Maximizing the Value of 529 Plans

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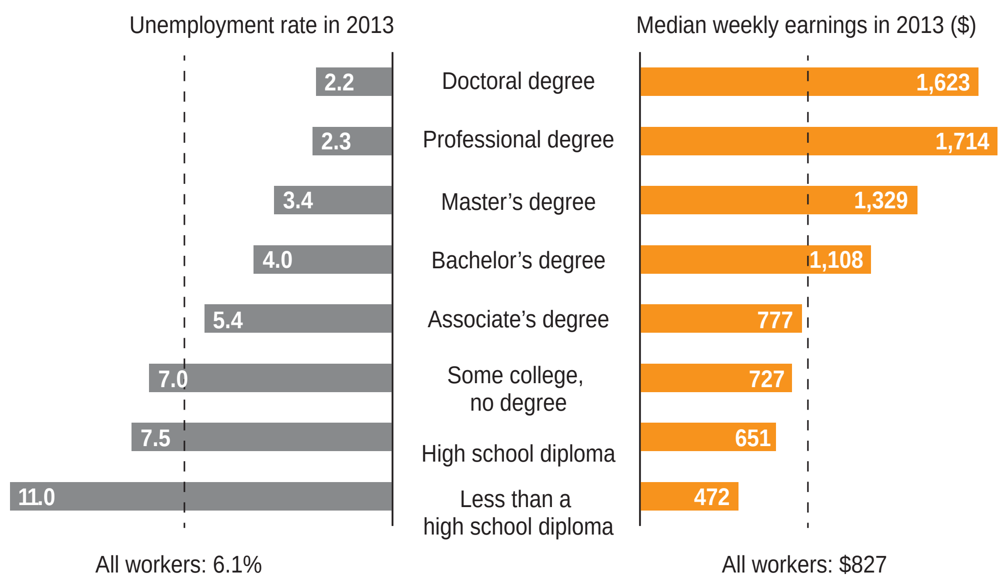
529 Plans — A Flexible Way to Invest for College

529 plans have come to be well known for the benefits they provide when saving and investing for college. In that respect, they are a useful tool for any parent, grandparent, relative, or friend saving and investing on behalf of a child who is planning to pursue higher education. Less well known are the ways the tax benefits of 529 plans may be used to aid in estate planning — uses that might be of interest to individuals whose primary investment concerns include planning an education legacy in addition to saving for college.

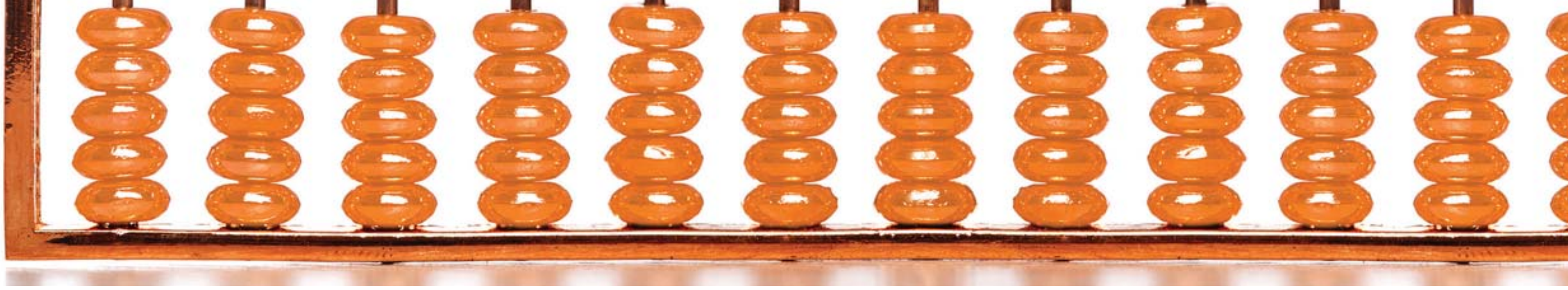
A Higher Education Degree Can Be Your Most Valuable Investment

Earnings and Unemployment Rates by Educational Attainment, 2013



Sources: Current Population Survey, U.S. Bureau of Labor Statistics, U.S. Department of Labor.

