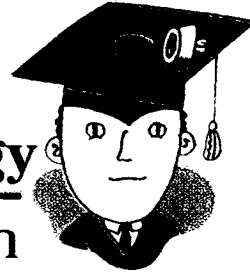


PLANNING HOTLINE

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Smart Addition to Your Estate/Gift Strategy

529 College Savings Plan



While 529 college savings plans are now income tax free, if withdrawals are used for higher education, they also offer gift and estate tax benefits.

Key: Money contributed to a 529 account is considered a gift, the same as if you had made a deposit into a youngster's custodial account.

Good news: Contributions to 529 plans are considered to be "present interests." Thus, they're eligible for the annual gift tax exclusion.

In 2004, you can give away up to \$11,000 worth of assets to any number of recipients, tax free. For married couples, the limit is \$22,000 per recipient.

in a class by themselves

Special tax rules apply to gifts to 529 accounts.

Loophole: You (or another benevolent donor) can make up to five years' worth of gifts up-front. Gifts in excess of \$11,000 or \$22,000 can be spread over more than one year, if you make an election on a gift tax return.

Example: You and your spouse put \$110,000 into a 529 plan for your daughter this year. There will be no gift tax consequences if you elect to spread this gift over five years.

Required: You must file gift tax returns each year.

Trap: If a donor dies before the fifth year, a portion of the gift

would come back into his/her taxable estate.

Outcome: You can move a large amount of money out of your estate without owing tax. Any appreciation is removed from your estate, too.

What's more, another large, multi-year gift may be made, tax free, after the five-year period is up.

strings attached

Unlike the case with other excluded gifts, 529 account owners still exercise considerable control over assets that have been removed from their taxable estate.

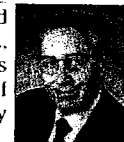
Options include...

- Shifting funds among different 529 plans.
- Changing the account beneficiary to another family member.
- Taking the money back if it's needed.

Trap: If you reclaim 529 funds, you'll have to pay income tax and a 10% penalty on any earnings. Nevertheless, there are few other opportunities for reducing estate tax yet retaining such control of your assets.

Key: The control factor may be appealing. If one 529 account beneficiary proves to be a disappointment, you can change the

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beneficiary to some other relative, without owing tax.

beyond the limits

Multiple 529 accounts may be used to deal with problems from the \$11,000 limit on the annual gift tax exclusion.

Example: You're presently unmarried and you would like to contribute \$11,000 to a 529 account for your daughter Beth this year. How-

ever, you already have given her \$7,000, leaving only \$4,000 of gift tax exclusion remaining.

You can make an \$11,000 gift to the 529 plan and use the five-year averaging election described previously to make the full \$11,000 gift.

Alternative strategy: In the above example, you could contribute \$4,000 to a 529 account for Beth, covered by the gift tax exclusion, and put another \$7,000

into a 529 account where you name yourself as the beneficiary.

Key: Although the IRS has not ruled on this issue, it is likely that no taxable gift will result when you or your spouse are the contributor to as well as the beneficiary of a 529 account.

In a later year, if you are below the gift tax exclusion ceiling, you can change the beneficiary from yourself to Beth.

Benefit: In the meantime, the entire \$11,000 will be in tax-free 529 accounts.

necessary powers

Because 529 plans are relatively new, special tax-planning efforts may be required.

Strategy: Anticipate the unpleasant possibility that you might become incapacitated someday. You should have a durable power of attorney that specifically permits gifts to 529 plans.

In particular, five-year front-loading should be allowed, up to the gift tax limits that will be in effect.

Key: Precise language may be necessary to spell out a power of attorney's authority over 529 plans.

Example: Your son John has three children, while your daughter Kathy has one child. Your power of attorney permits maximum five-year 529 front-loading for gift tax purposes.

In case of your incapacity, do you want each grandchild to receive the same gifts? Or do you want to equalize the amounts going to both sides of the family? Specific directions may minimize hard feelings while maintaining the desired tax shelter.

stretching a 529

Just as a multigenerational plan for an IRA can generate huge tax benefits, so can a long-range plan for a 529 account.

Key: Beneficiaries can be changed as often as desired, as long as each successor is related to the original beneficiary.

Currently, there is no gift tax on beneficiary changes within a gener-

ation. If the beneficiary designation moves down a generation, the original beneficiary is deemed to have made a gift, which can be covered by the annual gift tax exclusion.

Example: Some of the money that was contributed to a 529 plan for your son Bob is not spent by the time he graduates. Unused funds can grow tax free for decades, as Bob's younger sister, and then Bob's daughter, are named as beneficiaries.

One financial services firm shows a \$110,000 contribution growing to more than \$1.3 million in 50 years, given certain assumptions, even after paying to send a child and two grandchildren through four years of college.

The money that has been accumulated in such an account might be available for all types of accredited higher education over the years. The account can be tapped for noneducational purposes, too, if taxes and penalties are paid.

Trap: There might be problems with the generation-skipping transfer tax, but the future of that tax, along with the estate tax, is impossible to predict.

Caution: Many gift and estate tax issues relating to 529 plans are still unresolved. A knowledgeable tax adviser can help you keep up as questions are answered.

not for everyone

You might not want to use up your annual gift tax exclusions on 529 contributions. Other types of gifts may be more appealing.

Example: You own real estate or a closely held company. Interests might be transferred at a valuation discount.

With such techniques, you and your spouse might transfer \$30,000 worth of assets per year from your estate. If so, you might not want to use 529 plans to trim your estate by only \$22,000 per year.

Nevertheless, if you like the idea of control over gifts and the ability to reclaim your funds, 529 plans can play a vital role in your gift tax planning. **TH**