



Grace Global Alliance

An Independent Association of Christian Churches & Ministers

Saving For College An Overview Tax Year 2017

Prepared for:

Grace Global Alliance
Ministers & Churches

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The Benefits of a College Education

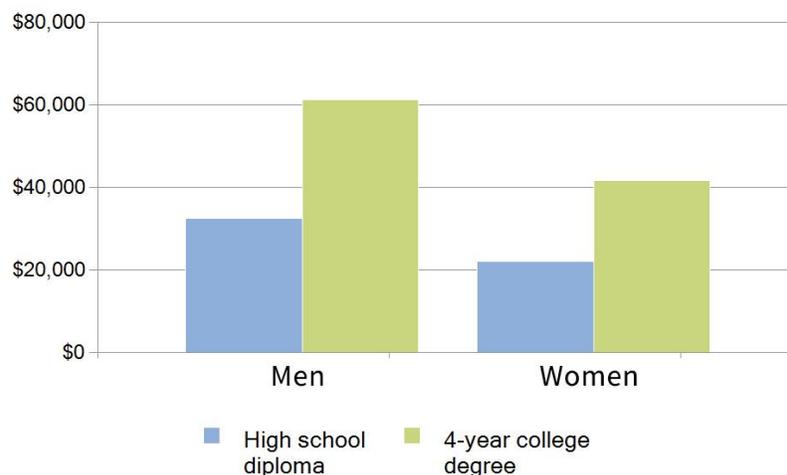
For many, accumulating funds for the children's education is a savings goal that is often thought about, but seldom acted upon. There are numerous reasons why saving for college is an essential need.

- **Economics:** Statistically, the average worker with a 4-year college education earns far more than the average worker with only a high school diploma.
- **Increasing costs:** In recent years, college costs have increased at a rate greater than the general rate of inflation.¹
- **Years of study:** Four years of study may not be sufficient. In many professions, six or even eight years of study are required.

What is a College Education Worth?

College educated, full-time workers statistically enjoy a higher median income than those with less education. In a recent report on education and earnings,² the Census Bureau found that those with four years of college could expect to have substantially higher annual earnings than high school graduates.

Median Annual Income



¹ See "Trends in College Pricing – 2016," published by The College Board, page 3.

² U.S. Census Bureau – Median Earnings in the Past 12 Months (in 2015 Inflation-Adjusted Dollars) by Sex, by Educational Attainment for the population 25 years and over. 2015 American Community Survey 1-Year Estimates.

The Benefits of a College Education

Over a lifetime of work, 39 years on average, a four-year college education can increase a man's total income by over \$1,065,012. Because of time spent raising children, the average woman spends 28 years in the workforce. A college education could increase her lifetime earnings by over \$545,748.¹

What Does a College Education Cost?

In recent years, college costs have often exceeded the general rate of inflation. The table below projects college costs for a small group of well-known institutions:

Private Institutions	Annual Costs ² (Assumes inflation is 4.0% per year.)			
	2017	2022	2027	2032
Yale University New Haven, Connecticut	\$64,650	\$78,657	\$95,698	\$116,431
Northwestern University Evanston, Illinois	66,344	80,718	98,205	119,482
Stanford University Stanford, California	62,541	76,091	92,576	112,633
Public Institutions	2017	2022	2027	2032
State University of New York Stony Brook, New York	\$21,916	\$26,664	\$32,441	\$39,469
University of Michigan Ann Arbor, Michigan	25,274	30,750	37,412	45,517
University of Colorado Boulder, Colorado	25,121	30,564	37,185	45,242

¹ Figures do not take inflation into account.

² Annual costs are for the 2016-2017 academic year and include tuition, fees, and on-campus room and board. Books, transportation, and personal expenses are additional. Costs for out-of-state students at public institutions are higher.

Choosing a College

With over 4,700¹ degree-granting institutions offering post-high school education in the United States, choosing the right school can be daunting. Although the final choice is an individual one, careful (and early) planning is essential. The following list of key points can help in the decision making process.

Admission

One of the first questions a student faces is whether or not he or she will be accepted for admission to a particular school.

- **Qualifications:** Does the student have the necessary academic and personal qualifications?
- **Ability to pay:** Does the school consider ability to pay as a factor in considering an application? Most colleges evaluate applications on a need-blind basis.
- **Popular schools:** Certain, popular big-name schools may be extremely difficult to enter simply because an overwhelming number of students apply. Lesser-known schools may provide an equal education and have admission standards less difficult to meet.

Cost

With the continually rising cost of a college education, paying for school is often a major concern.

- **Affordability:** How affordable is a school? In general, public schools, partially subsidized by tax dollars, tend to be less expensive than private institutions.
- **Living expenses:** A family may want to weigh the cost of dormitories or off-campus housing versus the cost of having the student live at home and commute to a local school.

¹ Source: U.S. Department of Education, National Center for Education Statistics, Digest of Education Statistics, Table 3.17.10, degree-granting postsecondary institutions, by control and level of institution: Selected years, 1949-50 through 2013-14.

Choosing a College

- **Cash flow or savings?** Can the education be paid for from current cash flow? If not, has enough money been saved to pay for the entire education or are additional funds needed?
- **Student debt:** Is the student or family willing and/or able to take on the financial burden of student loans?
- **Financial aid:** How much and what type of financial aid can a school make available? Some forms of aid are based on need; others on merit.
- **Scholarships:** Are there scholarships available for which the student may qualify?

Academics

What type and quality of education does the institution provide?

- **Specific programs:** For those individuals with clear ideas of what they want to do in life, does the school have the specific type of education and training needed?
- **Breadth:** For students who are less sure of their career goals, does the institution offer the breadth of courses and majors needed for a good liberal arts education? Can a student be undeclared until a major is chosen or must a major and course of study be decided upon immediately?
- **Academic standards:** Are academic standards rigorous or relaxed?
- **Time to complete:** Can a student complete a course of study in four years? Overcrowding may mean that key required courses are not available when needed.
- **Class size:** Are classes large or small? Do the professors do the teaching or is much of the teaching done by graduate students and/or teaching assistants? How much personal contact is there between professors and students?
- **Special programs:** Are special academic programs available, such as internships or study abroad programs?

Personality

Each college or university has its own personality. Will the student enjoy living and working at a particular school and with a particular student body for four years?

Choosing a College

- **Size:** Large institutions can offer greater choice, both academically and in extracurricular activities; however, their large size may be intimidating to some students. Smaller schools can be more personal, with greater opportunities for student involvement.
- **Single sex:** Some students may feel more comfortable and perform better academically at a single-sex, rather than at a co-educational institution.
- **Religious affiliation:** A religious focus to campus life may be an important consideration for a student.
- **Student body diversity:** Is it important that a student body be widely diverse? Or, would a student feel more comfortable at a school where one ethnic or socio-economic group is predominant?
- **Social life:** What is the predominant “flavor” to the social life on campus?
- **Athletics or other extracurricular programs:** Does the student have an interest in a sport or other extracurricular activity that may not be available at certain schools?

