

SEPTEMBER 2022 NEWSLETTER

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ESTATE PLANNING STRATEGIES FOR SCHOOL TUITION

1. AWARDS:

Pozzuolo Rodden Pozzuolo, P.C., is pleased to announce that the Selection Committee of the National Law Journal has reviewed over 55,000 attorneys and has chosen Joseph R. Pozzuolo, Esquire as a member of the 2022 Lawyers of Distinction.

Pozzuolo Rodden Pozzuolo, P.C., is pleased to announce that Joseph R. Pozzuolo has been awarded the 2022 Martindale-Hubbel AV Preeminent rating for the Highest Level of Professional Excellence – the highest Peer Review Rating achievable recognizing lawyers for their strong legal ability and high ethical standards. These rating are used to identify, evaluate and select the most appropriate lawyers by attorneys seeking to refer colleagues as well as individuals looking for legal counsel. This designation is trusted worldwide by seekers of legal services and held only by 10 percent of all attorneys.

2. SEMINARS:

Jeffrey S. Pozzuolo, Esquire recently presented a CPE seminar titled “Business Succession Planning and Buy-Sell Agreements” to the Montgomery County Society of Certified Public Accountants.

Speakers are available upon request to Joseph R. Pozzuolo at Joe@Pozzuolo.com

3. BLOGS:

The following are a few of the business, tax, employment, estate planning and business litigation blogs posted on our main website www.pozzuolo.com:

- a. Choosing A Retirement Plan;
- b. Living Wills and Power of Attorney; and,
- c. The Use Of A Will In An Estate Plan.

Please visit our website www.pozzuolo.com for more information on these and other relevant business, tax, estate, business litigation and employment topics.

ESTATE PLANNING STRATEGIES FOR SCHOOL TUITION

With school tuitions continually spiraling further and further out of control and college loan indebtedness continually hampering more and more young adults for decades after graduation, parents and grandparents may wonder how they can help lighten the financial burden on their children/grandchildren. The two most popular options are the use of 529 plans and the §2503(e) educational expense exclusion.

529 Plans

The 529 plan is one of the basic and historic estate planning building blocks any family should consider if they have young children. In a 529 college savings plan, someone, usually a parent or a grandparent, establishes a plan and deposits money into a special account sponsored by a higher educational institution, state government or state agency. Such plan funds grow tax free and can be withdrawn tax free as long as the withdrawal is for a qualified education expense. The estate planning strategy is to put away less money today to have more money tomorrow to pay for college and take advantage of the tax free gains.

PREPAID TUITION PLANS. There are also 529 prepaid tuition plans where, instead of putting money away into a 529 account, someone purchases tuition units or credits to essentially prepay for college at today's rates. The issue with the prepaid tuition plans is they are usually limited to public or in-state schools and have more restrictions on what can be covered, so most clients prefer college savings plans.

ANNUAL CONTRIBUTION LIMITS. Each person can contribute to a 529 Plan up to the annual gift tax exclusion (\$16,000 for 2023) for each beneficiary and can elect to accelerate five years of annual gift tax exclusions into one year. This means each person can contribute up to \$80,000 per beneficiary in one calendar year, however, if acceleration is used, one cannot contribute for another five years. This means grandparents with four grandchildren, could transfer \$128,000 each year (\$32,000 per grandchild) using both grandparents' annual gift tax exclusions, or with an acceleration, could contribute \$640,000 every five years (\$160,000 per grandchild).

If a family does not have a lot of liquid funds to put aside but has college aspirations for their children, it may be worth asking relatives and friends to contribute to the 529 plan in lieu of larger holiday/birthday gifts to children. It might not be much, but after 10 to 20 years of contributions and tax free growth, it will add up and every dollar helps. Contributions plus future tax free income

accumulation may fully cover or, if not, at least puts a major dent into the costs of higher education.

MAXIMUM 529 PLAN CONTRIBUTION LIMITS BY STATE. Another 529 limit is states limits based on the cost of attending undergraduate and graduate school in that particular state. Some states have limits as high as the mid \$500,000s all the way down to the mid-\$200,000s. For instance, the Pennsylvania maximum limit is currently \$511,758 whereas New Jersey's limit is \$305,000. Once the account value reaches this limit, no more contributions are permitted; however, the limits are based on the actual costs in the sponsoring state. Families will choose a particular state 529 plan based on these limits, plan fees, and investment track record.

