# School Funding Daze

## Combining College Funding with Estate Planning

When planning for a loved one's education, it might make sense to combine college saving with estate planning. In this article, we examine three tax-advantaged saving options that, in addition to helping you save for educational expense, could also further your estate planning goals.

### Employer coverage may be inadequate

These plans, named for the Internal Revenue Code (IRC) section that governs them, come in two types: the prepaid tuition plan and the college savings plan.

A prepaid tuition plan involves making payments today to guarantee that tuition (or a specific portion of tuition) will be covered in the future. Prepaid tuition plans may be offered by states or private educational institutions. State plans are usually accepted at any college or university in that state's system.

Regardless of whether you choose a state or private plan, it may be possible to transfer your prepayment from one school to another. Doing so may have additional costs, however, because some plans charge a penalty equal to a percentage of the tuition's value. In addition, even if the plan doesn't charge for the change, the school of choice may be more costly than the school for which you've prepaid, leaving a funding shortfall.

A 529 college savings plan is often a better option. Contributions go into a tax-deferred account that is generally invested in mutual funds (though investment choices are limited to those offered by the plan). Withdrawals are free from federal income tax when used for qualified higher education expenses at eligible institutions, as defined in IRC Sec. 529. Examples of qualified costs include not only tuition and fees, but also:

- Books, supplies and equipment required for attendance
- Room and board, subject to limits, for a student enrolled on at least a half-time basis
- In the case of a special needs beneficiary, expenses for special needs services incurred in connection with enrollment or attendance

The list of eligible institutions includes virtually every accredited college and university in the United States, as well as many foreign institutions.

State tax treatment varies, and some states offer income tax incentives for contributing to their plans.

529 plans offer significant estate planning opportunities. For example, gifts to 529 plans are eligible for the annual gift tax exclusion of $14,000 per beneficiary. This means that you may avoid the gift tax liability without having to use up any of your $5.25 million lifetime gift tax exemption. It also means that you may avoid any generation-skipping transfer (GST) tax liability that may otherwise be incurred when, for example, a grandchild is the plan beneficiary, without using up any of your $5.25 million GST tax exemption.

529 plans also allow flexibility in funding, as contributions can be made either periodically or as a lump sum. For example, you can front-load five years' worth of annual exclusion gifts ($70,000) in one year. Married couples splitting gifts can double this amount to $140,000 per beneficiary. However, if you die within five years of the gift, a portion of the upfront gift will come back into your estate.

## Coverdell Education Savings Accounts

Coverdell Education Savings Accounts (ESAs) are similar to 529 plans in that they allow money to be saved tax deferred for college expenses, and withdrawals used to pay qualified expenses are tax-free. But they have two additional advantages: 1) They also can be used for expenses related to primary and secondary education, and 2) They almost always offer more investment options.

However, contribution restrictions generally make ESAs less attractive as an estate planning tool for the following reasons:

- The maximum annual contribution is $2,000 per account beneficiary.
- Contributions may be further limited — or prohibited altogether — if your income exceeds certain limits.
- Contributions to an ESA are not permitted after the beneficiary turns 18 years old.
- Any funds in the ESA at the time the beneficiary turns 30 (except in the case of a beneficiary with special needs) must be distributed to that beneficiary and are included in taxable income if not used for qualified education expenses or transferred to another qualified beneficiary (who must be related in a specified way to the original beneficiary).

## Direct payment of tuition

One of the best ways to combine estate planning and college funding is to pay tuition on behalf of the student. Gifts of tuition paid directly to the institution are exempt from gift tax without counting as annual exclusion gifts or using any of your lifetime gift tax exemption. They also are exempt from GST tax without using any of your GST tax exemption.

## Do your homework

You can use education funding tools to also achieve estate planning goals. But choosing the combination that is right for you requires careful study. Your FirstPoint Financial team is available to answer your questions and create an educational funding strategy that meets your specific goals.

## Financial aid and 529 plans

How is financial aid affected by the various college savings plans and by other gifts? There are two aspects of financial aid: 1) federal assistance and 2) assistance generated through the institution itself. Institution-based aid calculations can vary greatly.

With federal assistance, student-owned assets are generally included at a higher percentage than a parent's assets. There are exceptions. For example, a student-owned 529 plan is included at the parent's percentage. But if a grandparent owns the 529 plan, the plan is excluded.

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