Location

Very often the geographic location of a college is a major factor in deciding which school to attend.

- **Locale:** Should the student live at home or move out to attend school?
- **Distance:** How far is a school from home? The cost of round-trip transportation between home and school can affect how often a student is able to return home.
- **Housing type:** What type of housing is available? Do most students live in school dorms or is off-campus housing the preferred choice?
- **Community:** Urban, rural, or suburban? Institutions located in large cities offer diversity, while schools located in rural areas can offer a strong sense of community. Institutions located in suburban areas can offer both.

Choosing a College

- **Region:** Which part of the Country? A student from one part of the country may simply want a change and choose to attend a college in a different area. For example, a student raised in a large city may want to attend a school located in a rural area; a student from the Northeast may want to study on the West Coast.
- **Safety:** How safe is the school environment? Federal law requires colleges to make campus crime statistics available to students and applicants.

Additional Resources

There are a number of excellent college guides and handbooks available in bookstores and public libraries. State and federal agencies involved in higher education are also excellent sources of information. In addition, there are a number of sites on the Internet which can provide information, including:

- **University of Texas:** Maintains a useful website with links to the home pages of many schools in the U. S., at: <http://www.utexas.edu/world/univ/state/>
- **The College Board:** Maintains a searchable database of colleges on their website located at: <http://www.collegeboard.org>

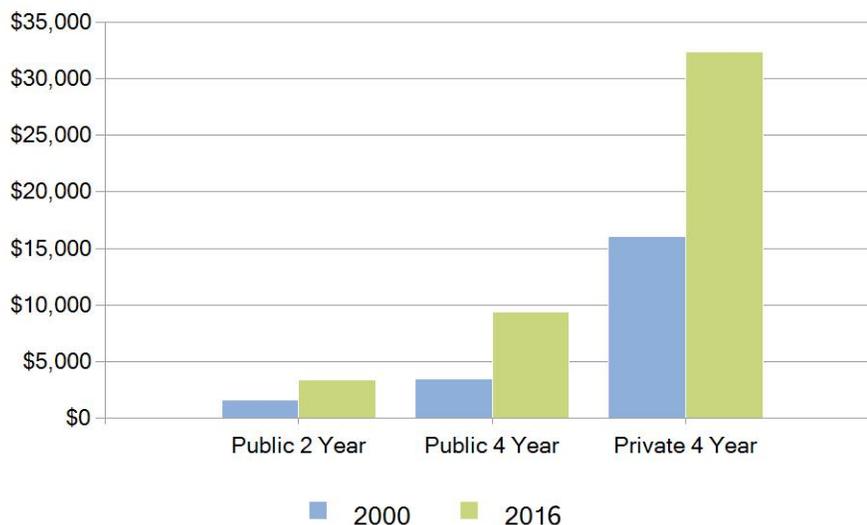
Growth in College Costs

2000-2016

Average Annual Costs¹

School	Tuition & Fees		Tuition, Fees, Room & Board	
	2000	2016	2000	2016
Public 2 Year	\$1,642	\$3,520		
Public 4 Year	\$3,508	\$9,650	\$8,439	\$20,092
Private 4 Year	\$16,072	\$33,480	\$16,072	\$45,365

Tuition and Fees 2000-2016



¹ Figures shown are for in-state students. Source: Trends in College Pricing © 2016. The College Board.

Ways to Save for College

In accumulating funds for college, one of the first questions a family will face is, “Where do we invest the money?” Many financial professionals will recommend that money for college be placed in relatively low-risk investments. If there is a long enough time frame, the savings may be placed initially in higher risk (and potentially higher return) investments. As the time for college gets closer, the funds can be shifted into more conservative choices.



The ultimate decision will depend on a range of factors such as the number of years until college begins, the amount of money available to invest, a family’s income tax bracket, risk tolerance, and investment experience. A few of the more traditional approaches are:

- **Savings accounts:** Including CDs, money market accounts, and regular savings.
- **Tax-free municipal bonds:** Held either directly or through a mutual fund.
- **U.S. Treasury securities:** Such as treasury bills or treasury bonds.
- **Growth stocks/growth mutual funds:** For the long-term investor.

Tax-Advantaged Strategies

Under federal income tax law (state or local income tax law may differ), there are a number of tax-advantaged strategies available to accumulate funds for college expenses. The rules surrounding these strategies can be complicated and they should only be used after careful review with a tax or other financial professional:

- **IRC Sec. 529 qualified tuition program:** These plans allow an individual to either prepay a student's tuition, or contribute to a savings account to pay the student's "qualified higher education expenses." Contributions are not tax deductible, but growth in an account is tax-deferred. If certain requirements are met, distributions to pay qualified higher expenses are excluded from income. 529 plans involve investment risk, including possible loss of funds, and there is no guarantee a college-funding goal will be met. The fees, expenses, and features of 529 plans vary from state to state.

Ways to Save for College

- **Coverdell education savings account:** Up to \$2,000 per year may be contributed to a Coverdell ESA for an individual. Contributions are not tax-deductible, but growth is tax-deferred. Distributions are excluded from income if used for qualifying educational expenses. Other restrictions may apply.
- **Cash value life insurance:** Cash value life insurance can be an attractive, tax-favored means of accumulating college funds. If an insured dies before the student starts school, the policy proceeds can be used to pay college expenses.
- **U.S. savings bonds:** Interest on series EE savings bonds issued after 1989, or Series I savings bonds, may (certain limits apply) be excluded from income if qualifying education expenses are paid in the year the bonds are redeemed. The exclusion also applies to savings bond interest contributed to an IRC Sec. 529 qualified tuition program or a Coverdell ESA.

Who Owns the Funds?

A second issue facing families planning for college is the question of “Who will own the funds?” The answer to this question involves issues of control, income and gift taxes, and can impact a future application for financial aid:

- **Parents:** Either in accounts specifically earmarked for college or as a part of a general family portfolio.
- **Child:** Often a custodial account is used, under either the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA).
- **Trust:** In certain situations, usually involving wealthy families, specialized types of trusts may be used, such as a Crummey trust or charitable remainder trust.

Impact On Financial Aid

For need-based financial aid purposes, assets considered to be owned by the **parents** have a relatively small negative impact. Assets considered to be owned by the **child** have a much greater negative impact. Trust assets are often considered to be owned by the child, but this can vary widely. Frequently, trust provisions restrict access to principal, thus forcing inclusion of the trust assets in the eligibility process each year that a student is in school. Non-trust assets can be “spent down” in a year or two, limiting their financial aid impact.

Ways to Save for College

Other Resources

There are a number of excellent references and guides to investments and college planning available in bookstores and public libraries. State and federal agencies involved in higher education also are excellent sources of information. In addition, there are a number of sites on the Internet which can provide information, including the following:

- **The College Board** – <https://www.collegeboard.org>
- **FinAid! The SmartStudent® Guide To Financial Aid** – <http://www.finaid.org>
- **College Savings Plan Network** – links to state-run web pages on prepaid tuition or college savings plans, at: <http://www.collegesavings.org>
- **U.S. Department of Education – student aid website** – <https://studentaid.ed.gov/sa/>

Begin Early and Seek Professional Guidance

Developing a plan to save for a child's college education can be complicated. Questions can arise involving income tax, estate and gift taxes, investment issues, and the impact of asset ownership on financial aid eligibility. Individuals are strongly advised to begin a savings program as early as possible, and seek professional guidance.

