Miller Wealth Advisors

CASE STUDY | VOLUME 118

TAX-FAVORED COLLEGE PLANNING FOR GRANDCHILDREN

Restructuring a Family's 529 Account for Future Generations Offers Big Tax Benefits

THE PROBLEM

Many years ago, Lewis and Shirley Morris*, both age 62, funded 529 Accounts for each of their three children. Due to stronger-than-expected stock market returns (and working with a savvy financial advisor), each child has a surplus of $100,000. The Morris' inquired about cashing out these accounts now that their youngest child had graduated from college with no plans for graduate studies. We explained that doing so would trigger undesired tax liabilities and penalties on all the earnings. What else could they do to optimize these tax advantaged accounts?

THE SOLUTION

We suggested that the Morris' maintain these accounts for the future benefit of their grandchildren. We explained that, as the account owners, they have 30 years after the projected date of their child's (beneficiary's) high school graduation to use up the assets. This means these accounts on average can continue to grow tax free for 20 more years. If $100,000 is left to grow by 7% per year for the next 20 years, the future value would be $387,000! It's worth noting that up to $10,000 per year can be accessed for private school tuition during their grandchildren's elementary school years. In addition, they can easily change the beneficiary to another grandchild at any time as needed.

TAX BENEFITS OF 529 PLANS

Many people are unaware of the many tax benefits of 529 plans. In terms of income taxes, the earnings may be tax and penalty-free if used to pay for qualifying education costs, like tuition and books. In terms of gift and estate taxes, the value of the 529 account is removed from the owner's taxable estate, yet the owner retains full control over the account. In addition, annual exclusion gifts that are normally limited to $15,000 per person can be frontloaded up to $75,000 per beneficiary (or $150,000 for a married couple) without generating a taxable gift. For purposes of this case study, we will focus on the income tax savings of a 529 Plan.

THE OUTCOME

- The Morris' 529 accounts can be left to accumulate income tax free for many more years than expected.
- Since the Morris' maintain control over these accounts, they can direct the ultimate disposition of these funds, i.e., to grandchildren.
- Special care must be given to Dynasty 529 strategies like these, as there are Gift Tax and Generation-Skipping Transfer Tax (GSTT) implications to navigate.

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