529 PLANS:
ESTATE PLANNING MAGIC

Luke Harriman

January 21, 2022

Much

Roadmap

- Fundamentals of 529 plans
- Income tax rules
- FAFSA eligibility
- Gift tax rules
- Estate tax rules
- GST tax rules
- Planning implications
- Q&A

Fundamentals of 529 plans

- Important for estate planners to understand the fundamentals of 529 plans beyond the transfer tax rules

Fundamentals of 529 plans

Much

- Prepaid tuition program (§ 529(b)(1)(A)) vs. § 529 savings accounts
  – Section 528 provides for both
  – Prepaid tuition plans are less flexible, and are being offered by fewer and fewer states
  – Shorthand: “529 plan” = “529 savings account”

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor
  - Account owner

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor
  - Account owner
  - Designated beneficiary

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor
    - “Contributor” and “donor” used interchangeably
    - The person who “funds” the 529 plan
    - Anyone can contribute to a 529 plan regardless of who the owner is
  - Account owner
  - Designated beneficiary

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor
  - Account owner
    - Power to change beneficiaries, invest, and make distributions
    - Does not have to be an individual
    - Can designate “successor account owner”
    - No fiduciary duties merely by being an account owner
  - Designated beneficiary

Fundamentals of 529 plans

- Four important characters in a 529 plan:
  - State
  - Contributor/donor
  - Account owner
  - Designated beneficiary
    - Must be an individual
    - No required accountings to beneficiary
    - May be changed (subject to tax-related limitations)