Note: Data are for persons 25 and over. Earnings are for full-time wage and salary workers.



529 Plans: the Benchmark in Preparing for College Costs

There are many ways to save and invest for college, but the most focused and flexible college investment program remains the 529 plan. These plans are established by states for the express purpose of allowing individuals to invest today for post-secondary educational expenses tomorrow. They offer:

Tax Advantages

- 529 plan investments grow tax-deferred, and qualified distributions to pay for the beneficiary's college costs are free of federal and, in almost all cases, state taxes.[1, 2]
- Your own state may offer additional tax breaks such as an upfront deduction for your contributions.

Professional Management

- The plans are overseen by state officials pursuant to federal tax law but most are professionally managed by qualified investment managers retained by such state officials.

High Contribution Limits

- Many state plans allow over $300,000 per beneficiary or account to be invested for higher education purposes.

Flexibility

- The funds can be used tax free at most two- or four-year college, graduate school, technical or vocational school for tuition, room and board, books, fees, supplies and equipment required for attendance.
- Anyone can contribute — parents, grandparents, family and friends — with no income or age restrictions to an account and with anyone named as beneficiary.

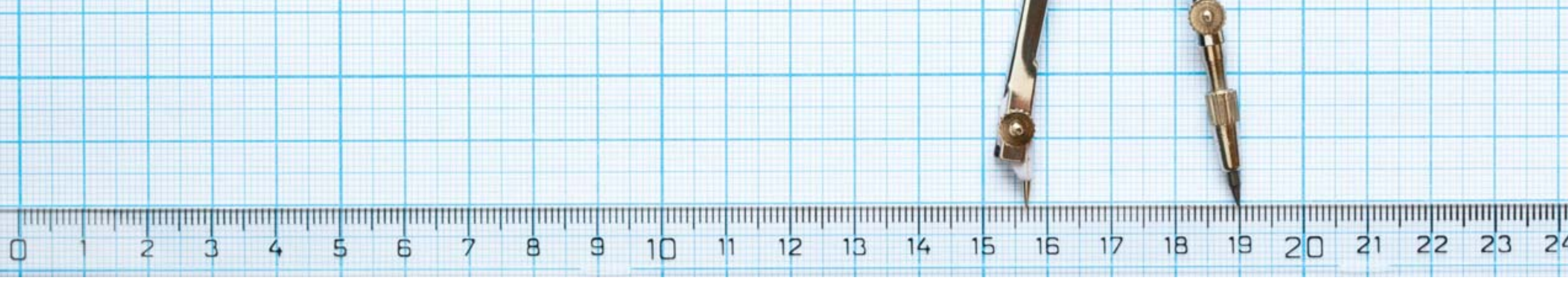
Control

- The 529 account owner retains control of account assets. Even after gifted, the assets are not considered part of the donor's taxable estate, a significant advantage.
- The 529 account owner can change beneficiaries any time, allowing one account to be used for multiple children.
- The withdrawal of some or all of the account balance can be used for any purpose.[2]

In addition to these standard benefits, 529 plans have unique features that are useful for legacy and estate planning, and other purposes. The next section explores some of those advanced uses of 529 plans to show how clients may benefit from their full potential.

[1] Only one state, Alabama, does not offer state tax-free withdrawals for qualified expenses for any plan but its own.

[2] Nonqualified withdrawals are subject to a 10% penalty on the earnings component of such withdrawal, unless such penalty is waived, as well as taxes at ordinary rates of the recipient on such earnings.



How Do 529 Plans Compare to Taxable and Other Investments?

The question is often posed as to how 529 plans compare to alternatives, including taxable investments that could result in a low capital gains tax regardless of whether or not the proceeds are applied to qualified expenses. There are a number of factors to consider in determining the net after-tax benefit to the account owner when comparing tax-advantaged 529 accounts versus more traditional vehicles. The tax impact of a distribution from an account has many variables. For example, the potential application of the new net investment income tax of 3.8% that went into effect in 2013 could impact distributions from taxable accounts.

