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Welcome!



IRC Section 529 –

1 Hour CLE offered through
Dauphin county Bar Association

April 12, 2016
12:00pm

Presenter:
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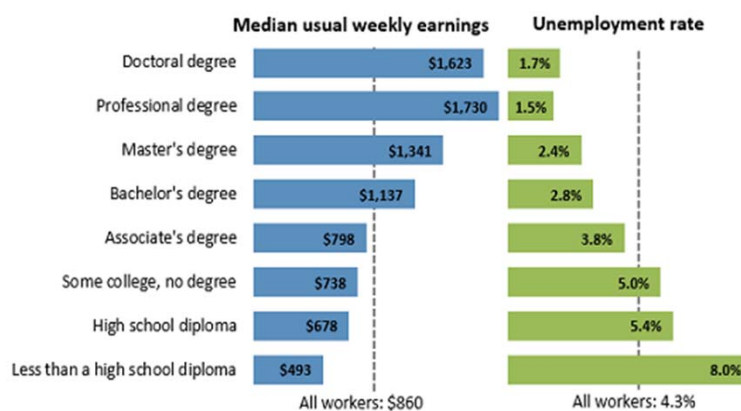
Agenda

1. Benefits and costs of college
2. What is a QTP authorized by IRC Section 529
3. Federal treatment
4. Pennsylvania treatment
5. Successor account owners
6. Disposition of 529 assets in divorce proceedings
7. Using a 529 account for disposition of funds in court awards or settlements
8. Use for Child Performer Trust Accounts
9. National picture and details of PA 529
10. ABLE

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It Pays to Save for College

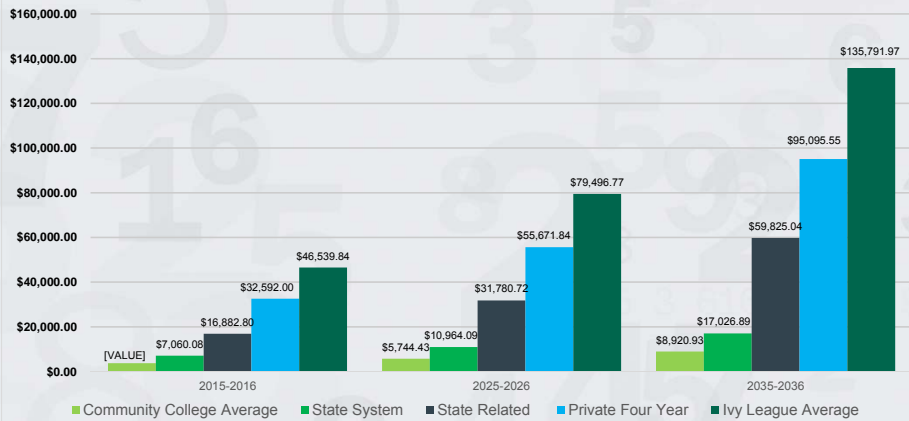
Earnings and unemployment rates by educational attainment, 2015



Note: Data are for persons age 25 and over. Earnings are for full-time wage and salary workers.
Source: U.S. Bureau of Labor Statistics, Current Population Survey

Current College Costs

Current and Projected Tuition Annual Costs



This chart assumes average annual tuition inflation rates: Community College – 4.5%, State System – 4.5%, State Related – 6.53%, Private Four Year – 5.5%, and Ivy League Average 5.5%. Although these projections are based on historical and projected rates of tuition inflation at each type of institution, there can be no assurance that they will accurately reflect future increases. Projected tuition rates do not represent actual tuition costs at a specific school.