Fundamentals of 529 plans

Much

Beneficiary
Jesse D Harriman

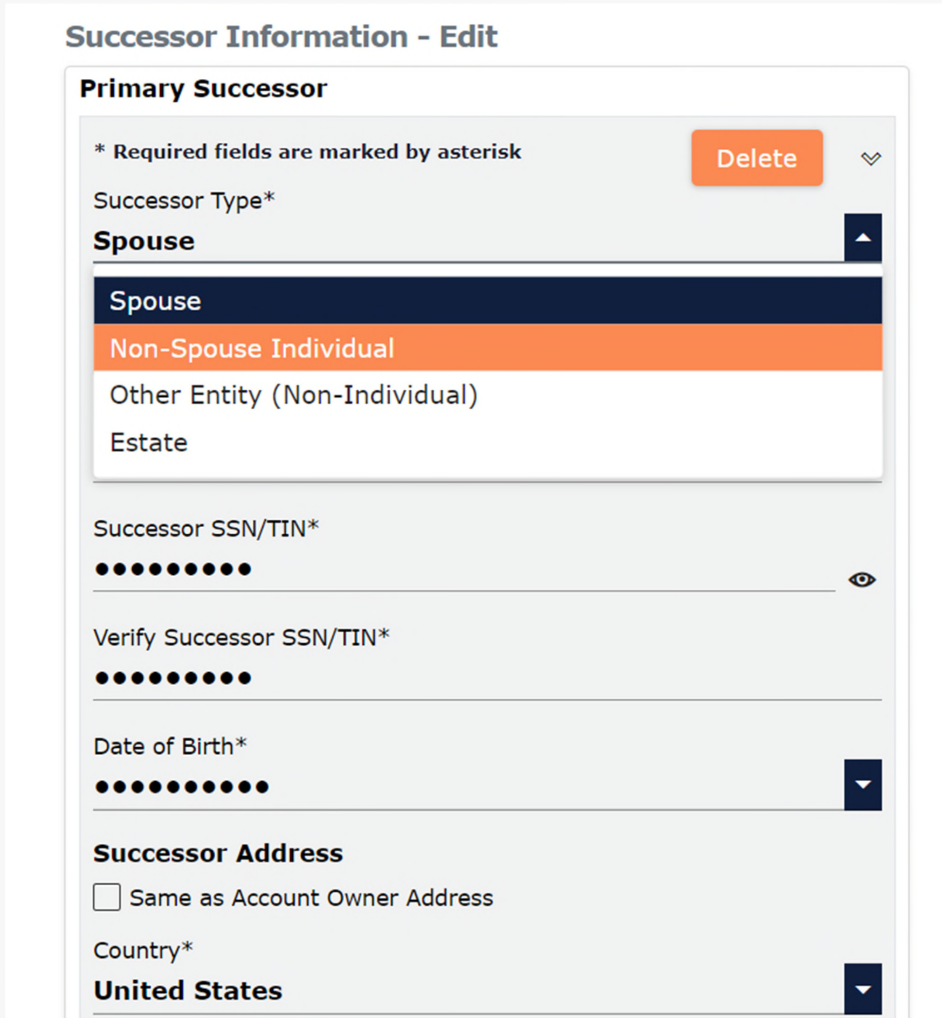
Owner
LUKE E HARRIMAN

Account 5000288845 - Individual

Current Balance	Rate of Return		
$[redacted]	**+13.09%**		
YTD Contributions	YTD Withdrawals	LTD Contributions	LTD Withdrawals
$0.00	**$0.00**	**$[redacted]**	**$0.00**

Account Holdings · Transaction Activity · Rate of Return

Fundamentals of 529 plans


Successor Information - Edit

Primary Successor

* Required fields are marked by asterisk

Delete

Successor Type*

Spouse

- Spouse
- Non-Spouse Individual
- Other Entity (Non-Individual)
- Estate

Successor SSN/TIN*

●●●●●●●●●

Verify Successor SSN/TIN*

●●●●●●●●●

Date of Birth*

●●●●●●●●●●

Successor Address

Same as Account Owner Address

Country*

United States

Fundamentals of 529 plans

Much

- Contribution limits
  - No limit to value of account

Fundamentals of 529 plans

- Contribution limits
  - No limit to value of account
  - Maximum lifetime limit for contributions varies by state
    - Arizona: $501,000
    - Illinois: $500,000

Fundamentals of 529 plans

- Contribution limits
  - No limit to value of account
  - Maximum lifetime limit for contributions varies by state
    - Arizona: $501,000
    - Illinois: $500,000
  - No limit on contributions in a given year

Fundamentals of 529 plans

- Improved investment options and fees in recent years

Income tax rules

- Ongoing interest and dividends exempt from income tax

Income tax rules

- Contributions
  - Not deductible for federal income tax purposes

Income tax rules

- Contributions
  - Not deductible for federal income tax purposes
  - May be deductible for state income tax purposes
    - Some states: contributions to any state’s 529 plan are deductible
      - Arizona: up to $4,000 per beneficiary per year for MFJ

Income tax rules

- Contributions
  - Not deductible for federal income tax purposes
  - May be deductible for state income tax purposes
    - Some states: contributions to any state’s 529 plan are deductible
      - Arizona: up to $4,000 per beneficiary per year for MFJ
    - Other states: only contributions to that state’s 529 plan are deductible
      - Illinois: up to $20,000 total per year for MFJ

Income tax rules

- Distributions: “qualified distribution” vs. nonqualified
  - Qualified distribution: “qualified higher education expenses” at an eligible educational institution
    - “Qualified higher education expenses”: tuition, fees, etc.
    - Up to $10,000 for elementary or secondary school (subject to state limitations)
    - Qualified distributions are free of income tax

Income tax rules

- Distributions: “qualified distribution” vs. nonqualified
  - Qualified distribution: “qualified higher education expenses” at an eligible educational institution”
    - “Qualified higher education expenses”: tuition, fees, etc.
    - Up to $10,000 for elementary or secondary school (subject to state limitations)
    - Qualified distributions are free of income tax
  - Non-qualified distributions: taxable income on earnings portion, plus 10% penalty

Income tax rules

- Changing beneficiaries
  - No income tax consequences as long as the new beneficiary is a “member of the family” of the original beneficiary