Feature	529 Account	Coverdell ESA	Custodial Account	Taxable Brokerage Account
Income limitations for participation	None	Single filers $95–110K; joint filers $190–220K	None	None
Control of account	Owner	Custodian, until beneficiary turns 30	Custodian until the minor reaches the age of majority	Owner
Annual maximum contribution limit	$14K/28K (single/couple) w/o gift tax	$2K per beneficiary <age 18[3]	$14K/28K (single/couple) w/o gift tax	None
Taxation of earnings	None	None	"Kiddie" tax applies to child <age 19 or full time student <age 24	At owner's rate
Distributions federal tax free	Yes	Yes	No	No
May offer state tax benefits	Yes	No	No	No
Penalty for nonqualified withdrawals	10% of earnings	10% of earnings	N/A	N/A
Investment choices	Owner chooses from many options	Owner chooses investments	Owner chooses investments	Owner chooses investments
Can change beneficiaries	Yes	Yes	No	N/A
Use for college expenses	Yes	Yes	Yes	Yes
Use tax-free for primary or secondary school expenses	No	Yes	No	No
Use tax-free for college expenses	Yes	Yes	No	No

[3] Any individual (including the designated beneficiary) can contribute to a Coverdell ESA if the individual's Modified Adjusted Gross Income for the year is less than $110,000. For individuals filing joint returns, that amount is $220,000.

In addition to the methods described on the previous page, there are other vehicles one can use to prepare for college. Many offer significant tax and other benefits, but when it comes to saving for education, they each present challenges. Here is a quick review of a few of the more popular college saving and investing options.

Taxable investment accounts may be the most popular way to save and invest for college costs. There are many options to choose from, and if simply held in a vehicle with no current income, may be subject to a low capital gains tax when liquidated. However, the capital gains tax may be augmented by the new 3.8% net investment income tax. In addition, taxes on income generated, such as dividends and interest, may be due annually.

IRAs are commonly used to pay college costs and are distributed without a penalty for qualified higher education expenses. While, like 529 plans, they grow on a tax-deferred basis, contributions are limited to $5,500 per year ($6,500 if over age 50). And, although there is no penalty, taxes may be due on earnings or deductible contribution portions of the distribution. Further, certain withdrawals may be considered income in the year taken, which may hamper your ability to receive financial aid in the following year. Most disadvantageous, any withdrawal from an IRA reduces the amount available for retirement in later years.

Permanent life insurance, accessed through a loan based on a percentage of the value built up over time through payment of annual premiums, is another frequently used vehicle. It allows a policy holder to accumulate value on a tax-deferred basis and then access a percentage of that value without a tax liability. The problem here is that the unpaid accrued interest on the loan reduces the insurance coverage, and the premium must continue to be paid to keep the insurance in force while the loan remains outstanding. Of course, one must qualify for life insurance and any loans taken reduces the amount available for a death claim.

Savings Bonds were a traditional way of disciplining families to save for college, with significant tax advantages. In a low interest rate environment, such as we have seen in recent years, savings bonds may not offer sufficient returns to keep pace with the rising costs of college. Also, for such earnings to be applied tax-free, certain strict requirements must be met including lower taxable income.

Understanding the Estate Tax Benefits of Contributing to, and Owning, a 529 Account[4]

529 plans offer unique gift and estate tax benefits that can play an important role in family wealth transfer planning. Beyond their important education advantages, every dollar gifted in a 529 plan is positioned to be excluded from the contributor's taxable estate. And unlike most other estate planning vehicles, the account owner always retains control of the assets. No other estate planning vehicle allows the owner to retain assets outside their taxable estate. Investors can employ annual or accelerated gifts to build their 529 education legacy while reducing the value of their taxable estate.

Annual Gifts

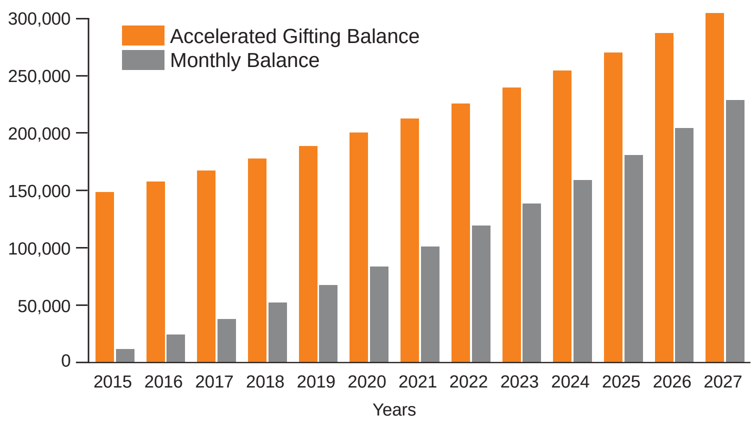
Contributors can make annual completed gifts to a 529 plan within the gift tax limits — currently $14,000 per year for individual contributors or $28,000 for couples filing jointly — *per beneficiary*. Any contributions in excess of the gift tax limits may be subject to the federal gift tax.[4]