Education Savings Plans Compared

Benefit or Feature	“529” Prepaid Tuition Plan ¹	“529” Higher Education Savings Plan ¹	Coverdell Education Savings Account
Basic concept	Buy tomorrow’s tuition at today’s prices.	Tax-advantaged savings account to accumulate funds for higher education.	Tax-advantaged savings account to accumulate funds for education.
Federal income tax treatment	Contributions are not deductible; growth is tax-deferred; withdrawals for qualified higher education expenses are exempt from tax.	Contributions are not deductible; growth is tax-deferred; withdrawals for qualified higher education expenses are exempt from tax.	Contributions are not deductible; growth is tax-deferred; withdrawals for qualified education expenses are exempt from tax.
State or local income tax treatment	Varies. Some states follow federal income tax law, while others do not.	Varies. Some states follow federal income tax law, while others do not.	Varies. Some states follow federal income tax law, while others do not.
Level of investment risk	Generally a low level of risk. Sponsoring state or organization typically promises to invest funds to match tuition increases. Later contributions may be required.	Varies, depending on the underlying investments. An investment manager typically manages the funds. Both gains and losses are possible.	Varies, depending on the underlying investment. A wide range of self-directed investments is available. Both gains and losses are possible.
Where to purchase	Directly from the state or private institution involved.	Investment brokers, banks, credit unions, insurance companies, or directly from the state involved.	Investment brokers, banks, credit unions, and insurance companies.
Who can contribute?	Generally, anyone. Residency restrictions may apply.	Generally, anyone. Residents in one state can often invest in another state’s plan.	Generally, anyone.

¹ “529” refers to Section 529 of the Internal Revenue Code, the section of federal law which authorizes these plans.

Education Savings Plans Compared

Benefit or Feature	“529” Prepaid Tuition Plan	“529” Higher Education Savings Plan	Coverdell Education Savings Account
How much can be contributed?	Contributions must be in cash and may not exceed what is needed to fund the beneficiary’s higher education expenses. The program sponsor will specify the maximum amount.	Contributions must be in cash and may not exceed what is needed to fund the beneficiary’s higher education expenses. The program sponsor will specify the maximum amount. ¹	Contributions must be in cash and may not exceed \$2,000 per beneficiary per year.
Beneficiary age limits for contributions?	None	None	Before age 18 unless a special needs student.
How are payments made?	In a lump-sum or periodic payments.	In a lump-sum or periodic payments.	Typically, in periodic payments.
Do income limitations apply to the donor?	No	No	Yes. Contribution is phased out for donors whose AGI exceeds certain limits. ²
Who controls the funds?	Generally, the donor. ³ If the account is a custodial account, the beneficiary becomes the owner when he or she reaches age 21 (18 in some states).	Generally, the donor. ² If the account is a custodial account, the beneficiary becomes the owner when he or she reaches age 21 (18 in some states).	Generally, the donor. ² If the account is a custodial account, the beneficiary becomes the owner when he or she reaches age 21 (18 in some states).

¹ In some higher education savings programs, more than \$250,000 may be contributed for a single beneficiary.

² For unmarried individuals, the contribution is phased out when adjusted gross income (AGI) is between \$95,000 - \$110,000. For married couples filing jointly, the phase-out range is an AGI of \$190,000 - \$220,000.

³ With a “529” prepaid tuition plan or a “529” savings plan, if the assets are not used for higher education they may be returned to the donor. In a Coverdell Education Savings Account, if the assets are not used for higher education, they will ultimately become the property of the beneficiary.

Education Savings Plans Compared

Benefit or Feature	“529” Prepaid Tuition Plan	“529” Higher Education Savings Plan	Coverdell Education Savings Account
What expenses are covered?¹	All plans cover tuition and fees. Some plans include a room and board option or allow excess tuition credits to be used for other qualified expenses.	Generally, most costs required to attend a qualified post-high school educational institution. Such costs may include tuition, fees, books, supplies and equipment, and computers, software and internet access. ² Reasonable costs for room and board also qualify if the student is attending school at least half time.	A wide range of expenses is allowed, to attend Kindergarten thru 12th grade, as well as post-high school educational institutions. May include tuition, fees, books, supplies, and equipment, as well as reasonable costs for room and board.
What schools may the beneficiary attend?	Prepaid tuition plans typically limit attendance to same-state post-high school institutions.	Funds accumulated in the savings plan of one state may usually be used at institutions of higher education throughout the U.S. Some foreign schools also qualify.	For K-12, any school that qualifies under state law, including public, private, or religious schools. For post-high school, most institutions in the U.S. qualify.
Effect on financial aid?	Generally reduces financial aid. Account owned by student penalized more than parent-owned account.	Generally reduces financial aid. Account owned by student penalized more than parent-owned account.	Generally reduces financial aid. Account owned by student penalized more than parent-owned account.
May account be rolled-over to other family members?	Yes	Yes	Yes

¹ Technically, under IRC Sec. 529, the same definition of “qualified higher education expenses” applies to both prepaid tuition plans and higher education savings plans. In practice, however, for prepaid tuition plans, the sponsoring entity will limit the use of the funds to the types of expenses shown above.

² The addition of computer equipment, software and internet access as qualified expenses was included in the Protecting Americans From Tax Hikes Act of 2015, effective for tax years beginning after December 31, 2014.

Coverdell Education Savings Account

The Taxpayer Relief Act of 1997 (TRA '97) created a tax-favored education individual retirement account designed to help certain taxpayers save for a child's education. These plans have been renamed as Coverdell Education Savings Accounts. Money contributed to a Coverdell ESA is nondeductible, but earnings accumulate tax-deferred.



Contributions to a Coverdell ESA are treated as nontaxable gifts to the beneficiary. In general, to the extent that earnings are distributed to pay qualified educational expenses, the earnings are excluded from the beneficiary's income and are received free of federal income tax.¹

The contributor need not be related to the beneficiary and there is no limit on the number of individual beneficiaries for whom one contributor may set up a Coverdell ESA.

Contributions

Federal income tax law currently limits contributions to a Coverdell ESA to \$2,000 per beneficiary per year. Contributions must be in cash and must generally be made before the beneficiary reaches age 18. Other considerations include:

- **Due date for contributions:** Contributions must be made by the due date (not including extensions) of the contributor's return for the tax year of the contribution, generally April 15 of the following year.
- **Special needs beneficiaries:** Contributions to accounts for special needs beneficiaries may be made past the age of 18.²
- **Multiple accounts:** May not be used to exceed the \$2,000 limit for any one beneficiary.
- **Excess contributions:** Excess contributions are subject to a 6% excise tax paid by the beneficiary for each year that any excess remains in the account.

¹ The income tax treatment of Coverdell ESAs discussed here reflects federal law; state or local law may differ.