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Cost with Borrowing

Interest Rate	5%	6%	7%	8%
Total Disbursements	\$27,000	\$27,000	\$27,000	\$27,000
Balance at Repayment	\$30,605	\$31,268	\$31,930	\$32,593
Balance Ratio (Repay/ Disbursements)	113%	116%	118%	121%
Total Payments	\$38,954	\$41,656	\$44,489	\$47,453
Ratio Total Payments to Disbursements	144%	154%	165%	176%

Source: Mark Kantrowitz, Edvisor.com

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Cost with Borrowing

- \$1.2 trillion in student debt nationally
- Graduates from PA schools
 - ❖ 70% graduate with debt – 3rd highest in nation
 - ❖ \$33,264 average debt – 3rd highest in the nation --exceeds national average by 15%
 - ❖ Average debt up 70% in 10 years vs. 24% for general inflation

Source: Student Debt and the Class of 2014, The Institute for College Access & Success. November 2014

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26 U.S.C §529

- Enacted in 1996
- Recognizes state college savings programs and provides federal tax advantages for savers
 - First in Florida and Michigan in 1988
 - PA enacted in 1992 – 7th state in nation
- Resulted from litigation between IRS and MI
 - Michigan v U.S. 40 F.3d 817(6th Cir., 1994)
- Recognizes 2 types
 - Prepaid tuition plans
 - Savings programs

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26 U.S.C. § 529

- Substantial amendments enhance benefits
 - 1998, 2001, 2006, 2014, 2015
- IRS proposed regulations
63 Fed. Reg.45,019 -45,032 (1998)
- IRS Notices
 - 2001-55 (2001-39 I.R.B. 299)
 - 2001-81 (2001-52 I.R.B. 617)
 - 2016-13

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26 U.S.C. §529

- Established and maintained by state or by a college or consortium of colleges (prepaid only)
- Beneficiary must be named when account is opened (except scholarship accounts)
- Only cash contributions
- Account can't be pledged as security
- Program must set and enforce contribution limit
- Investment direction limited to 2 in calendar year
- Many additional restrictions tied to tax benefits at time of contribution and withdrawal

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Federal Income Tax

- Contributions are made with after-tax dollars
 - But may be able to deduct them when used for tuition and fees (under 26 U.S.C. § 222)
- Earnings are tax-deferred while remain in account
- Earnings are tax exempt when withdrawn ***if***:
 - used for “qualified higher education expenses” at an “eligible educational institution”
 - used for a “qualified rollover” or “qualified transfer”
- Otherwise earnings are taxed at withdrawal (non-qualified)
 - as ordinary income to the account owner or beneficiary
 - with an additional 10% federal tax penalty (exceptions for specific non-qualified withdrawals)

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Federal Income Tax

- “qualified higher education expenses”
if required for enrollment or attendance:

tuition

fees

books

supplies

equipment

special need services for special needs beneficiary

computers, peripheral equipment, software, internet access

Room and board

if student is at least half-time

on-campus – full amount charged

off campus – set by school in “cost of attendance”

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Federal Income Tax

- “Eligible educational institution”
 - Eligible to participate in Title IV of Higher Education Act (financial aid)

Trade and career school
Community colleges
Colleges and universities
Graduate and professional schools
Institutions in foreign countries

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Federal Income Tax

- Qualified rollovers
 - To a different 529 for the same beneficiary
 - Funds must be re-deposited within 60 days
 - Can only be done once in a 12 month period
 - To a different 529 for a different beneficiary
 - Funds must be re-deposited within 60 days
 - New beneficiary must be “member of the family” of old
- Qualified transfers
 - Stays in same 529 but beneficiary is changed
 - New beneficiary must be “member of the family ” of old

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Federal Income Tax

- Member of family
 - Spouse
 - Relatives described in 26 U.S.C §152 (d)(2)(A)-(G)
 - Child or descendent of child
 - Sibling, step-sibling, half-sibling
 - Parent or ancestor of parent
 - Step-parent
 - Child of a sibling or half-sibling
 - Sibling of a parent
 - Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
 - Spouses of those §152 relatives
 - First cousins

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Federal Income Tax

- Specific non-qualified withdrawals not subject to 10% penalty:
 - Death of beneficiary (if paid to beneficiary or estate)
 - Disability of beneficiary
 1. Unable to engage in substantial activity
 2. Because of a medical physical or mental impairment
 3. Expected to result in death or to be of long-continued and indefinite duration
 - Scholarship or tuition waiver (limited to \$ received)
 - Veterans education assistance
 - Employer-provided educational assistance
 - Appointment to U.S. military academy
 - Coordination with other federal tax higher education benefits