Accelerated Gifts

A special provision of 529 plans allows a contributor to elect to aggregate five years of contributions (the current year plus four future years) through accelerated gifting.[5] This allows a one-time gift of up to $70,000 for individual contributors or $140,000 for couples filing jointly, or five times the annual gifting limit — *per beneficiary*. The size of the donor's taxable estate is reduced by the accelerated gift. In addition, the larger investment goes to work right away in the 529 plan, potentially offering greater accumulation of savings over time.

Accelerated gifting of $70,000 for an individual, and $140,000 for a couple, exhausts the donor's annual gift tax exclusion to that beneficiary for five calendar years, so no further gifts can be made until that time has passed. However, if you make an accelerated gift of an amount less than the allowed maximum, further contributions can be made in subsequent years within the gift tax limits. For example, if you make an accelerated gift of $50,000 in year one, it is treated as a $10,000 gift per year over five years, allowing a $4,000 gift to be made for that beneficiary in each of the next five years without exceeding the current $14,000 per year exclusion.

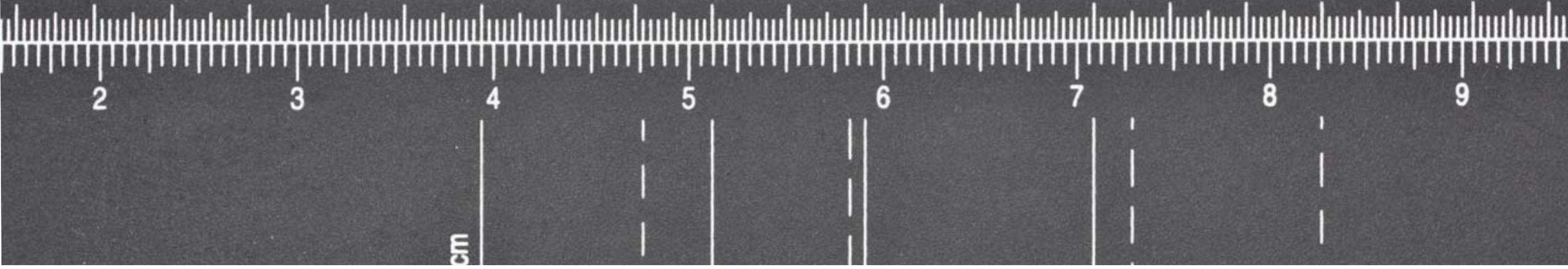
Accelerated Gifting vs. Monthly Contributions Totaling $140,000[6]



[4] The information presented herein should not be construed as tax advice. Before implementing any strategy that seeks tax advantages, 529 account owners should consult with their financial advisors, accountants or other tax professionals.

[5] The participant must indicate an accelerated gift by completing IRS Form 709 at tax filing.

[6] This example is hypothetical and assumes a 6.00% annual rate of return. This example does not represent the performance of any particular investment. Different assumptions will result in outcomes different from this example. Your results may be more or less than the figures shown. These figures do not reflect any management fees or expenses that would be paid by a 529 plan participant. Such costs would lower performance. This chart is shown for illustrative purposes only. Gift taxes apply to lump sum investments exceeding $70,000 per beneficiary from individual filers and $140,000 from married couples. Talk to your financial or tax advisor about gift tax implications in your specific situation. **Past performance does not guarantee future results.**



If a donor makes an accelerated gift but dies within the five-year period, the portion of the contribution allocable to the years after death will be added back into the donor's taxable estate.

