Wealth Management

Prepared by Forefield Inc, Copyright 2009