COLLEGE FUNDING – WHAT'S NEW, WHAT'S OLD

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Note: Section references are to the Internal Revenue Code of 1986, as amended.

I. INTRODUCTION

A. The Problem.

The cost of a college education continues to rise at a rate faster than many individuals can afford. According to the College Board, since 1980 the price of a college education has been rising between two and three times the Consumer Price Index. The cost of college education triples over a 17 year period from birth to college enrollment. According to the College Board, the average cost for full-time undergraduates in 2017-2018, including tuition, fees, room, and board, were $20,770 per year or $83,080 (without inflation) for 4 years for an in-state student at the average 4-year public university and $46,950 per year or $187,800 for 4 years (without inflation) at the average 4-year private college. Thus, parents are continually seeking ways to save for a college education for their children.

A recent OppenheimerFunds, Inc. survey of 1,000 parents and grandparents indicated that 60% of American adults are not currently saving for the future college education expenses of children or grandchildren. 65% are not thinking about how much they will need to pay for a college education and 80% of Americans said they put more money towards toys and clothes than they do for future college expenses.

B. Possible Solutions.

1. The following is a list of possible sources of funding educational expenses:

a. Family Savings.

b. US Savings Bonds.

c. UGMA/UTMA Accounts.

d. Gifts.

e. Education trusts.

f. Family Limited Partnerships

g. Scholarships.

h. IRAs.

i. Borrowing against Assets.

j. Loan Programs.

k. Federal tax credits and deductions.

l. Employer-sponsored education assistance.

m. Section 529 programs.

II. <u>APPROACHES</u>

A. Family.

1. Family Savings.

a. The traditional manner of paying for college expenses has been through the child’s parents budgeting for college and putting money into the “college fund.”

b. Increased costs of college are making this difficult.

c. Are baby boomer parents spending the money on themselves rather than putting it away for their children's education?

d. Should parents be saving for their retirement or paying for college?

2. US Savings Bonds.

a. Income from certain U.S. Savings Bonds (Series EE Bonds or Series I Bonds) is not taxable if used to pay qualified higher education expenses or contributions to a Section 529 Plan or to a Coverdell education savings account. Code Section 135.

b. Bonds must be issued:

i. After 12/31/89; and

ii. To an individual age 24 or older at the time of issuance.

iii. The bond must be in the name of the taxpayer, or in the name of the taxpayer's spouse, and not in the name of the dependent.

iv. If the taxpayer purchasing the bond is married, a joint return must be filed in order to qualify for the exclusion.

v. Qualified higher education expenses means tuition and fees (not room and board) required for enrollment of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer.

vi. No requirement that the bond proceeds be used to pay for higher education expenses, but the interest on the bond will be taxed.

vii. Interest exclusion phases out. This phase-out has been indexed for inflation. The current amounts are:

Joint:	$117,250 - $147,350
Single:	$78,150 - $93,150

c. There is a $10,000 ($20,000 per couple) per year purchase limit for each of the Series EE and Series I bonds.

3. UGMA / UTMA Accounts.

a. Uniform Gift to Minors Act ("UGMA") repealed in Michigan effective 12/30/98.

b. Uniform Transfers to Minors Act ("UTMA") replaced UGMA as to new accounts created after 12/30/98.

c. The UTMA made two significant changes over the former UGMA:

i. Assets can be held until age 21, if so specified at the time of the transfer of assets to the custodian; and

ii. Investments can be broader than under UGMA, including limited partnerships, L.L.C. membership interests, etc.

d. Disadvantages.

i. Child can take money at age 21 (age 18 if UGMA account).

ii. Account balance included in donor's estate if donor dies before all money is spent, and if donor is the custodian of the funds.

iii. Accounts treated as assets of the child for financial aid purposes.

iv. Subject to claims of the child's creditors.

v. The funds must be used for the benefit of the child only but not limited to education.

vi. Income generated in the account is subject to Kiddie tax rules and net investment income tax.

4. Annual Gifts.

a. Donor can make gifts to student for education expenses each year. If in excess of the annual exclusion ($15,000 per donee), excess applies against the person's lifetime estate/gift tax credit (equivalent to $11,180,000).

b. If donor makes payment directly to the school or college, the payment is not subject to annual exclusion limitations. §2503(e).

i. Must be paid directly to the institution.

ii. Limited to tuition – not room and board or other expenses.

iii. Same rule applies for medical expenses paid directly to medical provider.

iv. Amount does not reduce annual exclusion gifts that can be made to the student.

c. For an interesting application of the rule under § 2503(e), see PLR 200602002, which allowed a grandparent to make an unlimited gift through <u>prepayment</u> of tuition for her grandchild.