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Federal Income Tax

- 1099-Q
 - Issued for ALL withdrawals whether taxable or not
 - Issued to:
 - Beneficiary if:
 - Paid to school
 - Paid to beneficiary
 - Account owner – all other payees
 - Principal and earning breakdown
 - Uses earnings ratio: contributions/value
 - Aggregates all accounts with same account owner and beneficiary in same state – changed effective with tax years after 12/31/15
 - Losses not shown and cannot be claimed if funds remain in the account

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Federal Transfer Taxes

- Gift tax
 - Completed gift from contributor to beneficiary
 - HOWEVER account owner retains complete control
 - Annual (\$14,000/\$28,000) and unified gift and estate limits (\$5 million) apply
 - HOWEVER can give 5X the annual limit in one year and prorate over 5 years (\$70,000/\$140,000)
Excess not prorated – taken in year of gift
 - 5 year proration election taken on IRS form 709
 - If contributor dies within the 5 years, prorated amount for years after death are part of estate
 - Rollover/transfer/change in beneficiary = gift from old to new beneficiary (but directed by account owner)

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Federal Transfer Taxes

- Estate tax
 - Assets are considered to be in the estate of the beneficiary
 - Except if 5 year proration has been elected and contributor dies within the period
- Generation-Skipping tax
 - applies if beneficiary is two or more generations below contributor or new beneficiary is two or more generations below old beneficiary
 - If related, lineal generations
 - If not related
 - 12.5 years between = same generation
 - 37.5 years between = 1 generation
 - +25 years (62.5) = 2 generations

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Tax Benefits Coordination

- IRS Pub 970 – generally no double benefit
- American Opportunity & Lifetime Learning Credit 26 U.S.C. §25A
 - Can claim both IF used for different expenses
 - Coverdell ESA 26 U.S.C. §530
 - Can claim both IF used for different expenses
 - If combined use exceeds qualified expense must allocate between both
 - Tuition and Fee Deduction 26 U.S.C. §222
 - contribution (but not earnings) portion of qualified withdrawal can be used as basis

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Federal Financial Aid

20 U.S.C. §1087vv(f)(3)

- If account owner is parent or dependent student:
 - Treated as asset of parent
 - Roughly 5.6% counted in computing Expected Family Contribution (EFC)
- If the account owner is an independent student:
 - Treated as asset of student
 - 20% counted in computing Expected Family Contribution
- If account owner is a 3rd party
 - Not counted in year used
 - In year following use counted as non-taxed income to student

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Bankruptcy

11 U.S.C. §541(b)(6)

- Protected if beneficiary is child, stepchild, grandchild, or step-grandchild in year contribution made
- Limits:
 - Up to maximum contribution amount at time of filing adjusted by education expenditure category of CPI
 - Contributions made between 720 and 365 of filing \$6,225 protected
 - Contributions made less than 365 before filing NOT protected

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PA Income Tax

Contributions deductible. 72 P.S. §7303(a.7)

- Any PA taxpayer contributor – not just account owner
- \$14,000 per beneficiary per year (inflates with federal gift tax exclusion amount)
- \$28,000 if married filing jointly as long as each has income of at least amount deducted
- Contribution cannot be a rollover from another 529 plan or interest from U.S. Savings Bonds
- Can be redemption of Coverdell ESA
- No required length of time funds must remain in account
- “Recapture” governed by PIT Bulletin 2006-04

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PA Income Tax

Earnings – income tax deferred and exempt 24 P.S. §6901.316(b); 72 P.S. §7303(a.7)(2)(i)(A)

- Similar to federal income tax treatment
- Not taxed while funds remain in account
- For qualified withdrawals, no income tax
- For non-qualified withdrawals, entire amount--not just earnings--may be taxable (see PIT Bulletin 2006-4)
- No “additional tax”
- 1099-Q reflects federal p/e NOT state (cost recovery basis)

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PA Inheritance Tax

Asset is in estate of account owner

24 P.S. §6901.316(b)

PA 529 accounts: entire amount (principal and earnings) exempt

Non-PA accounts: entire amount subject to inheritance tax

– Tax rate depends on relationship of heir

- | | |
|-----------|------|
| » Spouse | 0% |
| » Lineal | 4.5% |
| » Sibling | 12% |
| » Others | 15% |