² A special needs beneficiary, generally, is an individual who, because of a physical, mental or emotional condition, needs extra time to complete his or her education.

Coverdell Education Savings Account

- **Contribution phase out:** The \$2,000 per year limit is phased out for taxpayers with an adjusted gross income (AGI) above certain levels. For single filers, the contribution phases out when AGI is between \$95,000 and \$110,000. For married couples filing jointly, the phase-out range is between \$190,000 and \$220,000.¹
- **Military death payments:** Under the provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008, an individual who receives a military death gratuity and/or a payment under the Servicemembers' Group Life Insurance (SGLI) program, may contribute to a Coverdell ESA an amount no greater than the sum of any military death gratuity and SGLI payment. Such a contribution, considered a qualified rollover contribution, must be made within one year of receiving the death gratuity or insurance payment. The annual dollar contribution limit and income-based phase-out of the dollar contribution limit do not apply to such contributions.
- **Qualified tuition programs:** Contributions to a Coverdell ESA for a beneficiary are permitted in the same year in which a contribution is made for the same beneficiary to a qualified tuition program (QTP).²
- **Contributions by other entities:** Contributions to Coverdell ESA may be made by entities such as corporations or tax-exempt organizations, not subject to the income phase-out rules.

Key Definitions

Coverdell Education Savings Accounts provide a tax-favored framework within which funds may be accumulated to pay for a beneficiary's "qualified education expenses." Depending on the educational level involved, the definition of qualified education expenses will change, as will the allowable educational institutions.

- **Kindergarten - Grade 12:** Qualified elementary and secondary education expenses refers to tuition, fees, academic tutoring, services for special needs individuals, books, supplies, and equipment. The term also includes room and board, uniforms, transportation, and supplemental services such as extended day programs. In specified circumstances, computer equipment and technology, including software and Internet connections, are qualified expenses. Contributions to a Qualified Tuition

¹ These phase-out limits are not subject to adjustment for inflation.

² See IRC Sec. 529 for more detail.

Coverdell Education Savings Account

Plan, under IRC Sec. 529 are considered allowable expenses. The term “school” refers to an institution that provides elementary or secondary education (kindergarten through grade 12), under state law. This may be a public, private, or religious school.

- **Post-secondary:** Qualified higher education expenses include tuition, fees, books, and supplies and equipment needed for attendance. Room and board is included for students attending half time or greater. The term also encompasses the expenses incurred to allow a special needs beneficiary to enroll at and attend an eligible institution. Contributions to a Qualified Tuition Plan, under IRC Sec. 529, are also considered allowable expenses. The term “eligible educational institution” refers, generally, to accredited post-high school educational institutions offering associates, bachelors, graduate level, or professional degrees. Certain vocational schools are also included.
- **Family member:** Certain tax-free transfers of Coverdell ESA assets are permitted between family members. In addition to the spouse, family members include:

Family Members
Son or daughter, or their descendants
Stepson or stepdaughter
Brother, sister, stepbrother, or stepsister
Father or mother or ancestor of either
Stepfather or stepmother
Son or daughter of a brother or sister
Brother or sister of father or mother
Spouse of any person listed above
First cousins

Distributions

Distributions from a Coverdell ESA are considered to be part principal (the original contributions) and part earnings. If qualified education expenses exceed the total amount distributed from the account for the year, all of the distributed earnings are excluded from the beneficiary’s income. If qualified education expenses are less than the amount

Coverdell Education Savings Account

distributed, a portion of the distributed earnings will be included in the beneficiary's taxable income for the year. An additional 10% tax may be added to the portion included in taxable income.

- **Additional tax:** Any earnings distributions included in a beneficiary's income because they are not used for qualified educational expenses are subject to an additional 10% tax. Certain exceptions apply, including the death or disability of the beneficiary, or the receipt of certain scholarships.
- **Rollovers/change of beneficiary:** If a beneficiary does not use the funds held for him or her in a Coverdell ESA, the money may be distributed and rolled over into a new account for a different beneficiary. If the rollover occurs within 60 days of the distribution, and if the new beneficiary is a member of the original beneficiary's family¹ and has not yet attained age 30, the distribution is not taxable to the original beneficiary. The same objective may be reached by simply changing the beneficiary of a Coverdell ESA. As long as the new beneficiary is a member of the original beneficiary's family, and has not reached age 30, the change is not treated as a taxable distribution.
- **Beneficiary reaches age 30:** If a beneficiary reaches the age of 30 and there are still funds remaining in the Coverdell ESA, federal tax law deems the remaining funds to be distributed and, therefore, subject to tax for that year. The 10% additional tax also applies to amounts so distributed because of the beneficiary reaching age 30. If a beneficiary dies before age 30, any remaining account balance must be distributed to the beneficiary's estate (and thus become taxable) within 30 days of death.
- **Special needs beneficiaries:** The requirement that any funds left in a Coverdell ESA must be distributed when the beneficiary reaches age 30 does not apply to a special needs beneficiary. Similarly, a special needs individual may be the beneficiary of an account rollover even though he or she is age 30 or older.
- **Coordination with other programs:** A Coverdell ESA beneficiary may generally also claim either the Hope Scholarship Credit or the Lifetime Learning Credit (not both in the same tax year), receive a distribution from a qualified tuition plan, or claim the tuition and fees deduction, as long as the qualifying expenses are not the same.

¹ As defined in IRC Sec. 529 (e)(2)

Coverdell Education Savings Account

Other Issues

- **Effect on financial aid eligibility:** Assets in a Coverdell ESA are considered in the “Expected Family Contribution” calculations. Tax-free distributions from a Coverdell ESA (those used to pay for qualified education expenses) are not counted as income to either the parent or student in the financial aid determination process.¹

Private institutions, however, may consider Coverdell ESA assets and income into consideration when awarding school-based financial aid, regardless of who is listed as the account owner.

- **Loss of control:** Ownership of the funds contributed to a Coverdell ESA will eventually pass to the beneficiary. A donor may not simply “take back” the account, as can be done with IRC Sec. 529 qualified tuition plans.
- **Federal bankruptcy impact:** If certain requirements are met, federal bankruptcy law can protect a portion (in some cases all) of the assets in a Coverdell ESA from creditors.
- **Losses:** If certain requirements are met, a complete loss in a Coverdell account may be deducted on your federal income tax return as a miscellaneous itemized deduction, subject to the 2%-of-adjusted-gross-income limit. See IRS Publication 970 for details. State or local law may vary.