Income tax rules

- Changing beneficiaries
  - No income tax consequences as long as the new beneficiary is a “member of the family” of the original beneficiary
  - “Member of the family” includes:
    - Spouse
    - Descendants
    - Sibling or stepsibling
    - Ancestor
    - Stepparent
    - Niece or nephew
    - Aunt or uncle
    - Son-, daughter-, father-, mother-, brother-, or sister-in-law
    - Spouse of any of the foregoing
    - First cousin

FAFSA

- FAFSA eligibility
  - 529 of which a dependent student or parent is the owner is a “parent asset”
    - 5.64% “tax rate”

FAFSA

- FAFSA eligibility
  - 529 of which a dependent student or parent is the owner is a "parent asset"
    - 5.64% "tax rate"
  - Compare to UGMA or UTMA account – "student asset"
    - 20% "tax rate"

FAFSA

- FAFSA eligibility
  - 529 of which a dependent student or parent is the owner is a “parent asset”
    - 5.64% “tax rate”
  - Compare to UGMA or UTMA account – “student asset”
    - 20% “tax rate”
  - Distributions from grandparent-owned 529 plans are no longer considered income to students starting this year

Gift tax rules

- Gift tax rules
  - “Completed gift” for gift tax purposes
    - Unusual given that the owner retains the power to change beneficiaries and control distributions

Gift tax rules

- Gift tax rules
  - “Completed gift” for gift tax purposes
  - Not treated as a transfer of a future interest, so annual exclusion from gift tax ($16,000 per recipient in 2022) applies

Gift tax rules

- Gift tax rules
  - "Completed gift" for gift tax purposes
  - Not treated as a transfer of a future interest, so annual exclusion from gift tax ($16,000 per recipient in 2022) applies
  - May "superfund" with five years worth of annual exclusion gifts if 709 is filed

Gift tax rules

- Gift tax rules
  - "Completed gift" for gift tax purposes
  - Not treated as a transfer of a future interest, so annual exclusion from gift tax ($16,000 per recipient in 2022) applies
  - May "superfund" with five years worth of annual exclusion gifts if 709 is filed
  - Married couples may split gifts

Gift tax rules

- Example: married couple with three children

$16,000 annual exclusion amount

x 5 (years worth of annual exclusion gifts)

x 2 (married couple splitting gifts)

x 3 (number of children)

Gift tax rules

- Example: married couple with three children

  $16,000 annual exclusion amount

  x 5 (years worth of annual exclusion gifts)

  x 2 (married couple splitting gifts)

  x 3 (number of children)

  = **$480,000**

. . . in one year, using <u>no</u> estate/gift tax exemption

Gift tax rules

- Gifts above annual exclusion amount use a portion of the donor’s $12.06 million estate/gift tax exemption

Gift tax rules

- Changing the beneficiary is a taxable gift unless:
  - the new beneficiary is in the same generation as the old beneficiary (or of a "higher" generation), and
  - the new beneficiary is a "member of the family" of the old beneficiary

Estate tax rules

- “No amount shall be includible in the gross estate of any individual for purposes of [the estate tax] by reason of an interest in a qualified tuition program.”
  IRC § 529(c)(2)(B).

Estate tax rules

- “No amount shall be includible in the gross estate of any individual for purposes of [the estate tax] by reason of an interest in a qualified tuition program.”
  IRC § 529(c)(2)(B).
- Definitely not includible in owner’s taxable estate upon owner’s death

Estate tax rules

Much

- “No amount shall be includible in the gross estate of any individual for purposes of [the estate tax] by reason of an interest in a qualified tuition program.”
  IRC § 529(c)(2)(B).
- Definitely not includible in owner’s taxable estate upon owner’s death
- May be includible in beneficiary’s taxable estate upon beneficiary’s death

GST tax rules

Much

- Contribution to a 529 plan for a grandchild is likely a “direct skip”