Applying future years annual exclusion with unique 529 funding rules puts more funds to work in a tax-deferred investment account sooner. One could further fund each 529 account utilizing their Unified Lifetime Gift Tax Exclusion. The exclusion is set at $5.43 million for 2015, but may be higher in future years to reflect adjustments for inflation.

Advantages of Gift Timing

Many families may also be able to take advantage of a two-calendar-year strategy to maximize gifts, avoid gift tax, obtain any available state tax deductions and reach investment fee breakpoints. For example, a couple with two children or grandchildren can contribute up to $28,000 to each beneficiary each year. In the fourth quarter of the first year, the couple contributes $28,000 to each child's account. In the second year, they contribute five-year accelerated gifts of $140,000 to each child's account. Their gifts total $336,000, all of which remains exempt from gift tax and grows invested outside their estate.

Using Accelerated Gifting as Part of an Estate Plan

You can open 529 accounts for as many beneficiaries as you wish; thus, it is possible to extend even further the estate planning advantages of 529 plans. For example, suppose a married couple, Bill and Donna, want to contribute to college savings accounts for their five grandchildren, Josh, Matt, Sarah, Aria and Luke. They open 529 accounts for each grandchild, then take advantage of accelerated annual gifting to maximize the amount contributed to each.

Josh	Matt	Sarah	Aria	Luke	Total Gifts
$140,000	$140,000	$140,000	$140,000	$140,000	$700,000

Pre-gift estate	$6,400,000
Less gift total	$700,000
Post-gift estate	$5,700,000

Bill and Donna have given Josh, Matt, Sarah, Aria and Luke a good start on funding their college educations; at the same time, the couple have significantly reduced their taxable estate.[7]

For gift tax purposes, the assets are considered completed gifts and thus removed from the account owners' estate, yet Bill and Donna retain control of the assets.

State Tax Advantages for Estate Plans

The estate and gift tax benefits of 529 plans have made them popular with high net worth investors. In recent years, however, Congress has moved to raise the federal state tax exemption, currently at $5.43 million for individuals and $10.86 million per couple (2015), so far fewer investors are affected by federal estate taxes. Under current law, this amount is to be increased annually to reflect an adjustment for inflation.

On the other hand, many states still have much lower estate tax thresholds. States such as New Jersey ($675,000) and Minnesota ($1 million) have estate and/or inheritance tax challenges that may be at least partially addressed by utilizing 529 plans. Consult with your Tax Advisor to see if you could benefit from 529 plans as an estate tax planning vehicle in your state or circumstance.

[7] This is a hypothetical example for illustrative purposes only.

Understanding How Trusts May Benefit from Investing in 529 Plans

Trusts are a regular part of estate and education funding planning. Trusts typically can own 529 plan accounts; the benefit of doing so is to avoid the onerous income taxes normally imposed on trust income. A grantor who has set up an irrevocable trust to fund a beneficiary's college education might want to consider transferring it to a 529 plan for greater tax advantages and asset control.

Tax Advantages

Irrevocable trusts outside a 529 plan are normally taxed at trust tax rates. In 2015, taxpaying trusts only needed to realize $12,300 in taxable income to be subject to the maximum 39.6% federal tax rate, and that's before the new 3.8% net investment income tax (and any applicable state income taxes) are applied. By moving your irrevocable trust into a 529 plan, all assets start immediately to grow income tax free, and all distributions from that point are also tax free as long as they are used for qualified educational expenses.

Example: Grandparents set up a trust for their grandchildren to invest in 529 plans, resulting in tax savings for the grandparents and higher long-term growth for their grandchildren.

Better Alignment with Educational Goals

By allowing donors to earmark assets specifically for college savings, 529 plans may better help the trust meet educational objectives. 529 plans also offer investments specifically designed to fit the time parameters between birth and college.