QUALIFIED EXPENSES FOR 529 PLANS. Traditionally, qualified education expenses include room and board, mandatory fees, books, computers, and other post-secondary educational expenses including undergraduate, graduate school, and even qualified apprenticeships after the SECURE Act of 2019. Additionally it allows for the payment of \$10,000 per year for each beneficiary for qualifying education expenses for K-12 tuition and \$10,000 to help pay off school loans of the beneficiary and each of such beneficiary's siblings. However, to be clear, the student loan limit is a lifetime limit, not an annual limit. Withdrawals that are not for qualified education expenses or which are above the specific \$10,000 limits for K-12 or student loans are subject to a 10% penalty and ordinary income taxes. As a result, care needs to be taken to not over withdraw for K-12 expenses and student loan payment limits.

529 PORTIBILITY. If a family contributes too much and there is a large sum of funds sitting in the plan after the beneficiary graduates and has no plans for further schooling an excellent option to avoid income taxes and 10% penalty, if withdrawn, is to change the beneficiary or have a plan to plan transfer for the benefit of an eligible family member of the beneficiary. Eligible family members are siblings, step siblings, parents, children, nieces and nephews, aunts and uncles, in laws, and first cousins. In other words, if the beneficiary has a child or sister, the excess can help the beneficiary's child or sister. If not, then the beneficiary may have a niece or a nephew to transfer the excess funds by a plan to plan rollover or a beneficiary change.

All in all, 529 plans are a great way to plan and save a tremendous amount of money for one of the largest expenses, if not the largest, many parents and children may face: schooling.

§2503(e) Educational Expense Exclusion

While 529 plans do a great job of saving funds for college, they fall short if you want your child to go to K-12 private and/or religious school or your child needs to go to a school that caters to children who learn differently. In Pennsylvania, many of these private schools are \$25,000 to \$405,000 per school year with some peaking over \$60,000 per year. While the \$10,000 a year from a 529 plan for K-12 is great, it's a drop in the bucket for some private schools, especially with multiple children.

That is where the IRC §2503(e) an "Educational Expense Exclusion" allows grandparents, great grandparents, or other individuals to help make up the difference. This allows someone to gift an unlimited amount to an individual in excess of the current \$16,000 annual exclusion (i.e. this does not reduce the annual exclusion) for tuition to a qualifying educational organization for the education or training of the individual. Note the definition of a qualifying educational expense is somewhat liberal where the tuition for even martial arts schools, certain educational summer camps, eight week yoga instructional courses, and certain wilderness camping and survival programs have passed muster. See IRS Rev. Rul. 79-130 & Rev. Rel. 83-140.

There are some limits on this unlimited exclusion which need to be minded. First, this only works for direct payments to the educational institution. The payments cannot be made to the parents and relayed, but directly by the payor. Second, it is important that the parents do not have a contractual obligation for the tuition fee when payment is made. If there is a contractual obligation from the parents, the payment of that tuition becomes a gift for the benefit of the parents by relieving the parents of liability. If tuition is \$50,000, then this will be considered a gift of \$34,000 (\$50,000 less \$16,000 for the annual exclusion) to the parents requiring a gift tax return and using up the grandparent's lifetime federal unified credit exemption. Thus, care must be taken to communicate this with the school to avoid such a situation. Finally, the use of funds is limited only to the payment of tuition. It expressly does not include books, supplies, dormitory fees, board, or other similar expenses which do not constitute direct tuition costs. However, there is a gray area on boarding schools which do not break down boarding from tuition where the IRS has, historically permitted the exclusion, but there is no clear guidance supporting that treatment.

The §2503(e) educational expense exclusion is a highly recommended technique if grandparents have excess wealth to remove money from the grandparents' taxable estate, and it provides the benefit of a good education opportunity to the younger generation.

Summary

A 529 plan and the §2503(e) exclusion are great tools for individuals looking to reduce his/her taxable estate and looking to help support the newest generation. The 529 plan is recommended for everyone to put aside what they can, when they can, as it forces college savings, and will make an expense they will likely shoulder 10 to 20 years down the line (or which their kids will) cheaper and/or doable. The §2503(e) exclusion enables wealthy grandparents to provide the added support today for K-12 private and religious education and possibly other educational experiences. Both the 529 plan and §2503(e) exclusion help families plan to pay for continually skyrocketing education costs, which allow the next generation to get a leg up on education. Just as important, the §2503(e) direct payments are excluded from the 40% marginal federal estate and gift tax designed to prevent high net worth individuals from skipping over generations in an effort to reduce federal estate taxes or generation skipping transfer taxes ("GST").

Feel free to contact Jeffrey S. Pozzuolo, Esquire to discuss your specific facts or circumstances so that we can create an Estate Plan that is tailored to your specific family needs and requirements.

This newsletter is courtesy of Pozzuolo Rodden Pozzuolo, P.C.

To subscribe, unsubscribe, or for any questions, please contact us at INFO@POZZUOLO.COM.