5. Trusts - Education. Typically an irrevocable trust created by grandparents for benefit of grandchildren.

   a. 2503(c) Trust.

      i. Contributions to the trust qualify for the $15,000 annual exclusion without the requirement of providing a withdrawal right ("Crummey Power") to the beneficiary at the time of contribution.

      ii. Interest and principal may be expended for the benefit of the donee who has not attained the age of 21.

      iii. Beneficiary must be entitled to withdraw the trust assets at age 21.

   b. Crummey Trust.

      i. Child has right to withdraw contribution when made, up to $15,000 ($30,000 if donor's spouse joins in gift) for limited time period – typically 30 or 60 days.

      ii. After withdrawal period lapses, assets remain in Trust. The right to withdraw the contribution converts it into a present interest, thereby ensuring that the gift qualifies for the annual gift tax exclusion.

      iii. Assets are distributed pursuant to the trust terms – can be held past age 21, as grantor of trust determines when creating the trust.

c. HEET Trust

This Trust (a Health and Education Exclusion Trust) is a form of Irrevocable Dynasty Trust which lasts for generations. Distributions are made to beneficiaries **solely** for tuition or medical payments. In addition, a charity is also named as a significant beneficiary. Because the charity is a beneficiary, the Trust is treated as having a non-skip person for purposes of the generation skipping transfer tax. Thus, there is no GST tax upon the creation of the HEET Trust. Since distributions are made solely in accordance with IRC §2503(e), the Trust can continue in perpetuity without being subject to generation skipping transfer tax.

d. Under IRC §2611(b) any transfer made that qualifies under IRC §2503(e) is exempt from GST tax. §2503(e) excludes payments made directly for tuition or medical expenses. Since the assets in the HEET Trust can only be used for these purposes, direct distributions made for these purposes are not subject to GST tax.

e. Irrevocable trusts are not included in the donor's estate and may be structured to avoid inclusion in child's estate.

f. Typically, irrevocable trusts are protected from parent's creditors as a completed gift and from child's creditors by a spendthrift clause so long as the asset is held in trust.

g. The use of funds must be specified in the trust agreement; no other use is permitted.

6. Family Limited Liability Company / Family Limited Partnership.

   a. Parent forms entity, family limited liability company (LLC) or family limited partnership (FLP).

   b. Parent gifts portion of LLC or FLP to child (annually or one time). If properly structured, the child's interest in the entity qualifies as a gift of a present interest and is subject to the $15,000 annual gift tax exclusion.

   c. Child's ownership interest grows over the years to the extent income is not distributed or the value of the underlying assets increase. Distributions of accumulated cash can be made when child needs funds for college.

   d. Distributions remain under the control of the Parent as the General Partner of the FLP or Manager of the LLC. However, IRS may claim assets are still in parent's estate under Section 2036 if parent is the General Partner or Manager.

   e. Kiddie tax rules apply.

   f. Protection from creditors of parent's and child's creditors based upon state law.

   g. If properly structured as a gift, the interests given to the child are not included in the parent's estate.

B. Scholarships.

1. In General. Scholarships may be awarded for academic, extra-curricular and athletic ability.

2. Under Section 117, scholarships received by a candidate for a

degree are tax-free as long as the funds are spent toward tuition, books, fees, and required supplies.

a. Scholarship amounts used for room and board are taxable.

b. Amounts received for teaching, research, or other services that the student must perform as a condition for receiving the scholarship are not covered.

3. Dependency exemption. Under Section 152(d), amounts received as a scholarship do not count as self-provided support by the student/child in determining eligibility to claim the student as a dependent.

4. Michigan Promise Scholarship Program

Michigan Promise Scholarship: the Michigan Promise Scholarship provided up to $4,000 to high school graduates for successfully completing two years of postsecondary education beginning with the class of 2007. (Public Act 479 of 2006). However, this program has been discontinued.