Tips on How Trusts Can Be Used with 529 Plans

- It's a good idea when drafting a trust document to specify that the trust may invest in a 529 plan, even though 529 plans generally meet the standard prudent investor rule applicable to trusts.
- There are nuances and legal considerations with any transfer of a trust into a 529 plan, so it is important that you speak with counsel when employing this strategy. Make sure the terms of your trust allow you to invest inside of a 529 plan. The rules of the trust always apply.
- 529 accounts can accept only cash, so trust assets not held in cash must be sold to effect a transfer, which can create a taxable event.
- The trust should be named as the participant of the 529 plan and the child as the beneficiary. Trusts with multiple beneficiaries will have to open separate 529 accounts for each one.
- If you have a large trust, consider retaining some funds outside of the 529 plan for other, non-educational purposes.
- Indicate on your account application that this is a transfer from a trust. You must submit a certified trust document with your account application, which the 529 custodian will hold on file.
- Nothing changes when the beneficiary reaches the age of majority; control is transferred to the beneficiary, as is the case with most trusts.
- All distributions will be tax free if used for qualified higher education expenses.

529s: Flexible Alternatives to Custodial Accounts

UGMA/UTMA custodial accounts, established at a financial institution under a state's Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA), are managed for a minor child by a parent or other designated custodian. They are held in the child's name, and considered the child's property. This provides significant tax advantages, as all earnings and distributions are taxed at the child's rate.

Custodial accounts also offer a great deal of flexibility; they do not limit how much you can set aside for the child, provide unlimited investment selection within a tax-advantaged framework, and do not restrict how the assets can be used. All of this makes UGMAs/UTMAs suitable for college savings. On the other hand, they are considered irrevocable gifts, meaning all the assets are turned over to the beneficiary's control at the age of 18 or 21. Let's take a look at the ins and outs of custodial accounts as a college savings vehicle.

Taxes — In an UGMA/UTMA, only the first $1,050 of earnings and gains are tax-exempt. The second $1,050 is taxed at the minor's tax rate and earnings over $2,100 are subject to the parents' tax rate — which is typically higher and now may be subject to the new additional 3.8% net investment income tax. Thus, for larger balances a 529 plan may make more sense, since earnings grow tax free and can be applied tax free as long as they're used for qualified educational expenses.

Control — The beneficiary is entitled to take control of an UGMA/UTMA from the custodian at the age of majority, while a 529 account owner never loses control of the assets — in fact, you can change the beneficiary in a 529 account to another family member at any time.

Investments — UGMA/UTMA accounts require a great deal of long-term investment oversight and expertise, while 529 plans usually have built-in investment management, including cost-effective age-based options to help you navigate investing from birth to college.

Financial Aid — UGMA/UTMA accounts are considered assets of the beneficiary, so they count more heavily than parental assets like 529 accounts in federal needs-based financial aid eligibility (20% of student's assets are counted in the financial aid calculation vs. 5.6% of parental assets).

Estate Taxes — All UGMA/UTMA assets still under the control of the custodian at death are included in the donor/custodian's taxable estate. 529 contributions, on the other hand, are generally considered completed gifts and may be deemed removed from the donor's taxable estate.

Paperwork — UGMA/UTMA accounts require a 1040 filing (and quarterly estimated taxes) for the child in any year the income exceeds the standard deduction. In a 529 plan, you won't receive a Form 1099 to report taxable or nontaxable earnings until the year after the owner makes a withdrawal.

In contrast to the freedom a 529 account owner is given to manage the account, UGMA/UTMA custodial accounts are subject to a number of specific ownership restrictions:

- The custodian cannot change the designated beneficiary of the account.
- The custodian can only appoint a successor custodian as account owner.
- The custodial account must be separate from any individual accounts to qualify as UGMA/UTMA assets.
- When the custodianship terminates, the designated beneficiary becomes the account owner.

If a client already has an UGMA/UTMA or other college funding vehicle, it's not too late — or too difficult — to transfer it into a 529 plan. Once the UGMA/UTMA is invested in the 529 plan, such assets are then treated as assets of the parent under the federal financial aid formula; i.e., are weighted 5.6%. If the majority of the client's savings is earmarked for college, consider the tax benefits, flexibility and control 529 accounts offer.

Investing an Existing UGMA/UTMA in a 529 Plan

- 529 accounts can only accept cash, so custodial assets not held in cash must be sold, which can create a taxable event.
- Indicate on your account application that this is a transfer from an UGMA/UTMA account.
- Don't change the beneficiary, as this is prohibited with all UGMA/UTMA custodial accounts.
- Understand that control must be transferred to the beneficiary at the age of majority, just as was the case in the UGMA/UTMA.
- All accounts will grow tax free and be distributed tax free if used for qualified higher education expenses.