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PA Financial Aid

24 P.S. §6901.309.2 (c)

- Assets in PA account not used in determining eligibility for financial aid “administered by any agency of the Commonwealth”
- Assets in NON-PA account counted as asset

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PA Protection from Creditors

24 P.S. § 6901.309.2(c)

- Assets in PA account protected from attachment, levy execution by creditor of account owner or beneficiary
 - No time limits
 - No \$ limits
- Assets in NON-PA account not protected

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Successor Account Owners

- Only 1 account owner. Not joint accounts.
- PA 529 allows authorized agents
 1. Account info and statement
 2. Make electronic contributions and change investments
 3. Make withdrawals
 4. Full control
- Most states allow designated "successor owner"
- If none, program documents may specify
 - Will
 - If no will, surviving spouse
 - If no surviving spouse, beneficiary if an adult
 - If beneficiary is a minor, intestate law
- Conflicts between will and successor owner designation

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529 Assets in Divorce

- Address automatic contributions
- Unless property settlement addresses, pre-divorce account owner has complete control
 - Withdrawal the funds for any purpose
 - Change the beneficiary
 - Change successor owner
 - Name a new account owner
 - Revoke previous authorized agent
- Property settlement should address
 - Can include restrictions
 - Can't change beneficiary or change only to sibling
 - No non-qualified withdrawals
 - Successor owner
- Make sure program gets copy!!!

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Court Awards/Settlements

Court order/documents consider including:

- 529 Plan to be used
- Account owner, successor owner, beneficiary
- Investment option chosen & ability to change
- Age at which beneficiary becomes owner
- Whether beneficiary can be changed
- When/what type of withdrawals can be made

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Child Performer Trust Account

43 P.S. §40.5(e): Irrevocable child performer trust or 529 account required if:

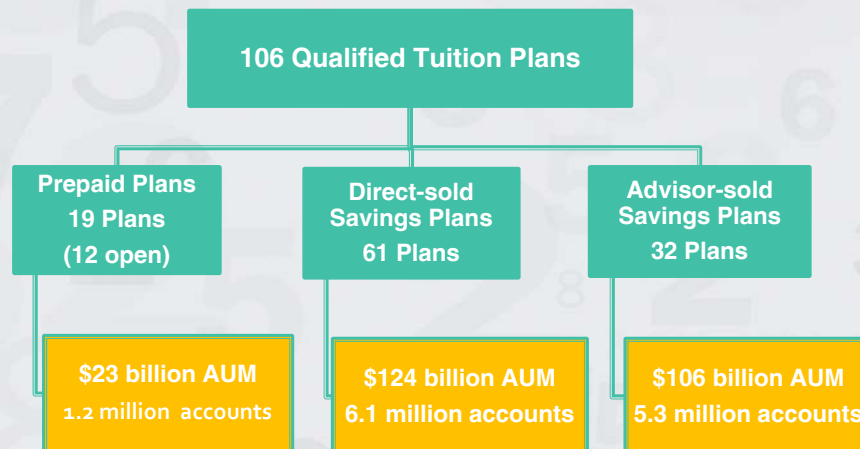
- Unemancipated minor entitled to residuals, anticipated earnings over \$2,500, or already earned over \$2,500

Requirements

- Parent/guardian **MUST** establish
- Gives info to employer to transfer funds to account
- Transfer 15% of compensation; 100% if paid to a 3rd party
- Transfer within 30 days of last day if employment < 30 days; otherwise every pay period
- If no account or info given, employer sends funds to State Treasurer to establish account for minor
- Transfers governed by UTMA
- Over \$150,000 trust or independent custodian appointed
- Use before 18 limited to health and education

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National Picture



Source: AKF Consulting, based on CSPN data as of 12/31/15

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PA Program

PA 529 Guaranteed Savings Plan

Growth: with tuition inflation

Residency: Required

Investment Manager: Treasury

Fees: \$50 enrollment (**discounted**)
0.44% annual w/ paper delivery
*0.35% annual w/ e-delivery

PA 529 Investment Plan

Growth: with financial markets

Residency: Not Required

Investment Manager: Vanguard

Fees: No enrollment fee
0.36% - 0.50% annual
**\$18.00 maintenance per account

*E-delivery required for statements and transaction/profile confirmations.

