FUTURE SCHOLAR
529 COLLEGE SAVINGS PLAN

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NEVER TOO AFFLUENT FOR 529 PLANS: 529 GIFTING AND ESTATE PLANNING STRATEGIES

High-net-worth individuals are in a unique position when it comes to financing their children's college education. Not only do they want to provide the best education money can buy, they also may be seeking ways to reduce their taxable estate while creating an education legacy for future generations. Even if they are able to cover the cost of their children's college education with their current income and assets, these affluent individuals may be pleasantly surprised to learn that no one is too affluent to benefit from a 529 college savings plan. 529 plans are not only effective college savings vehicles, they also have unique gift and estate tax benefits not found anywhere else in the federal tax code. These benefits have great appeal for affluent clients concerned with optimizing their estate planning. This white paper will explore 529 plan strategies for affluent families.

Know the basics

A 529 plan — named for the section of the Internal Revenue Code that authorizes them — is a tax-favored savings plan designed to help families save for college costs. 529 plans may be operated by either a state or higher education institution. States may operate both prepaid and savings plans (most states offer only savings plans), while higher education institutions may offer only prepaid plans. A prepaid plan allows a saver to purchase credits calculated in part based on today's tuition costs. A 529 savings plan, on the other hand, allows contributions to accumulate a value that can be used to pay for college education expenses at some time in the future.

Understand plan contributions and limits

529 college savings plans can only accept contributions made in cash. The maximum contribution limit is plan-specific and may vary widely. For example, the maximum contribution per beneficiary for Georgia's 529 plan is $235,000,* whereas the maximum contribution for New York's 529 plan is $520,000.*

Contributions are made on an after-tax basis; that is, the donor does not receive a federal tax deduction for contributions. Earnings accumulate tax-deferred, and distributions are federal income tax-free if used for qualified higher education expenses[1] of the beneficiary. State tax treatment varies by state; state income tax deductions or credits may be available.

Qualified expenses at eligible institutions include:

- Tuition
- Room and board (subject to certain conditions)
- Computers
- Books
- Supplies and equipment required for the course of study at an eligible institution, as well as certain expenses for special needs beneficiaries.

An eligible institution is any higher education institution, either U.S. or foreign, eligible to distribute federal financial aid.[2] For distributions taken for reasons other than to pay for qualified higher education expenses, the earnings portion of these nonqualified distributions may be subject to income taxation and an additional 10% penalty.

*Source: savingforcollege.com as of 12/14/18.

[1] As a result of tax reform, qualified higher education expenses also include up to $10,000 a year for tuition only at an eligible K-12 institution.

[2] IRS Publication 970.

Take advantage of four unique gift and estate tax benefits

Beyond education savings benefits, 529 college savings plans have unique estate and gift tax benefits not found anywhere else in the federal tax code. For 2019, the estate and gift tax exclusion is $11.4 million for individuals ($22.8 million per couple). The generation-skipping transfer (GST) tax exemption is also $11.4 million per individual. For 2019, the tax rate for estate, gift and GST taxes is 40%.

Benefit #1: A 529 donor's gift is complete for federal gift tax purposes

For 2019, each person has an annual federal gift tax exclusion of $15,000, or $30,000 for a married couple. For each donor, a separate annual exclusion applies to each person to whom a gift is given. So a person generally can give up to $15,000 each to any number of people, and none of the gifts will have gift tax consequences. Contributions to a 529 plan qualify for the annual gift tax exclusion.

529 plans also have a special accelerated gifting rule that allows a donor to gift up to five times the annual gift tax exclusion amount (that is, $75,000 for a single person and $150,000 for a married couple for 2019) in a single year—without incurring gift tax consequences. This is known as the five-year accelerated or front-loaded gifting option, which is unique to 529 plans. Maximum accelerated gifting uses the donor's annual gift tax exclusion for gifts to the beneficiary for the current year and next four years. Additional gifts from the donor to the beneficiary during the five-year period will generally reduce the donor's unified credit (lifetime exclusion amount), unless the annual exclusion amount increases.

Total gift
$35,000

Gifting year	$7,000
Gifting year + 1	$7,000
Gifting year + 2	$7,000
Gifting year + 3	$7,000
Gifting year + 4	$7,000

This option enables a donor to make a larger initial gift (thereby allowing for a greater time period of tax-deferred growth), without having to pay gift tax (and without reducing the unified credit, which could be used to offset estate taxes at death). Normally, the total amount of gifts from one individual to another individual in a single year must be equal to or less than the annual gift tax exclusion in order to avoid gift tax consequences. If amounts contributed to a 529 plan exceed the annual gift tax exclusion, an election can be made to treat the contribution as five separate, equal gifts to avoid gift tax consequences, up to a limit of five times the annual gift tax exclusion. For example, if a donor wishes to contribute $35,000 to a 529 plan for a child or grandchild, it can be treated as five separate, equal gifts of $7,000 over a five-year period (for gift tax purposes), as illustrated.