Seek Professional Guidance

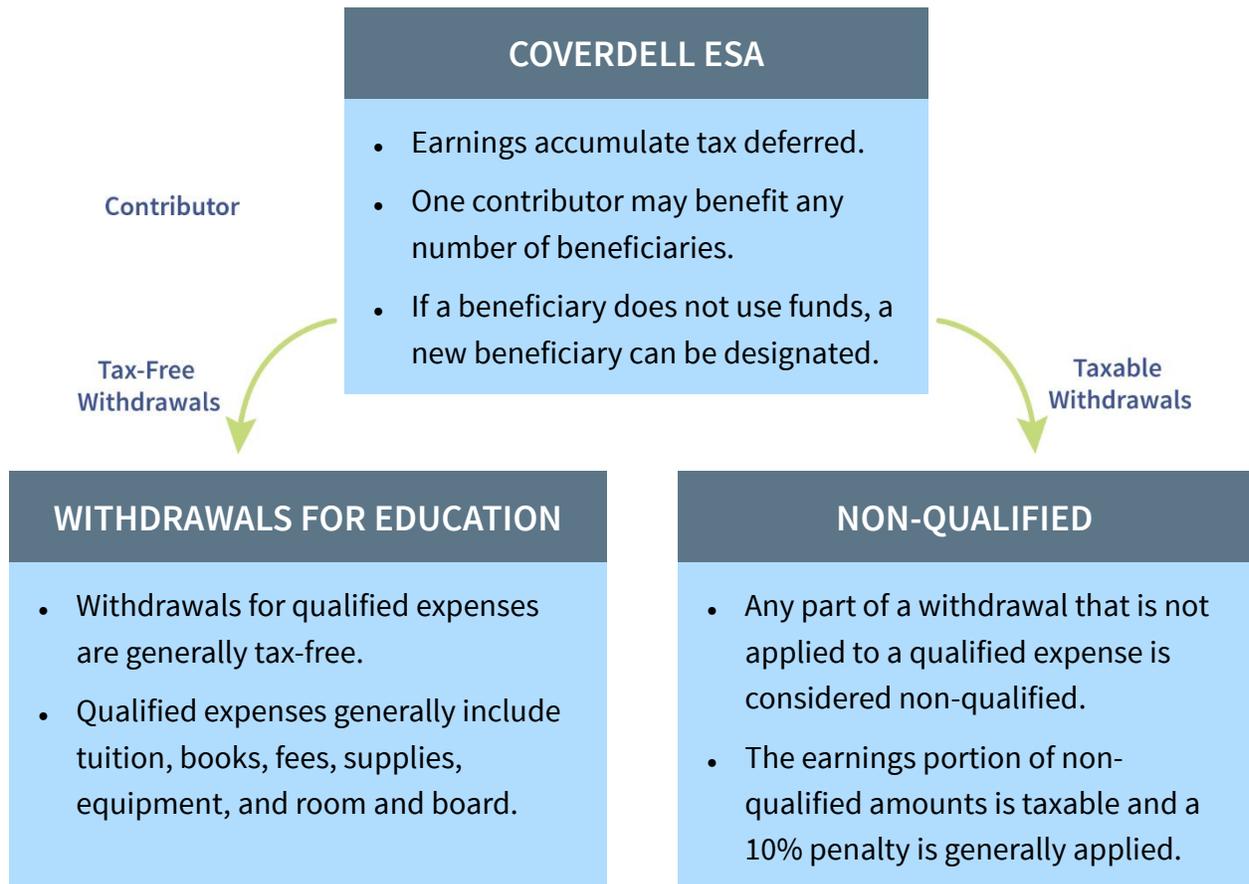
TRA '97 presented each taxpayer with a wide range of tax-favored tools for funding a child's education. A qualified tax or financial professional can help select the best approach.

¹ See the U.S. Department of Education “Dear Colleague” letter of January 22, 2004, GEN-04-02.

How a Coverdell ESA Works

A Coverdell Education Savings Account is a tax-favored account designed to help families accumulate funds for future education costs. While contributions are not deductible, earnings accumulate tax deferred, and qualified withdrawals are tax-free.¹

How Does It Work?



¹ The rules discussed here concern federal tax law; state or local law may vary.

529 Higher Education Savings Plan

Federal tax law allows¹ the states to establish tax-advantaged savings programs to pay for a student's qualified higher education expenses. In these programs, cash contributions are made to an account established for a named beneficiary. An investment management firm typically manages account funds. The amount ultimately available to pay for the beneficiary's education depends on growth in the account between contribution and withdrawal. Higher education savings accounts are not insured and losses are possible.



Under federal tax law, contributions are not tax deductible and any growth in an account is tax-deferred. Distributions used solely to pay for qualified higher education expenses are federally tax-exempt. State or local law, however, can vary widely; contributions may or may not be tax deductible, and distributions may or may not be tax exempt.

Key Definitions Under IRC Sec. 529

- **Qualified higher education expenses:** Generally, tuition, fees, books, supplies, and equipment required for attendance qualify. Computers, software, peripheral equipment, and internet access also qualify if they are to be used primarily by the beneficiary while the beneficiary is enrolled at an eligible education institution.² Reasonable costs of room and board are also included if the student is attending school at least half time. Additionally, qualified expenses include costs incurred to allow a special needs beneficiary to enroll at and attend an eligible institution.
- **Eligible educational institution:** Accredited post-high school educational institutions offering associate's, bachelor's, graduate level, or professional degrees typically qualify as eligible. Certain vocational schools are also included.

¹ "529" refers to Section 529 of the Internal Revenue Code, the section of federal law which authorizes these plans. The discussion here concerns federal income tax law. State or local law may differ.

² The addition of computer equipment, software, and internet access as qualified expenses was included in the Protecting Americans From Tax Hikes Act of 2015, effective for tax years beginning after December 31, 2014.

529 Higher Education Savings Plan

Contributions

Contributions to a savings plan must be in cash and may not exceed the amount necessary to provide the beneficiary's qualified higher education expenses. Program sponsors will specify the maximum allowable contribution. In many programs, more than \$250,000 may be contributed for a single beneficiary. While some donors contribute lump-sum amounts, many 529 savings plan accounts are set up with automatic monthly payments. Other considerations include:

- For federal gift tax purposes, contributions are considered completed gifts of a present interest. Generally, no federal gift tax will be payable if a contribution is limited to the annual gift tax exclusion amount. For 2017, this is \$14,000. A married couple can elect to "split" gifts for a total annual contribution of \$28,000.
- If a contribution for a single beneficiary in one calendar year exceeds the annual exclusion amount, the donor may elect to treat the contribution as having been made ratably over a five-year period.¹ Thus, for 2017, an individual could contribute up to \$70,000 for a single beneficiary in one calendar year. If a married couple elects gift splitting, \$140,000 could be contributed.
- Contributions may be made to both a savings plan and a Coverdell Education Savings Account (Coverdell ESA) for the same beneficiary in the same year.

Distributions

For federal income tax purposes, distributions used to pay for qualified higher education expenses are generally excluded from income if the amount distributed does not exceed the amount of qualified education expenses. If a distribution is greater than the amount of qualified education expenses, a portion of the earnings may be subject to federal income tax and a 10% penalty tax may also apply.

- **Distributions due to the death or disability of the beneficiary, or the receipt of certain scholarships:** The earnings portion of the distribution is taxable as ordinary income to the recipient of the payment.

¹ If the donor dies before the end of the five years, a pro-rata portion of the contribution is included in his or her estate. Any amounts in a savings plan when the beneficiary dies will generally be includable in the beneficiary's estate.