**Waived with e-delivery of statements and transaction/profile confirmations.

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PA Program GSP

Save now for one credit/one semester/4 years, have enough for that much later

Growth based on tuition increases at the designated tuition level

Peace of mind – not subject to ups and downs of financial markets

Guarantee is obligation of the GSP Fund, not the Commonwealth

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PA Program GSP



Choose

Average Level

OR

Specific PA Public School

PA Community College Average	Allegheny County, Beaver County, Bucks County, Butler County, Delaware County, Harrisburg Area, Lehigh-Carbon County, Luzerne County, Montgomery County, Northampton County, Pennsylvania Highlands, Philadelphia, Reading Area, and Westmoreland Area
PA State System Average*	Bloomsburg, California, Cheyney, Clarion, East Stroudsburg, Edinboro, Indiana, Kutztown, Lock Haven, Mansfield, Shippensburg, Slippery Rock, and West Chester <i>*The average does not include Millersville University</i>
PA State-Related Average	Penn State (including the Pennsylvania College of Technology), Pitt, Lincoln, and Temple Thaddeus Stevens College of Technology
Private Four-Year Average	No specific schools
Ivy League Average	No specific schools

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PA Program GSP



Flexibility of Tuition Levels

- Change Tuition Level at any time retroactive to date of each contribution
- Automatically changed if student attends a Pennsylvania publicly funded school
- Importance of Tuition Levels
 - Helps account owners measure progress
 - Aids actuarial analysis

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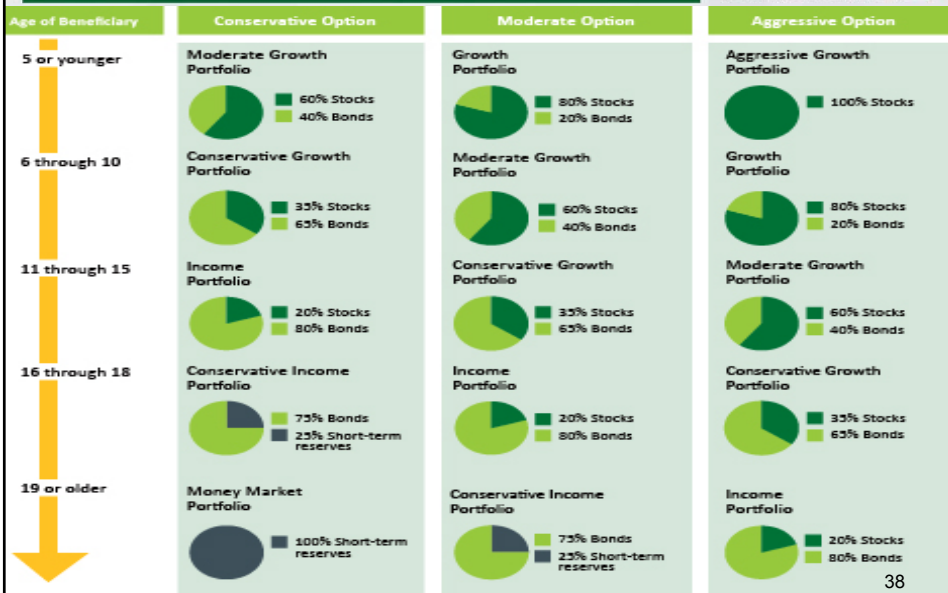
PA Program GSP


Actual Tuition Inflation Last 5 years (through 2015-2016)

- Community College Average 33.99%
- State System of Higher Education 21.64%
- State-Related Average 17.51%
 - Penn State University 14.98%
 - University of Pittsburgh 22.85%
- Private Four-year College Average 20.07%
- Ivy League Average 21.42%

