FOSTER GRAHAM MILSTEIN CALISHER
ATTORNEYS AT LAW

FGMC Newsletter **Second Quarter 2012**

"Planning for College: 529 Plan Accounts As A Private Scholarship Fund" by Steven M. Weiser

Consider this: for 2010 the College Board estimated that the average annual tuitions to attend a private and public university were $40,476 and $20,339, respectively. Using this as a starting point and assuming 6% inflation, the cost of four years of tuition at a private and public university beginning in 2022 (ten years from now) will be $317,100 and $159,341, respectively. In order to pay for tuition a family would have to set aside $1,550 or $779, respectively (for a private or public university education) each month assuming 5% growth on savings. Now consider that many families have more than one child they hope will attend college. What to do about this predicament?

The Internal Revenue Code provides several tax-preferred methods of saving for college. Unfortunately many of these opportunities are unavailable to families with moderate to high incomes. Even still, these opportunities such as Coverdell Education Savings Accounts (formerly known as education IRAs) provide limited benefit. A Coverdell Education Savings Account allows a maximum annual contribution of only $2,000 per beneficiary (and the contribution limitation is reduced or phased out as incomes reach a certain level).

Fortunately 529 Plans provide a more effective means of savings for college. 529 Plans allow for the creation of a plan account for a single beneficiary. The owner of the account can be an individual, trust, etc. After-tax dollars are contributed to the account and grow tax-free. So long as distributions from the account are made for certain qualifying expenses associated with higher education (e.g., tuition, books, and school fees) the distributions are tax-free as well. Non-qualifying distributions are subject to a 10% penalty.

There's no income limitation on who can open a 529 plan, and the amount you can contribute is not phased out based on income levels. Each state's 529 plan does have a limit on contributions though. For example, Colorado's CollegeInvest has a maximum contribution of $280,000 per 529 plan account (it should be noted that there is no limitation on how large the account may

grow). For these reasons, I often recommend that clients interested in saving for college strongly consider the use of a 529 plan.

Let's take this planning opportunity a step further. Consider the case of a grandparent with multiple grandchildren. What could be better than giving the gift of an education to your grandchildren? The grandparent has a couple of options here. Since a 529 account can only have a single beneficiary (the future student), the grandparent can make one or more periodic gift(s) to the account on behalf of the beneficiary. Upon the completion of college, and if there are funds remaining in the account, the grandparent can name another grandchild as the new account beneficiary of the account. This could go on and on as long as funds remain in the account and each new beneficiary is a member of the old beneficiary's family. Alternatively, the grandparent could create separate 529 plan accounts for each grandchild, making periodic contributions to all the accounts.

High net worth individuals may consider large gifts approaching the contribution limitation for the particular 529 plan. These contributions are taxable gifts. To avoid paying gift tax, the contributor could either use all or part of any available lifetime gift tax exemption (currently $5.12 million) or the gift tax annual exclusion (currently $13,000) for each 529 account/beneficiary. However, a provision in the Internal Revenue Code actually allows an individual to front-load contributions to a 529 plan by making a single gift of up to five times the annual exclusion amount in a single year ($65,000). Married grandparents could make an initial gift to each 529 account of up to $130,000 without incurring gift tax or using their lifetime exemption!

If a contribution of this size or larger is made well before the intended beneficiary is expected to enter college, given the tax-free growth associated with the account, it is entirely possible and even desirable that the fund balance will exceed the beneficiary's cost of higher education. This is not a bad thing where there are multiple family members expected to attend college. Remaining funds can always be rolled over to the next family member (which includes cousins, nieces, nephews, etc.) to assist with their education. The contributor has in effect created a private scholarship fund for the family.

How long the scholarship fund carries on for is in some regard a factor of how much money is contributed to the 529 account(s) initially. Also, insuring that funds are only used for qualifying purposes is important, particularly considering who might inherit the account if the original owner passes away.

For clients interested in creating a private scholarship fund and making this fund available to multiple beneficiaries even in multiple generations, Foster Graham Milstein & Calisher has created a special trust, designed to own the 529 accounts. The trust insures that assets are used for education purposes, are protected from the claims of any beneficiary's creditors, and insures that available funds are effectively rolled-over and made available to other family members, particularly as older family members complete their educations.

Considerable time is spent preparing these trusts. Attention must be paid to income, estate and gift tax planning when using 529 plan accounts with the intention that amounts be rolled over for

the benefit of other family members. Additionally, parameters may be set concerning a prospective beneficiary's qualification for funds. For example, does the trust creator want to pay the professional student, or just those individuals seeking an undergraduate degree with the hope that those individuals will then put that degree to good use in the real world. Of course, consideration is also given to the initial number of 529 accounts established (dependent upon the number of available beneficiaries) and amounts contributed to these accounts.

One final and important note. Many States provide a state income tax deduction for amounts contributed to a 529 plan account. For example, Colorado provides a state income tax deduction equal to the amount contributed to a CollegeInvest account.

A private scholarship fund truly is an excellent means of establishing dynastic planning for your family and establishing a legacy for your descendants. The nuances of a private scholarship fund and 529 plans are too complex to address in a single newsletter article. If you are interested in learning more about private scholarship funds or 529 plans in general feel free to contact tax attorney Steven Weiser at 303-333-9810.