The accelerated gifting option may be particularly attractive to donors who expect to leave a sizable estate and would like to make a large gift but do not want to reduce their unified credit (because they would prefer to use it to offset estate taxes). For grandparents, it has the added value of not being associated with the GST tax.

Accelerated gifting also exempts future asset growth from estate tax. Donors elect the accelerated gifting option on federal gift tax Form 709. If a donor elects to treat a donation as five separate, equal gifts to avoid gift tax, then the donation will be excludable from his or her estate on a pro rata basis. To fully avoid inclusion in the donor's estate, the donor must survive to January 1 of the fifth calendar year.

Many high-net-worth individuals use a two-calendar-year giving strategy to maximize gifts, obtain state tax deductions/credits (if available), avoid gift tax and reach investment breakpoints. Breakpoints (offered by most mutual fund companies) are reductions in sales charges obtained by exceeding certain investment amounts. An example would be if a married couple with two beneficiaries contributed $30,000 to each beneficiary's plan in one year, and then contributed $150,000 to each beneficiary's plan the next year and made accelerated-gifting elections.

Example (for one beneficiary)

Year	Actual contribution amount	Federal gift tax exclusion[3]	Amount donated for federal gift tax purposes
2019	$15k per parent ($30k in total)	$15k ind./$30k couple	$30k from couple
2020	$75k per parent ($150k in total)	$15k ind./$30k couple	$30k from couple
2021		$15k ind./$30k couple	$30k from couple
2022		$15k ind./$30k couple	$30k from couple
2023		$15k ind./$30k couple	$30k from couple
2024		$15k ind./$30k couple	$30k from couple

[3] The annual gift tax exclusion of $15,000 in 2019 may increase due to inflation adjustments in later years. Married couples may each gift tax-free up to the exclusion amount per donee or consent to gift splitting to have gifts from one spouse treated as being made one-half from each spouse.

In this case, the married couple contributes a total of $180,000 per beneficiary ($360,000 in total) in two calendar years. But by making the election to treat the second gift as pro rata over a five-year period, the couple avoids exceeding the annual gift tax exclusion and may qualify for a reduction in sales charges by investing a larger amount at once. Of course, the timing and amount of contributions must meet the specific breakpoint requirements, which vary by investment, in order to receive reduced charges.

Benefit #2: The 529 account owner maintains rights of property

529 plans allow the account owner, not the beneficiary, to retain control of the account assets (some conditions apply). This is a significant advantage that 529 plans have over other gifting and estate planning vehicles. Consequently, the account owner has the freedom to decide — for any reason — to change beneficiaries on the 529 plan (though there may be gift or GST tax consequences) or to recall the assets. If the assets are not used for qualified higher education expenses of the beneficiary, the earnings portion of the nonqualified distribution will be treated as ordinary income for federal and state income tax purposes and, in most instances, is subject to a 10% penalty tax.

Benefit #3: 529 assets are excluded from the donor's or owner's estate

Although the account owner retains control of the assets in a 529 plan, those assets are excluded from the donor's or owner's taxable estate (subject to the limited exception explained previously, i.e., if the donor dies during the five-year period associated with the accelerated gifting option).

Benefit #4: 529 plans are flexible

529 plans are flexible because the account owner can:

- Roll over money between beneficiaries who are family members, without income tax ramifications
- Change beneficiaries within the family (to a qualified family member) and still preserve tax benefits
- Change the beneficiary to future heirs and still avoid gift tax consequences by managing the gift process, as outlined later in this paper
- Name a successor account owner who will assume control of the account upon death of the account owner while avoiding probate (the successor owner may be an individual or a trust)

Manage the gift process

If the account owner names a new beneficiary who is one or more generations below the former beneficiary, there is a gift tax event and the former beneficiary could be treated as the donor for gift tax purposes.[4] However, the accelerated gifting option can be used to avoid exceeding the single-year gift tax exclusion limit in this instance as well.

Another consideration is the GST tax. Gifts during life or bequests from the estate can also be subject to the GST tax if the gifts or bequests are to a person who is more than one generation younger (for example, a grandchild).

Bottom line

Based on current income and assets alone, some affluent parents may plan on paying higher education costs out of pocket. This may lead them to forego college savings vehicles such as 529 plans. While that may be a sensible short-term strategy, it should not prevent them from considering 529 plans for longer term estate and legacy planning strategies. Getting a head start on funding the next generation's education through a 529 plan could lead to decades of tax-deferred growth outside of one's gross taxable estate. No one is ever too affluent to benefit from a 529 plan.

[4] Internal Revenue Code Section 529(c)(5)(B) and proposed regulations.

To learn more about college savings planning with a 529 plan, contact your financial advisor.

To find out more, call **800.426.3750**
or visit **columbiathreadneedle.com**

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CT-LC/**245044 J (01/19)** EPJH/2350023