Estate Planning Newsletter - Spring/Summer Edition

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For many students, this time of year signals the end of their high school careers and the beginning of the transition to college. With that transition, students and their families must address difficult issues, including how to pay for tuition, room and board, and other necessities. Parents may have additional concerns, including how to handle emergency situations that could arise when their child is away from home for the first time. The following presents some methods to proactively prepare for this family transition.

529 Plans

A Qualified Tuition (or 529) Plan allows a donor or a trust to fund education expenses (including tuition, fees, books, supplies, reasonable room and board, and equipment) for a child or other beneficiary ("the beneficiary"). While historically such plans were designated for higher education, a recent change in the law allows these plans to cover tuition for private elementary and high school education on a limited basis (up to $10,000 annually). The earnings in a 529 plan grow tax-free; additionally, no income tax will be imposed on distributions to the beneficiary so long as distributions do not exceed qualified education expenses. Additionally, a contribution to a 529 plan may result in a state income tax deduction.

When funding a 529 plan, a donor may elect to treat contributions as having been ratably made over a five-year period. For a single donor, a contribution in an amount up to $75,000 can be used to fund a 529 plan and such amount will be protected by the donor's annual gift tax exclusion ($15,000 in 2019). For married donors, a contribution up to $150,000 can be similarly protected.

In many cases, a 529 plan will have assets remaining after the beneficiary completes his or her education. In such event, the donor may name a new beneficiary for the plan or elect to roll the remaining funds into a different plan. If the new beneficiary is a member of the donor's family, there will be no adverse tax consequences; otherwise, distributions from the plan would be treated as income to the recipient, with an additional 10% penalty imposed.

Trusts and UTMA Accounts

Trusts may be utilized as annual gifting vehicles for children or other beneficiaries, and a variety of trust options are available. One example is a 2503(c) trust, which allows a donor to make annual contributions to

a trust for the benefit of a beneficiary; such contributions can be protected by the donor's annual gift tax exclusion. The trustee may distribute income and principal for the beneficiary's health, education, maintenance and support. Generally, the trust must terminate when the beneficiary attains the age of 21 years. However, if the beneficiary is given a right to withdraw the remaining balance when he or she attains the age of 21 years, the trust may continue pursuant to its terms so long as the withdrawal right is not exercised. For income tax purposes, a 2503(c) trust may be taxed as a grantor trust or as a complex trust. If taxed as a grantor trust, the income is reported and taxed on the donor's income tax return; in such event, the tax paid by the donor is an additional gift to the trust but is not treated as a gift for gift tax purposes. A complex trust is taxed as a separate taxpayer and must report the income, unless distributed out to the beneficiary.

An alternative to establishing a trust is contributing funds to a Uniform Transfers to Minors Act ("UTMA") account. A donor may make annual contributions to a UTMA account titled in the name of a custodian for the benefit of a minor and such contributions can be protected by the donor's annual gift tax exclusion. The custodian manages the account for the minor's benefit until the minor attains the age as determined by state law (typically 18 or 21 years). The custodian may make distributions for the benefit of the minor; however, upon attaining the designated age under state law, the account must be terminated and the funds paid to the minor.

The income earned by a UTMA account is reported on the minor's income tax return, and could result in the application of the "kiddie tax." Under this rule, a minor child's unearned income is taxed at the child's parent's rate, instead of the child's rate, to the extent unearned income exceeds $2,100.

UTMA accounts are often viewed as a simpler solution than a trust since UTMA accounts have fewer administrative requirements and there is no need to prepare a trust agreement. However, UTMA accounts are required to terminate at an early age, whereas a trust can generally continue to hold assets in trust for a longer period. Additionally, the income tax treatment of each arrangement should be compared.

Ultimately, there are a number of options that may be pursued; each option has different tax protections and benefits. We are happy to work with clients to determine which option best fits their particular need.

Powers of Attorney for Children

Powers of Attorney are legal documents that allow an Agent to make certain decisions on behalf of a Principal. A Health Care Power of Attorney allows an Agent to make decisions regarding the Principal's healthcare-related matters. A General Durable Power of Attorney allows an Agent to make decisions regarding the Principal's financial and other non-healthcare related matters. If such documents do not exist, the Principal may not have a qualified person in place to make decisions in an emergency or other critical

situation. In such event, a guardianship and/or conservatorship may be required.

Decision-making authority can be an especially tough issue for parents. Once a child attains the age of 18 years, a parent is no longer an automatically authorized legal representative under the law. Having an adult child sign a Health Care Power of Attorney and General Durable Power of Attorney can help avoid any uncertainty in the decision-making chain. By pre-planning for possible emergencies, family members can initiate difficult but necessary conversations, and a parent serving as an Agent can be confident they are carrying out their child's wishes.