GST tax rules

- Contribution to a 529 plan for a grandchild is likely a “direct skip”
- Eligible for annual exclusion from GST tax (also $16,000 per donee per year)

GST tax rules

- Contribution to a 529 plan for a grandchild is likely a “direct skip”
- Eligible for annual exclusion from GST tax (also $16,000 per donee per year)
- “Skip” contributions above GST annual exclusion use up a portion of the transferor’s $12.06 million lifetime GST tax exemption

GST tax rules

Much

- Contribution to a 529 plan for a grandchild is likely a “direct skip”
- Eligible for annual exclusion from GST tax (also $16,000 per donee per year)
- “Skip” contributions above GST annual exclusion use up a portion of the transferor’s $12.06 million lifetime GST tax exemption
- Changing the beneficiary is subject to GST tax if the new beneficiary is two or more generations younger than the old beneficiary

Planning Implications

- 529 plans are underutilized

Planning Implications

- Comparing and coordinating with other transfer vehicles
  - UTMA/UGMA
  - Direct payment of tuition
  - Intentionally defective grantor trusts
  - Spousal lifetime access trusts

Planning Implications

- UTMA/UGMA
  - Donors often regret “overfunding” UTMA/UGMA accounts shortly before the beneficiary reaches age 21

Planning Implications

- Direct payment of tuition
  - Uses no transfer tax exemption
  - Very high net worth clients should always take advantage of this
  - Unlike 529 plans, limited to current obligations

Planning Implications

- Intentionally defective grantor trusts
  - Donor paying ongoing income tax liability vs. no income tax liability
  - Crummey withdrawal rights, but:
    - No “superfunding”
    - Generally no GST annual exclusion
  - IDGTs are better for GST transfers if the intent is to benefit children first, before grandchildren

Planning Implications

Much

- Intentionally defective grantor trusts
  - Donor paying ongoing income tax liability vs. no income tax liability
  - Crummey withdrawal rights, but:
    - No “superfunding”
    - Generally no GST annual exclusion
  - IDGTs are better for GST transfers if the intent is to benefit children first, before grandchildren
  - IDGTs offer more investment choices

Planning Implications

- Spousal lifetime access trusts
  - Comparable flexibility (with spousal limited power of appointment)

Planning Implications

Much

- Spousal lifetime access trusts
  - Comparable flexibility (with spousal limited power of appointment)
  - More investment choices

Planning Implications

- So, how much money do you put in these things? Factors:

Planning Implications

- So, how much money do you put in these things? Factors:
  - Number of descendants

Planning Implications

- So, how much money do you put in these things? Factors:
  - Number of descendants
  - Expected future educational expenses

Planning Implications

- So, how much money do you put in these things? Factors:
  - Number of descendants
  - Expected future educational expenses
  - Willing to benefit “ancillary” family members

Planning Implications

- So, how much money do you put in these things? Factors:
  - Number of descendants
  - Expected future educational expenses
  - Willing to benefit “ancillary” family members
  - Expected estate tax rate

Planning Implications

Much

- So, how much money do you put in these things? Factors:
  - Number of descendants
  - Expected future educational expenses
  - Willing to benefit “ancillary” family members
  - Expected estate tax rate
  - Availability of state income tax deduction

Planning Implications

Much

- So, how much money do you put in these things? Factors:
  - Number of descendants
  - Expected future educational expenses
  - Willing to benefit “ancillary” family members
  - Expected estate tax rate
  - Availability of state income tax deduction
  - Desire to retain control over assets

Planning Implications

- Don’t necessarily limit gifts to the annual exclusion amount, especially given expected reduction of federal transfer tax exemption in 2026

Planning Implications

Much

- Don’t necessarily limit gifts to the annual exclusion amount, especially given expected reduction of federal transfer tax exemption in 2026

Questions

Much

Thank You

Luke Harriman

Much Shelist, P.C.

Vice Chair, Wealth Transfer & Succession Planning

lharriman@muchlaw.com

Much