C. Individual Retirement Accounts.

1. Penalty – Free IRA Withdrawal.

a. Can now make withdrawals from a regular IRA to pay qualified higher education expenses.

b. Qualified higher education expenses include: tuition, fees, books, supplies, and equipment. Also includes room and board for students who are enrolled at least half-time time as well as expenses for special needs services [§529(e)(3)]

c. Not subject to 10% penalty that usually applies to withdrawals prior to age 59-1/2. § 72 (t)(2)(e).

d. Subject to income tax on amount withdrawn from regular IRA.

2. Roth IRA.

a. Withdrawals from Roth IRA also not subject to penalty for early withdrawal if used for qualified higher education expenses.

b. Distributions from Roth IRA are first treated as a return of contributions made.

c. Distributions are, therefore, non-taxable until basis in the amount contributed has been repaid.

3. Coverdell Education Savings Account (ESA) - Education IRAs.

a. Under Section 530, parents may now contribute up to $2,000 per year per child to a Coverdell education savings account (“ESA”). This limit was previously only $500, and the account was previously known as an “educational IRA.” [§ 530(b)(1)(A)(iii)].

b. Formed to pay “qualified higher education expenses” (“QHEE”) of the designated beneficiary. QHEE - tuition, fees, books, supplies, and equipment required for attendance or enrollment at an eligible educational institution (almost all accredited public, non-profit, or proprietary post-secondary institutions). Room and board is included in QHEE if the student is enrolled at least half time. Computer technology or equipment is now included as a QHEE.

c. Contributions.

   i. Contributions to ESA are not deductible.

   ii. Aggregate contributions for a beneficiary limited to $2,000 per tax year.

   iii. Contributions phased out for modified adjusted gross income between $95,000-$110,000 for single and $190,000-$220,000 for joint return.

   iv. Excess contributions are subject to a 6% excise tax.

   v. According to the Committee Reports, the income limit does not apply to entities, such as corporations, LLCs, or irrevocable trusts. In addition, the limitation can be avoided by making a gift to the beneficiary, who then contributes the funds to the ESA.

   vi. Contributions must cease once the donee reaches age 18.

   vii. Contributions are treated as a completed gift and thus should be protected from parent's creditor.

   viii. Contributions qualify for the annual gift tax exclusion.

   ix. Contributions are not included in parent's estate.

d. Earnings of ESA are tax-free if used to pay QHEE.

e. Distributions from an ESA for QHEE are not includable in beneficiary's income. Distributions in excess of amounts used for QHEE are subject to tax and 10% penalty tax.

f. Accounts must be shut down when child reaches age 30, except for beneficiaries with special needs.

g. Accounts can be changed to another beneficiary if original beneficiary does not use the funds.

h. A taxpayer can claim an American Opportunity credit or Lifetime Learning credit (discussed below) for a taxable year and exclude from gross income amounts distributed (both the contributions and the earnings portions) from an ESA IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.

i Individual contributors to ESAs are deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the individual's Federal income tax return for such taxable year (not including extensions). Thus, individual contributors generally are allowed to make contributions for a year until April 15 of the following year.

j. Use Prior to College.

Under a major change made by the 2001 Act, the ESA may be used for qualifying expenses related to attendance at a public, private or religious elementary or secondary school. Qualifying expenses include:

Tuition
Fees
Tutoring
Books

Supplies

Room and board

Uniforms

Transportation

Computers

Internet access

Educational software

k. The ESA may be invested in any type of assets suitable for an IRA.

l. Disadvantages:

i. Low contribution limits.

ii. Account assets included as student owned asset for financial aid.

iii. No contributions after age 18.

iv. Required distributions at age 30.

v. Donor cannot get the funds back.

D. Borrowing Against Assets.

1. New: Home Equity Loan – in the past, interest was generally deductible on home equity loans up to $100,000 of home-equity debt if the taxpayer itemizes deductions. Under the 2017 tax law, interest is only deductible if the funds were used to buy, build, or substantially improve your home. Interest on funds used to pay for college will not be deductible.

2. Cash Surrender Value of Life Insurance – interest not deductible, but may be at a reasonable rate. Another alternative is to borrow

from a bank and assign the cash value of the life insurance as collateral.

3. Qualified Retirement Plans – if allowed by the plan, the account owner can borrow up to 50% of the vested account balance, up to $50,000.

E. Federal Loan Programs.

1. In some situations, such as when a child is less than three years away from college, it may be more important for parents to focus on maximizing potential financial aid.