529 Higher Education Savings Plan

- **Rollover distributions:** Federal law allows one tax-free transfer every twelve months, from one savings plan to another, for the same beneficiary. Funds may be rolled from a 529 higher education savings plan to a 529 prepaid tuition plan and vice versa. If there is a change of beneficiary within the same family, the rollover must be completed within 60 days or the earnings portion will be subject to tax. If a new beneficiary is not part of the same family as the original beneficiary, the earnings portion of the transfer is subject to current income tax.
- **Other distributions:** If a distribution is made from a savings plan for any other reason, the earnings portion of the distribution is included in the taxable income of the recipient. A 10% penalty tax is also applied against the distributed earnings.
- **State and local law:** State and local law can vary widely from federal law with regard to the income tax treatment of contributions and withdrawals.
- **Coordination with other programs:** A beneficiary may generally also claim either the American Opportunity Tax Credit¹ or Lifetime Learning Credit (not both in the same tax year), receive a distribution from a Coverdell ESA, or claim the tuition and fees deduction, as long as the qualifying educational expenses are not the same.

Higher Education Savings Account Characteristics

There are a number of account characteristics that a donor should clearly understand:

- The beneficiary must be identified at the time an account is created.² The account owner is usually the primary contributor. However others, such as grandparents, may also contribute.
- The account owner may change the beneficiary. If the new beneficiary is a member of the same family,³ there is generally no current federal income tax liability.
- Amounts accumulated in a savings plan operated by one state generally may be used at educational institutions in a different state.

¹ Or its predecessor, the Hope Scholarship Credit.

² An exception exists for organizations accumulating funds for future scholarships.

³ Generally, siblings, children, grandchildren, parents, grandparents, nieces or nephews, uncles or aunts, their spouses, and first cousins are considered members of the same family.

529 Higher Education Savings Plan

- A higher education savings plan involves investment risk, including the potential to lose money.¹ Contributing to a higher education saving plan does not ensure that your college funding goals will be met. Further, there is no guarantee that a beneficiary will be admitted to college.
- Under federal law, neither the beneficiary nor the account owner is permitted to direct the investments in the account. Account owners may, however, choose among broad investment strategies established by the program sponsor. A change in investment strategy is generally permitted twice each calendar year, or when a new beneficiary is named.
- Most 529 savings plans require that funds contributed for a beneficiary from a custodial account become the property of the beneficiary when the beneficiary reaches his or her majority. A custodial account is one set up under the Uniform Gifts to Minors Act (UGMA), the Uniform Transfers to Minors Act (UTMA), or the local state version.

Other Issues to Consider

- **Home State Plans:** The fees, expenses, and features of higher education savings plans vary widely from state to state; some states have more than one plan. Consider whether the plan in your (or the beneficiary's) home state offers any tax or other benefits that are only available to participants in that particular state's plan.
- **Effect on financial aid:** Assets in a 529 savings plan are considered in the "Expected Family contribution" calculations. Tax-free distributions from a 529 savings account (those used to pay for qualified education expenses) are not counted as income to either the parent or student in the financial aid determination process.²

Internet Resources

- **The College Board:** <https://www.collegeboard.org>
- **FinAid! The SmartStudent® Guide To Financial Aid:** <http://www.finaid.org>

¹ If certain requirements are met, a complete loss in a 529 plan account may be deducted on your federal income tax return as a miscellaneous itemized deduction, subject to the 2%-of-adjusted-gross-income limit. See IRS Publication 970 for details. State or local law may vary.

² See the U.S. Department of Education "Dear Colleague" letter of January 22, 2004, GEN-04-02.

529 Higher Education Savings Plan

- **College Savings Plan Network:** links to state-run web pages on prepaid tuition or college savings plans, at: <http://www.collegesavings.org>
- **U.S. Department of Education – student aid website:** <https://studentaid.ed.gov/sa/>

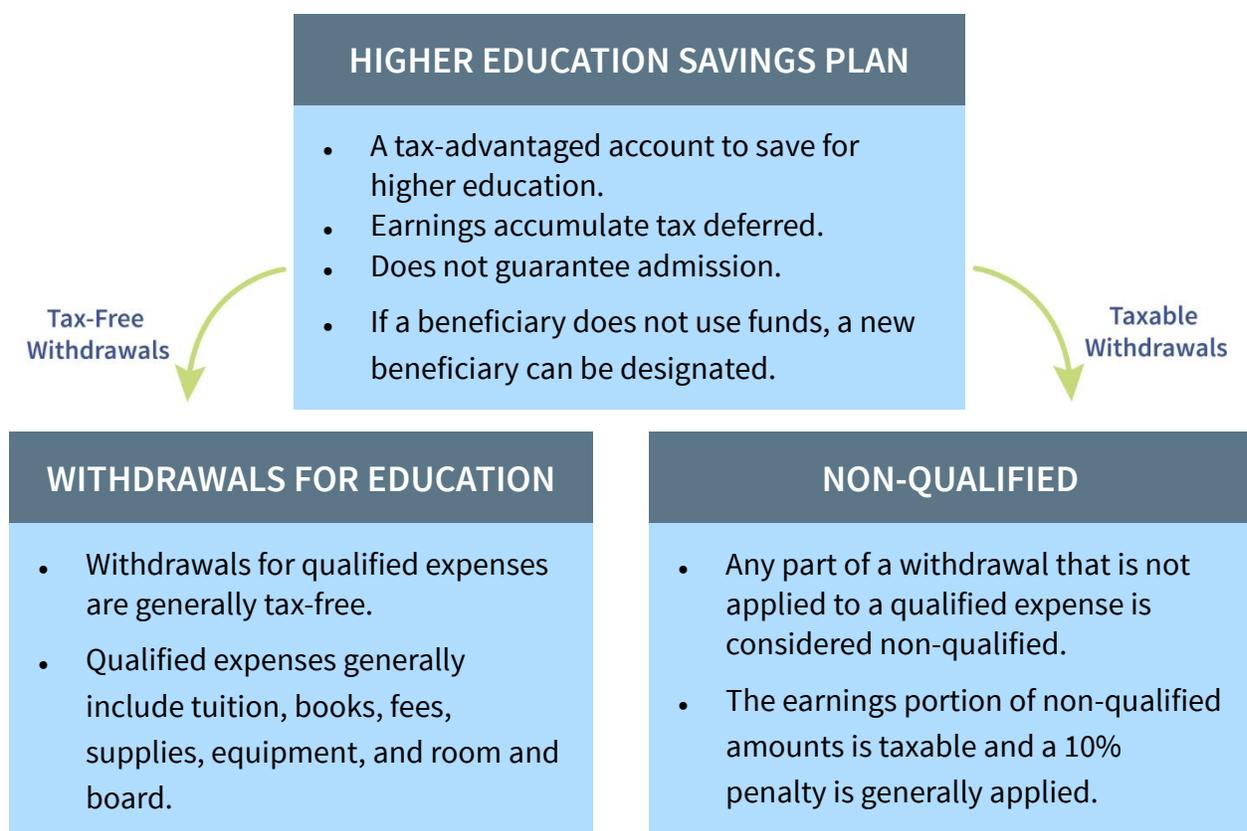
Seek Professional Guidance

Individuals considering a higher education savings plan are faced with a number of income, gift, estate tax, and investment questions. The guidance of appropriate tax, legal, need-based student aid, and financial professionals is highly recommended.