Extending the Benefits of 529 Plans Through Transfers

Coverdell Educational Savings Account (ESA) to a 529 Plan

If a child is about to turn 30 with unspent funds in the ESA, you may wish to transfer those assets to a 529 plan. You can do so without tax consequences as long as the beneficiary remains the same and any untaxed earnings are reported for later cost-basis purposes. The reverse does not work; transfers from a 529 plan to an ESA are treated as distributions subject to tax and penalty.

Savings Bonds to a 529 Plan

If you already started college savings with Series I or post-1989 Series EE savings bonds and they have recently matured, you can retain their tax-free status by transferring the proceeds to a 529 plan. You can expand the tax-free use of the funds to include not just tuition and fees but room and board as well as books and supplies. You can also expand your growth potential, with equity and fixed income investment options that have greater long-term potential than savings bonds.

Tips for Transferring Savings Bonds

- Keep track of any interest earned on the saving bonds. This amount can also be rolled over tax free to a 529 plan as long as your income is below $92,199 single/$145,749 married.
- Indicate on your enrollment form that this is a transfer from Savings Bonds.
- Complete the transfer within 60 days.
- Remember you still maintain control over the assets at the age of majority, unless you want to transfer control to the beneficiary.
- File IRS Form 8815 to claim the exclusion from income.
- All distributions will be tax free if used for qualified higher education expenses.

Transferring a 529 Account to Another 529 Account

You can transfer all or a portion of one 529 account to another as a rollover to better organize your finances. If the accounts have the same beneficiary, federal tax law provides that you can roll over once every 12 months. You can roll over as often as you like if you are changing beneficiaries. You can choose to have the proceeds be transferred directly from the current trustee to the new one, or opt to receive the money yourself, in which case you have 60 days to deposit it in the new 529 account to avoid taxes and penalties.

Setting Up a 529 Account under Joint Ownership

Some 529 plans allow the option of joint account ownership, which may be particularly beneficial for couples who each want a say in how the money is invested, managed and distributed. As with a joint banking account, a joint 529 account allows either party to act on the account.

Tips on Joint Ownership

- Make sure the 529 plan provider makes joint ownership available, as most plans do not allow it.
- The name and Social Security Number of the primary account owner will be used for Internal Revenue Service ("IRS") reporting purposes.
- Account statements and trade confirmations are typically sent to the primary account owner's address, but it is usually possible to have duplicate statements sent to the joint account owner at a different address.
- Each account owner should consult their tax advisor regarding the proper treatment of any IRS reporting. All distributions will be tax free if used for qualified higher education expenses.

Other Ways to Take Advantage of 529 Plans

Fund 529 Accounts with Required Minimum Distributions

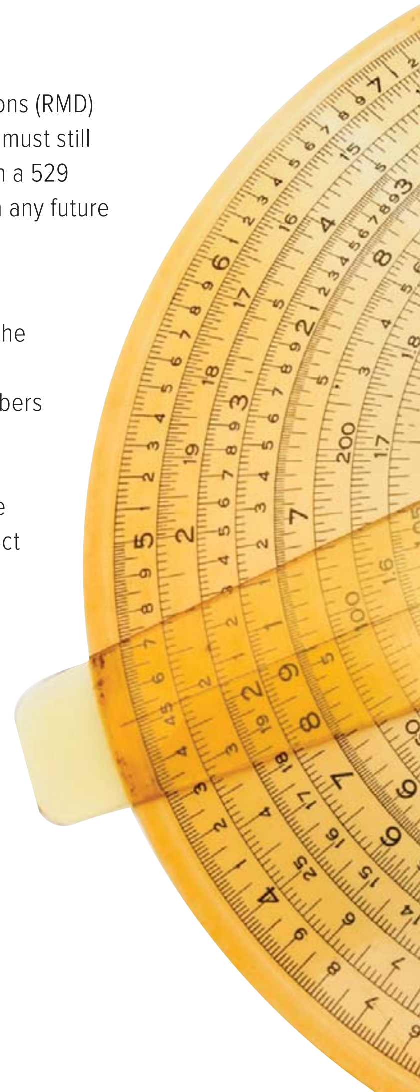
If you have savings in a defined contribution plan or IRA, you must start taking required minimum distributions (RMD) by age 70½. If you don't need this regular income, consider using the proceeds to fund a 529 account. You must still pay the taxes due on the RMD, but you can plough the savings back into another tax-advantaged vehicle. In a 529 account, unlike an IRA, you never have to make a withdrawal as there are no RMDs. Also, you pay no tax on any future distributions as long as the money goes for qualified higher education expenses.