Past performance is not a guarantee of future results


PA Program IP



PA Program IP		<small>PENNSYLVANIA</small> TREASURY <small>529 COLLEGE SAVINGS PROGRAM</small> 
Investment Option	Investment Objective	Underlying Investments
Aggressive Growth Portfolio (asset-based fee 0.38%)	Seeks to provide capital appreciation.	70% Vanguard Institutional Total Stock Market Index Fund 30% Vanguard Total International Stock Market Index Fund
Total Stock Market Index Portfolio (asset-based fee 0.36%)	Seeks to track the performance of a benchmark index that measures the investment return of the overall stock market.	100% Vanguard Institutional Total Stock Market Index Fund
Social Index Portfolio (asset-based fee 0.50%)	Seeks to track the performance of a benchmark index that measures the investment return of large- and mid-capitalization stocks that are screened on social and environment criteria.	100% Vanguard FTSE Social Index Fund
Growth Portfolio (asset-based fee 0.39%)	Seeks to provide capital appreciation and low to moderate current income.	55% Vanguard Institutional Total Stock Market Index Fund 25% Vanguard Total International Stock Market Index Fund 20% Vanguard Total Bond Market II Index Fund
Moderate Growth Portfolio (asset-based fee 0.38%)	Seeks to provide capital appreciation and current income.	45% Vanguard Institutional Total Stock Market Index Fund 15% Vanguard Total International Stock Market Index Fund 40% Vanguard Total Bond Market II Index Fund
Conservative Growth Portfolio (asset-based fee 0.39%)	Seeks to provide current income and low to moderate capital appreciation.	25% Vanguard Institutional Total Stock Market Index Fund 10% Vanguard Total International Stock Market Index Fund 65% Vanguard Total Bond Market II Index Fund
Income Portfolio (asset-based fee 0.38%)	Seeks to provide current income.	80% Vanguard Total Bond Market II Index Fund Index Fund 20% Vanguard Institutional Total Stock Market Index Fund
Conservative Income Portfolio (asset-based fee 0.41%)	Seeks to provide current income and some inflation protection as well as income consistent with the preservation of principal.	50% Vanguard Total Bond Market II Index Fund Index Fund 25% Vanguard Inflation-Protected Securities Fund 25% Vanguard Prime Money Market Fund
Inflation-Protected Securities Portfolio (asset-based fee 0.41%)	Seeks to provide inflation protection and income consistent with investment in inflation-indexed securities.	100% Vanguard Inflation-Protected Securities Fund
Money Market Portfolio (asset-based fee 0.43%)	Seeks income consistent with the preservation of principal.	100% Vanguard Prime Money Market Fund

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PA 529 Success Story		<small>PENNSYLVANIA</small> TREASURY <small>529 COLLEGE SAVINGS PROGRAM</small> 
<h3>The PA 529 Guaranteed Savings Plan</h3> <ul style="list-style-type: none"> ■ 107,723 accounts; \$1.690 Billion AUM ■ 64,543 students used their accounts (since AY 1997) ■ Attended 2,265 different schools ■ \$1.789 billion total paid ■ \$537 million in growth ■ 43% increase in value from contribution to use 		
<h3>The PA 529 Investment Plan</h3> <ul style="list-style-type: none"> ■ 97,803 accounts; \$1.881 Billion AUM ■ Over 22,061 students used their accounts (since July 2002) ■ \$609.5 million total paid ■ \$100.2 million in growth ■ 20% increase in value from contribution to use <p style="text-align: center;"><i>Past performance is not a guarantee of future results</i></p>		

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ABLE

26 U.S.C. §529A--modelled on §529

- Provides for tax-advantaged savings for qualified disability expenses
- Protects eligibility for federal needs based benefits (with limits)
- Significant differences from 529
- Eligible individual
 - Disability onset before age 26 AND
 - SSI disability recipient
 - SSDI recipient OR
 - Doctor-certified disabled
- Eligible individual must be account owner
- Can only be one account
- \$14,000 annual contribution limit

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Questions?

This presentation provides only highlights of the PA 529 College Savings Program. For important details about the Program, including how the PA 529 GSP guarantee works and its limitations; the tax benefits, requirements, and consequences of nonqualified withdrawals; and investment objectives, risks, and costs, please carefully read each Plan's Disclosure Statement before investing.

They are available by visiting www.PA529.com or by calling 1-800-440-4000.

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