How a 529 Higher Education Savings Plan Works

A “529” higher education savings plan is a tax-favored program operated by a state designed to help families save for future college costs. While the fees, expenses, and features of these plans will vary from state to state, as long as a plan satisfies the requirements of Section 529 of the Internal Revenue Code,¹ federal tax law provides tax benefits for both the contributor and the beneficiary.

How Does It Work?



¹ Federal law does not allow income tax deductions for contributions to 529 plans, although growth inside a plan is tax-deferred and qualified distributions are tax-exempt. State or local tax law can vary widely. 529 plans involve investment risk, including possible loss of funds, and there is no guarantee a college-funding goal will be met.

529 Prepaid Tuition Plan

Federal law¹ allows the states and qualifying private colleges to establish tax-advantaged prepaid tuition plans. Under these plans, contributions are made into a qualified trust to prepay, at today's prices, some or all of a beneficiary's tuition costs. There are two general types of prepaid plans:



- **Contract plans:** Most prepaid plans are contract plans, which commit the account owner to purchase a specified number of years of tuition in exchange for a lump-sum or periodic payments. Generally speaking, contract plans offer lower prices for younger beneficiaries since the state or college will have more time to invest the money.
- **Unit plans:** Unit plans allow the account owner to purchase a fixed percentage of tuition. In a typical unit plan, one unit represents 1% of a year's tuition. All participants in the plan pay the same price for a unit.

Independent 529 Plan

A number of private colleges and universities have joined together to form the Independent 529 Plan. Under this arrangement, an account owner purchases tuition certificates (similar to units in a state-run plan) guaranteeing payment of a specified percentage of future tuition. These certificates can be “redeemed” at a participating college or university when the beneficiary reaches college age.

Key Definitions Under IRC Sec. 529

- **Qualified higher education expenses:** Generally, tuition, fees, books, supplies, and equipment required for attendance qualify. Computers, software, peripheral equipment, and internet access also qualify if they are to be used primarily by the beneficiary while the beneficiary is enrolled at an eligible education institution.² Reasonable costs of room and board are also included if the student is attending school at least half time. Additionally, qualified expenses include costs incurred to allow a special needs beneficiary to enroll at and attend an eligible institution.

¹ “529” refers to Section 529 of the Internal Revenue Code, the section of federal law which authorizes these plans.

² The addition of computer equipment, software, and internet access as qualified expenses was included in the Protecting Americans From Tax Hikes Act of 2015, effective for tax years beginning after December 31, 2014.

529 Prepaid Tuition Plan

- **Eligible educational institution:** Accredited post-high school educational institutions offering associate's, bachelor's, graduate level, or professional degrees qualify as eligible. Certain vocational schools are also included.

Contributions

Contributions to a prepaid plan must be in cash. Broadly speaking, anyone (parents, grandparents, friends, etc.) can contribute to a plan. Many state plans require that either the account owner or beneficiary be a state resident, either at the time an account is opened, or at the time the beneficiary begins school. Under federal law, contributions are not tax deductible and any growth in an account is tax-deferred:

- Contributions may be made to both a prepaid plan and a Coverdell Education Savings Account (Coverdell ESA) for the same beneficiary in the same year.
- For federal gift tax purposes, contributions are considered completed gifts of a present interest. Generally, no federal gift tax will be payable if a contribution is limited to the annual gift tax exclusion amount. For 2017, this amount is \$14,000. A married couple can elect to "split" gifts for a total annual contribution of \$28,000.
- If a contribution for a single beneficiary in one calendar year exceeds the annual gift tax exclusion amount, the donor may elect to treat the contribution as having been made ratably over a five-year period.¹ Thus, for 2017, an individual could contribute up to \$70,000 for a single beneficiary in one calendar year. If a married couple elects gift splitting, \$140,000 could be contributed.

Distributions

For federal income tax purposes, distributions used to pay for qualified higher-education expenses are generally excluded from income if the amount distributed does not exceed the amount of qualified education expenses. If the distribution from a prepaid plan is greater than the amount of qualified education expenses, a portion of the earnings may be subject to federal income tax and a 10% penalty tax may also apply.

¹ If the donor dies before the end of the five years, a pro-rata portion of the contribution is included in his or her estate.

529 Prepaid Tuition Plan

- **Distributions due to the death or disability of the beneficiary, or the receipt of certain scholarships:** The earnings portion of the distribution is taxable as ordinary income to the recipient of the payment.
- **Rollover distributions:** If there is a change of beneficiary within the same family,¹ the rollover must be completed within 60 days or the earnings portion will be subject to tax. If a new beneficiary is not part of the same family as the original beneficiary, the earnings portion of the transfer is subject to current income tax. Funds may be rolled from a 529 prepaid tuition plan to a 529 higher education savings plan and vice versa.
- **Other distributions:** If a distribution is made from a plan for any other reason, the earnings portion of the distribution is included in the taxable income of the recipient. A 10% penalty tax is also applied against the distributed earnings.
- **State and local law can vary:** State and local law can vary widely from federal law with regard to the income tax treatment of contributions and withdrawals.

Other Issues to Consider

- **Limited use of funds:** Although the federal law governing prepaid plans has a very broad definition of “qualified higher education expenses,” most prepaid tuition plans are limited to paying for tuition and required fees for undergraduate study; in a few programs, room and board is also covered. Costs that are not covered by the prepaid tuition plan must be paid for from other resources.
- **Increased tuition costs:** Many prepaid plans agree to cover all future increases in tuition costs. However, some plans limit that promise; if tuition costs increase more than the limit, will you have to contribute more money to the plan?
- **No guarantees:** A prepaid tuition plan does not guarantee that a beneficiary will be admitted to college, nor that a college funding goal will be completely met.
- **Change in plans:** If the beneficiary does not attend college, or does not complete the full course of study, what does it cost to cancel or withdraw from a prepaid plan? Does the plan allow the account owner to “roll over” the funds to another beneficiary? If a beneficiary attends an out-of-state school, what amount of tuition credit is allowed at the out-of-state school?

¹ Generally, siblings, children, grandchildren, parents, grandparents, nieces or nephews, uncles or aunts, their spouses, and first cousins are considered members of the same family.