Changing Beneficiaries on a 529 Account

One of the unique features of 529 plans is the ability of the account owner(s) to change the beneficiary on the account at any time to another member of such beneficiary's family. If the designated beneficiary does not attend college, for example, the beneficiary can be re-designated to a wide variety of qualified family members ranging from a step-sibling to a first cousin or to even the parent, who may be the account owner as well as the beneficiary at the same time. It is important to note that unlike other beneficiary change scenarios, a change to a younger generation could result in certain gift or generation skipping taxes, as a gift from the prior beneficiary to the successor beneficiary. Consult your tax advisor as to how any such change may affect your tax liability.

529 Plans Offer Favorable Impact on Financial Aid

529 plans are specifically designed to have a minimal impact on needs-based financial aid calculations. The expected family contribution calculation uses 20% of the value of accounts held in the child's name — such as UGMA/UTMAs and trust accounts — as available financial resources. 529 accounts by contrast are considered parental assets, and are assessed only 5.6% of their value in financial aid calculations. If grandparents own the account, none of the value is included, and would only be if money is distributed from the account prior to the financial aid application.



529 Plans: College Investments and Estate Planning

Perhaps the most valuable investment you can make in your children's future is to fund the cost of a college education. College costs continue to climb, however, making it ever more important to have a plan to reach this investment goal. There are many ways to do this, but the benchmark for college saving remains the 529 plan. These plans are structured to encourage investment today to accrue savings for tomorrow and therefore offer attractive long-term benefits:

- Investments grow tax deferred.
- Distributions to pay the beneficiary's college costs are generally tax free.
- Certain states offer additional tax breaks such as upfront deductions for contributions.

The tax advantages and flexibility of 529 plans make them effective college saving vehicles. The benefits don't stop there, however:

> 529 accounts allow participants to take advantage of tax savings unavailable elsewhere in the federal tax code, and thus offer high potential value as estate planning tools. For example, generally 529 contributions fall outside the contributor's taxable estate. And unlike any other estate planning tool, the account owner retains control of the assets. Families commonly use two strategies with 529 accounts to achieve wealth transfer objectives:
>
> - Annual gifts — because 529 plans have high annual contribution limits, large amounts can be positioned to grow outside your taxable estate each year.[8]
> - Accelerated gifts — for those able to contribute more, you can aggregate five years of contributions, creating a one-time gift of up to $70,000 per beneficiary or $140,000 for couples, reducing the size of your estate.

These and other advantages may make 529 plans the "go-to" choice for college saving. What's more, they may offer attractive estate planning benefits for families that may wish to provide for future generations a vehicle that allows the most efficient manner to pay for college. Talk to your financial advisor today to see how a 529 plan can help meet your college savings or wealth transfer goals.

[8] Because 529 plan beneficiary contributions are considered gifts, however, contributions in excess of the gift tax limits — $14,000 per year for individual tax filers and $28,000 for couples filing jointly — are subject to the federal gift tax, except for gifting inside the 529 account which allows for tax-free accelerated gifting.

Investments in 529 plans are not guaranteed or insured and are subject to investment risks, including the loss of the principal amount invested.

The tax information herein is not intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding tax penalties. Taxpayers should seek advice based on their own particular circumstances from an independent tax advisor.

An investor's home state may offer state tax or other benefits that are only available for investment in that state's qualified tuition program. Please consider this possibility before investing.

The earnings component of nonqualified withdrawals may be subject to federal and state taxes and the additional federal 10% tax.

Investors should carefully consider the investment objectives, risks and charges and expenses of 529 plans and their underlying funds before investing. This and other information can be found in the Program Description or other disclosure documents of the 529 Plan. You may obtain this information from the program's administrators or your financial professional. Please read all materials carefully before investing or sending money.

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