

WHITE PAPER



Education Planning

Outside of one's home, education is the biggest investment for many families. It is also often the expense that grows at the highest rate, increasing up to 4% annually, or twice the rate of average annual inflation. For these reasons, it is essential to plan appropriately for education expenses, as doing so can help you to achieve both your short-term and long-term financial goals.

To that end, the following information highlights some of the most commonly-used education planning tools. While each plan is unique and there is no “one-size-fits-all” answer, this information will help you make an informed decision about what is best for you and your family.



BROOK H. LESTER, CPA
PRINCIPAL & CHIEF
WEALTH STRATEGIST



HUNTER MERIWETHER
VICE PRESIDENT

continued on next page >

**DIVERSIFIED
TRUST**

diversifiedtrust.com

EE Education Bonds

Series EE bonds, sometimes called “Patriot Bonds” are issued by the U.S. government and are non-transferable, interest-bearing bonds. EE Bonds are guaranteed to at least double over the typical 20-year initial term, which equates to approximately 3.5% interest annually. Interest will continue to accrue at the stated interest rate from years 20 to 30 and stop accruing after year 30. An individual may purchase up to \$10,000 in EE bonds each calendar year. Once purchased, the individual must hold them for at least 12 months before redemption, and they will be charged 3 months of interest if redeemed within 5 years of issuance. Interest is tax-free as long as:

1. They are held by a person (usually the parent) that is age 24+, and
2. They are redeemed in a year in which the owner is making post-secondary school tuition and fee payments (which may be in the form of contributions to a qualified tuition program or a Coverdell Account); other expenses do not qualify.

Assuming that EE bonds will not have doubled by the 20-year original maturity date at the stated interest rate (currently 0.1%), the Treasury will make a one-time adjustment at the original maturity date to make up the difference. Accordingly, in the current interest environment, after year 20, EE Bonds are not an attractive investment. Note that interest is taxable at redemption if not used for education purposes, but the owner may elect to pay the corresponding tax each year that it is earned.

529 Plans

Section 529 was initially added to the Internal Revenue Code with the Small Business Job Protection Act of 1996. Congress has made numerous changes to the law over the years, the most significant of which came with the Tax Cuts and Jobs Act (TCJA) of 2017. The original legislation created two types of 529 plans: college savings plans and prepaid tuition plans.

College savings plans are usually what comes to mind when you hear “529 plan” today. This type of plan more closely resembles a standard investment account than does a prepaid tuition plan. The owner (usually a parent) opens a 529 account, usually sponsored by a state, and makes contributions to the account on behalf of the designated beneficiary (usually a child). The owner maintains control of the account and the power to designate a beneficiary. Contributions qualify for the gift tax annual exclusion (currently \$15,000) and allow for 5-year averaging of the donor’s annual exclusion gifts (\$75,000 contribution per donor in one year, then nothing else for 5 years). Contributions are not deductible for federal income tax purposes, but many states allow a state income tax deduction for contributions to the state’s 529 plan. Each state is unique, so be sure to clarify the rules with your accountant prior

to a contribution. Growth and distributions are tax-free when used for qualified expenses. Qualified expenses are any education expenses in undergraduate or graduate school, such as tuition and fees, room and board, computers, supplies, etc. Under the 2017 TCJA, up to \$10,000 may also be used for K-12 tuition payments each year. Funds not used by a designated individual may be rolled over to a “qualified family member”: a sibling, parent, first cousin, niece, nephew, and others.

Prepaid tuition plans are essentially a prepayment of future tuition at today’s rate. The investor purchases tuition credits that will work with most (or all) of a state’s public colleges and universities. This type of plan allows the investor to pay for college now, while putting the investment risk on the state, as the prepayment is guaranteed to track tuition inflation. Note that funds are restricted for tuition only and do not cover room and board. This type of 529 plan is being offered less and less and is only available in a handful of states.

UGMA & UTMA Accounts

The Uniform Transfers to Minors Act (UTMA) was drafted in 1986 by the National Conference of Commissioners on Uniform State Laws and was subsequently enacted by all states but South Carolina (though legislation was introduced last year to enact UTMA). For the states that adopted it, UTMA replaced the Uniform Gifts to Minors Act (UGMA), originally passed in 1956.

UGMA/UTMA accounts allow individuals to give or transfer assets to underage beneficiaries without the need for a formal trust. UTMA accounts may hold all cash-type investments, such as stocks, mutual funds, CDs, savings accounts, etc., plus real estate and limited partnerships (UGMA may only hold cash-type investments). Qualified distributions from UTMA and UGMA accounts include any expense for the benefit of the minor. Most UGMA/UTMA accounts are transferred to the minor at age 18 or 21, according to state law.