529 Prepaid Tuition Plan

- **Home state plans:** Prepaid plans will vary widely from state to state. Consider whether the plan in your (or the beneficiary's) home state offers any tax or other benefits that are only available to participants in that particular state's plan.
- **Effect on financial aid eligibility:** Assets in a 529 prepaid tuition plan are considered in the "Expected Family Contribution" calculations. Tax-free distributions from a 529 prepaid tuition plan (those used to pay for qualified educational expenses) are not counted as income to either the parent or student in the financial aid process.¹
- **Ownership:** The donor is generally the owner of the funds. However, funds in a custodial account (set up under the Uniform Gifts to Minors Act, UGMA, or the Uniform Transfers to Minors Act, UTMA), become the property of the beneficiary when he or she reaches the age of majority, or the age specified in state law.
- **Coordination with other programs:** A beneficiary may generally also claim either the American Opportunity Tax Credit² or Lifetime Learning Credit (not both in the same tax year), receive a distribution from a Coverdell ESA, or claim the tuition and fees deduction, as long as the qualifying educational expenses are not the same.

Internet Resources

- **The College Board** – <https://www.collegeboard.org>
- **FinAid! The SmartStudent® Guide To Financial Aid** – <http://www.finaid.org>
- **College Savings Plan Network** – links to state-run web pages on prepaid tuition or college savings plans, at: <http://www.collegesavings.org>
- **U.S. Department of Education – student aid website** – <https://studentaid.ed.gov/sa/>

Seek Professional Guidance

Individuals considering a prepaid tuition plan are faced with a number of income tax, gift tax, estate tax, and financial aid issues. The guidance of appropriate tax and financial professionals is highly recommended.

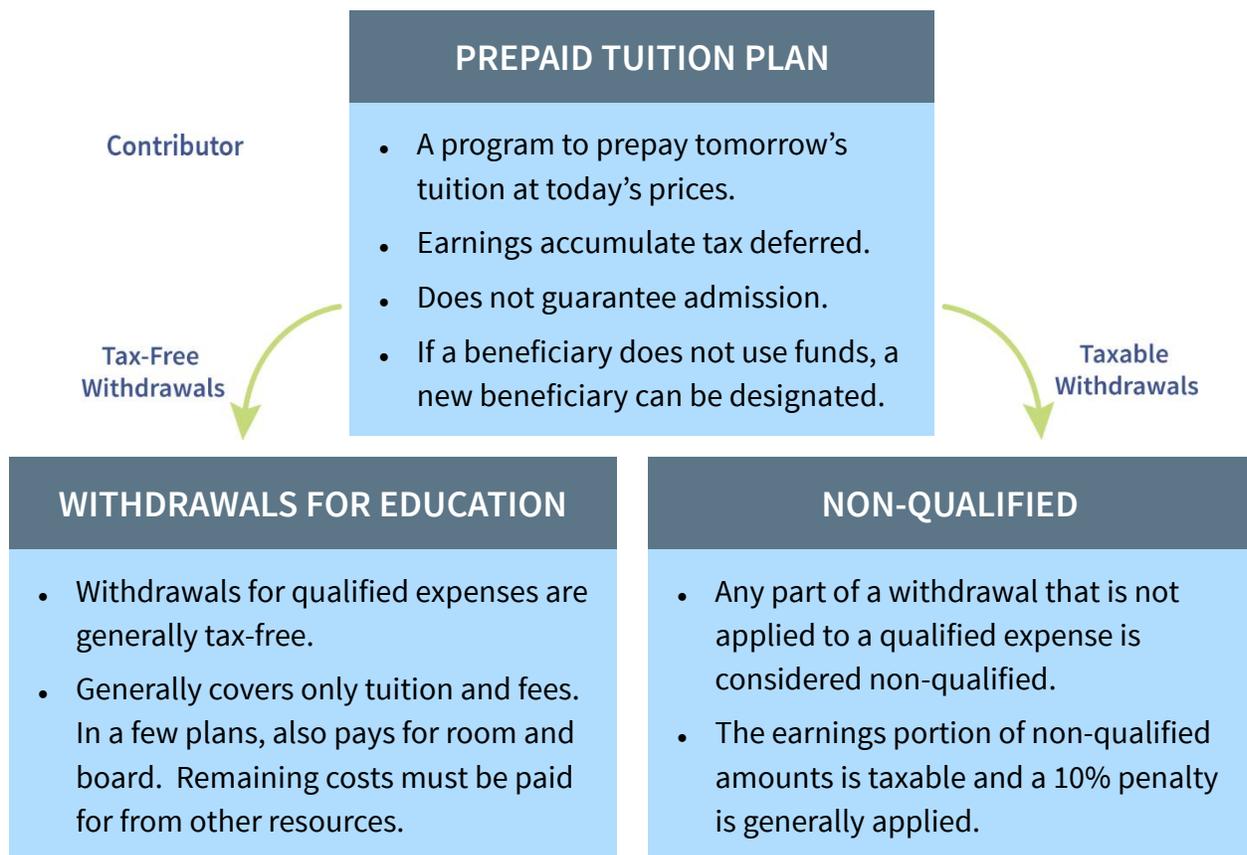
¹ See the U.S. Department of Education "Dear Colleague" letter of January 22, 2004, GEN-04-02.

² Or its predecessor, the Hope Scholarship Credit.

How a 529 Prepaid Tuition Plan Works

A “529” prepaid tuition plan is a tax-favored program operated by a state or eligible private institution designed to help families prepay future college costs. While the specific details of these plans will vary, as long as a plan satisfies the requirements of Section 529 of the Internal Revenue Code,¹ federal tax law provides tax benefits for both the contributor and the beneficiary.

How Does It Work?



¹ Federal law does not allow deductions for contributions to 529 plans; growth inside a plan is tax-deferred and qualified distributions are tax-exempt. State or local income tax law can vary widely. The fees, expenses, and features of 529 plans will vary from state to state and from institution to institution and should be carefully considered. 529 plans involve risk, including the possible loss of funds or the need to make additional contributions. There is no guarantee a college-funding goal will be met.

College and Financial Aid Calendar

As Early as Possible

- Explore college options.
- Research scholarship opportunities via the Internet.



Junior Year/Summer Prior to Senior Year

- Visit campuses and narrow college choices.
- Learn how to apply for scholarships.
- Find out the priority admission application period for the colleges you wish to attend.

Senior Year In High School

NOVEMBER	DECEMBER	JANUARY
<ul style="list-style-type: none">• Admission application period for many colleges begins.	<ul style="list-style-type: none">• If needed, complete and mail the CSS Profile.• Attend any financial aid nights offered at your school.	<ul style="list-style-type: none">• Apply for financial aid every year at this time.• Mail the completed FAFSA.• Apply for scholarships.

College and Financial Aid Calendar

FEBRUARY

- Student aid report received from processor. Review for accuracy.
- Submit required documents to financial aid offices.

MARCH

- Receive and compare financial aid award letters.

APRIL/MAY

- Make final decision regarding college choice. Submit any required deposits.

JUNE/JULY

- Prepare for starting college.
- Work extra hours and save money.

AUGUST/SEPTEMBER

- Start college.
- Look for on-campus employment.

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The information that follows is intended to serve as a basis for further discussion with your financial, legal, tax and/or accounting advisors. It is not a substitute for competent advice from these advisors. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney. The application of other concepts may require the guidance of a tax or accounting advisor. The company or companies listed below are not authorized to practice law or to provide legal, tax, or accounting advice.

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John L. Terry, III - National Producer Number # 1265727 CRD # 1972803

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