HIGHTOWER
RDM Financial Group

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# Estate Planning and 529 Plans

*At RDM, we understand that wealth is more than money - it's about freedom, security, philanthropy, legacy and balance...we help you coordinate multiple financial goals through a maze of tax, legal and investment options. It is critical to understand, develop and implement effective, long-term strategies that align with your objectives and prepare you for the future.*

# Estate Planning and 529 Plans

When you contribute to a 529 plan, you'll not only help your child, grandchild, or other loved one pay for school, but you'll also remove money from your taxable estate. This will help you minimize your tax liability and preserve more of your estate for your loved ones after you die. So, if you're thinking about contributing money to a 529 plan, it pays to understand the gift and estate tax rules.

## Overview of gift and estate tax rules

If you give away money or property during your life, you may be subject to federal gift tax (these transfers may also be subject to tax at the state level).

Federal gift tax generally applies if you give someone more than the annual gift tax exclusion amount, currently $15,000, during the tax year. (There are several exceptions, though, including gifts you make to your spouse.) That means you can give up to $15,000 each year, to as many individuals as you like, federal gift tax free.

In addition, you're allowed an "applicable exclusion amount" that effectively exempts around $11,580,000 in 2020 for total lifetime gifts and bequests made at death.

Note: State tax treatment may differ from federal tax treatment, so look to the laws of your state to find out how your state will treat a 529 plan gift.

## Contributions to a 529 plan treated as gifts to the beneficiary

A contribution to a 529 plan is treated under the federal gift tax rules as a completed gift from the donor to the designated beneficiary of the account. Such contributions are considered present interest gifts (as opposed to future or conditional gifts) and qualify for the annual federal gift tax exclusion. In 2020, this means you can contribute up to $15,000 to the 529 account of any beneficiary without incurring federal gift tax.

So, if you contribute $18,000 to your grandchild's 529 plan in a given year, for example, you'd ordinarily apply this contribution against your $15,000 annual gift tax exclusion. This means that although you'd theoretically need to report the entire $18,000 gift on a federal gift tax return, you'd show that only $3,000 is taxable. Bear in mind, though, that you must use up your federal applicable exclusion amount (about $11,580,000 in 2020) before you'd actually have to write a check for the gift tax.

## Special rule if you contribute a lump sum

Section 529 plans offer a special gifting feature. Specifically, you can make a lump-sum contribution to a 529 plan of up to five

times the annual gift tax exclusion ($75,000 in 2020), elect to spread the gift evenly over five years, and completely avoid federal gift tax, provided no other gifts are made to the same beneficiary during the five-year period. A married couple can gift up to $150,000.

For example, if you contribute $75,000 to your grandchild's 529 account in one year and make the election, your contribution will be treated as if you'd made a $15,000 gift for each year of a five-year period. That way, your $75,000 gift would be nontaxable (assuming you don't make any additional gifts to your grandchild in any of those five years).

If you contribute more than $75,000 ($150,000 for joint gifts) to a particular beneficiary's 529 plan in one year, the averaging election applies only to the first $75,000 ($150,000 for joint gifts); the remainder is treated as a gift in the year the contribution is made.

## What about gifts from a grandparent?

Grandparents need to keep the federal generation-skipping transfer tax (GSTT) in mind when contributing to a grandchild's 529 account. The GSTT is a tax on transfers made during your life and at your death to someone who is more than one generation below you, such as a grandchild. The GSTT is imposed in addition to (not instead of) federal gift and estate tax. Like the basic gift tax exclusion amount, though, there is a GSTT exemption (also about $11,580,000 in 2020). No GSTT will be due until you've used up your GSTT exemption, and no gift tax will be due until you've used up your applicable exclusion amount.

If you contribute no more than $15,000 to your grandchild's 529 account during the tax year (and have made no other gifts to your grandchild that year), there will be no federal tax consequences — your gift qualifies for the annual federal gift tax exclusion, and it is also excluded for purposes of the GSTT.

If you contribute more than $15,000, you can elect to treat your contribution as if made evenly over a five-year period (as discussed previously). Only the portion that causes a federal gift tax will also result in a GSTT.

Note: Contributions to a 529 account may affect your eligibility for Medicaid. Contact an experienced elder law attorney for more information.

## What if the owner of a 529 account dies?

If the owner of a 529 account dies, the value of the 529 account will not usually be included in his or her estate. Instead, the value of the account will be included in the estate of the designated beneficiary of the 529 account.

There is an exception, though, if you made the five-year election (as described previously) and died before the five-year period ended. In this case, the portion of the contribution allocated to the years after your death would be included in your federal gross estate. For example, assume you made a $50,000 contribution to a 529 savings plan in Year 1 and elected to treat the gift as if made evenly over five years. You die in Year 2. Your Year 1 and Year 2 contributions of $10,000 each ($50,000 divided by 5 years) are not part of your federal gross estate. The remaining $30,000 would be included in your gross estate.

Some states have an estate tax like the federal estate tax; other states calculate estate taxes differently. Review the rules in your state so you know how your 529 account will be taxed at your death.

When the account owner dies, the terms of the 529 plan will control who becomes the new account owner. Some states permit the account owner to name a contingent account owner, who'd assume all rights if the original account owner dies. In other states, account ownership may pass to the designated beneficiary. Alternatively, the account may be considered part of the account owner's probate estate and may pass according to a will (or through the state's intestacy laws if there is no will).

## What if the beneficiary of a 529 account dies?

If the designated beneficiary of your 529 account dies, look to the rules of your plan for control issues. Generally, the account owner retains control of the account. The account owner may be able to name a new beneficiary or else make a withdrawal from the account. The earnings portion of the withdrawal would be taxable, but you won't be charged a penalty for terminating an account upon the death of the beneficiary.

Keep in mind that if the beneficiary dies with a 529 balance, the balance may be included in the beneficiary's taxable estate.

***Note:*** *Before investing in a 529 plan, please consider the investment objectives, risks, charges, and expenses carefully. The official disclosure statements and applicable prospectuses - which contain this and other information about the investment options, underlying investments, and investment company - can be obtained by contacting your financial professional. You should read these materials carefully before investing. As with other investments, there are generally fees and expenses associated with participation in a 529 plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated. Investment earnings accumulate on a tax-deferred basis, and withdrawals are tax-free as long as they are used for qualified higher-education expenses. For withdrawals not used for qualified higher-education expenses, earnings may be subject to taxation as ordinary income and possibly a 10% federal income tax penalty. The tax implications of a 529 plan should be discussed with your legal and/or tax advisors because they can vary significantly from state to state. Also be aware that most*

*states offer their own 529 plans, which may provide advantages and benefits exclusively for their residents and taxpayers. These other state benefits may include financial aid, scholarship funds, and protection from creditors.*

**DISCLOSURES**

RDM Financial Group does not give tax or legal advice. Consult your tax advisor and attorney on all tax and legal matters.

This is not an offer to buy or sell securities. No investment process if free of risk and there is no guarantee that the investment process described herein will be profitable. Investors may lose all of their investments. Past performance is not indicative of current or future performance and is not a guarantee.

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