Contributions to both UGMA and UTMA accounts qualify for the annual gift tax exclusion, but there is no 5-year averaging as there is with 529 plans. It is also important to note that assets in this type of account are deemed to be owned by the child, so earnings are subject to the “Kiddie Tax”.

IMPORTANT NOTES AND DISCLOSURES

This White Paper is being made available for educational purposes only and should not be used for any other purpose. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. Diversified Trust Company, Inc. believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based.

Opinions expressed in these materials are current only as of the date appearing herein and are subject to change without notice. The information herein is presented for illustration and discussion purposes only and is not intended to be, nor should it be construed as, investment advice or an offer to sell, or a solicitation of an offer to buy securities of any type of description. Nothing in these materials is intended to be tax or legal advice, and clients are urged to consult with their own legal advisors in this regard.

Coverdell Education Savings Accounts

Coverdell accounts were initially introduced in 1997 as the “Education IRA”. Congress subsequently expanded its benefits and renamed it the Coverdell ESA in 2001. Similar to Section 529 plans, contributions to a Coverdell account are not income tax deductible, but growth and distributions used for educational purposes are tax-free.

These accounts have traditionally been very attractive for the owner’s ability to use the funds to pay for elementary and secondary school expenses, including tuition and fees, room and board, books and supplies, tutoring, uniforms, etc. Since the 2017 TCJA expansion of the use of 529 plans, Coverdells have become slightly less attractive. However, they may still be used for more expenses than just tuition at the elementary and secondary school level, and they have more flexible investment options than do 529 plans.

Contribution levels are set at a total of \$2,000 per child per year, no matter who contributes the money. The contribution limit is reduced dollar for dollar by the excess of the contributor’s modified AGI over \$95,000 (single filers) or \$190,000 (joint filers). Note that Coverdell accounts must be used or rolled over to another qualified beneficiary by the time the beneficiary turns age 30, or the earnings become subject to income tax plus a 10% penalty.

In summary, there are a myriad of investment vehicles that can be utilized for education savings. When deciding between them, you must consider several factors: length of time the funds will be invested, tax savings attributes, ownership of accounts, desired flexibility, and tolerance for risk. For example, if the funds will be invested for less than 20 years, EE Bonds would not be a very attractive option right now. However, EE bonds are the safest investment vehicle offered, along with Prepaid Tuition Plans, so these would be good options for the conservative investor. That said, EE Bonds are limited by their \$10,000 per year cap and Prepaid Tuition Plans are limited by the small number of states that offer them, so a College Savings Plan with a conservative allocation may be a better option, especially with the 5-year averaging. From a flexibility standpoint, however, an UGMA or

ATLANTA

877.955.8266



CHARLESTON

866.619.1003



GREENSBORO

855.821.4999



MEMPHIS

800.264.7498



NASHVILLE

877.386.7332

UTMA may be the best option, but ownership and control of the assets will transfer to the child at age 18 or 21 and the tax treatment is not as favorable as some other types of accounts. These are the types of options that must be considered when saving for education expenses. While making a decision regarding which investment vehicles to use is a big decision and can feel overwhelming, just take it one step at a time. Below is a quick reference guide to help you make the best decision for you and your family.

As always, please contact us with any further questions that you may have.

	EE Bonds	529 Plans	UGMA/UTMA	Coverdell ESAs
Contribution Limits	\$10,000 per investor	\$15,000 per donor; \$75,000 up front if nothing else for 5 years – donors will owe gift tax on excess contributions	\$15,000 per donor – donors will owe gift tax on excess contributions	\$2,000 per donee, regardless of the number of donors
Qualified Expenses	Tuition and Fees	Tuition and Fees, Room and Board, Supplies, Computers, K-12 tuition up to \$10,000, \$10,000 in Student Loans for the Beneficiary and Siblings, Cost of Apprenticeships	Any expense for the benefit of the minor	Tuition and Fees, Room and Board, Supplies, Computers, K-12 expenses
Investments	N/A	Stocks, Bonds, CDs Mutual Funds, limited to plan offerings	UGMA – Marketable Secs. UTMA – Marketable Secs., plus real estate and LPs	Stocks, Bonds, CDs, and Mutual Funds
Tax Treatment if Used for Qualified Expenses	Interest tax-free	Contributions with after-tax dollars, growth and distributions tax-free.	Taxed to child, subject to Kiddie Tax	Contributions with after-tax dollars, growth and distributions tax-free
Control Converts to Child	Never	Never; can rollover to qualified family member	UGMA – 18 or 21, depending on state UTMA – age 25	Age 30; can rollover to qualified family member