The equation for determining financial aid is:

Cost of Attendance - Estimated Family Contribution = Financial Need

2. Four types of Financial Aid

a. Need-based: The most predictable and consistent financial aid available, but calculations are very complex. A financial aid calculator can be found at www.collegeboard.com.

b. Merit-based: Financial assistance that is showered on students with extraordinary ability. This type of aid usually has nothing to do with the parents' financial circumstances. It can be in the form of athletic scholarships, academic scholarships or talent scholarships.

c. Selectively discounted tuition: The most recent development in the financial aid game. Rather than awarding one $20,000 scholarship to one needy student, colleges are offering tuition discounts in which they break that $20,000 award into four $5,000 scholarships and thus have the

chance of enrolling four good students and four sources of revenue rather than just one. Discounted tuition provides parents who can just about afford a certain school an incentive to choose it over another school.

d. Negotiated: A process by which parents contact the various schools for explanations as to the varying amounts of aid awarded from school to school. Often mistakes are discovered during this process and the student is awarded more financial aid. Also, the school is put on notice that the student is being competitively bid for attendance at colleges, which could lead the school to bring more money to the table.

Keeping the income in the parents' name rather than the student's is financial aid friendly.

3. Strategies for maximizing Financial Aid Eligibility

   a. avoid titling assets in the student's name

   b. spending down assets

   c. shifting assets to nonassessable assets

   d. accelerating or deferring income

   e. using flexible spending arrangements

   f. replacing income-producing assets with appreciating assets

4. There are numerous types of loans available. See Student Guide available from U.S. Department of Education. http://studentaid.ed.gov

a. Federal Pell Grant. These are undergraduate awards from the federal government made only on a need-based assessment. The maximum award for the 2018-2019 year is $6,095, and no repayment is required.

b. Federal Supplemental Educational Opportunity Grant. This program is administered by participating schools. No repayment of these awards to needy undergraduates is required.

c. Stafford Loans. Repayment of these loans is required, but students do not need to begin payments until six months after graduation. Loan amounts for undergraduate students range from $5,500 to $12,500 annually with interest at 4.45%. Loans with subsidized interest rates are need-based, while the unsubsidized loans are not.

d. Perkins Loans. Perkins loans are no longer authorized.

e. PLUS Loans. These are non-need based loans to parents and graduate or professional students. The loan amount is determined as a residual of educational costs less other aid received. The interest rate for loans disbursed is a fixed rate, which is currently 7.6%. Required repayments must start within 6 months after the student ceases to be enrolled on at least a half-time basis. PLUS loans are forgiven in the event of death or disability of the signor.

f. Federal Work-Study. Students may work to defray a part of their educational costs. The remuneration is taxable income. The permitted work time depends on educational costs, other aid received and the funding for work-study available at the respective institution.

g. Private Loans. Many Credit unions and local banks run promotions to assist in meeting college costs.

5. Deduction for Student Loan Interest Paid.

a. Under Section 221, individuals can take a limited deduction for interest paid for repayment of student loans.

b. Available even if taxpayer does not itemize deductions. "Above the line deduction".

c. The deduction is limited to $2,500.

d. Phased out for joint filers with adjusted gross income between $135,000 and $165,000, and single filers with adjusted gross income between $65,000 and $80,000, for tax years beginning in 2018.

e. Available for all educational loans, including loans made to students or parents.

f. Only interest from a qualified lender is deductible, including loans from the government and loans from an educational institution.

g. The funds received from the loan must be used within a reasonable time before or after the loan was taken.

h. The taxpayer claiming the deduction must be an eligible student enrolled at least half-time, or the parent of such eligible student.

F. Federal Tax Credits and Deductions.

1. Section 25A provides tax credits that may be elected by low and middle income taxpayers against tuition expenses incurred by students pursuing college, graduate degrees and vocation training.

   a. American Opportunity Tax Credit. Section 25A(b) provides a maximum allowable nonrefundable credit of $2,500 per student for each of the first four years of post-secondary education. Specifically,

      i. 100% tax credit for first $2,000 of tuition and fees,

      ii. and a 25% credit on the next $2,000.

      iii. Only available for first 4 years of college undergraduate studies. Credit is determined on a per student basis.

      iv. Phases out for joint filers who have between $160,000 and $180,000 of adjusted gross income, and for single filers between $80,000 and $90,000. These amounts are statutory and not subject to adjustments for inflation.

      v. The credit can include the cost of books and other required course materials.

      vi. 40% of the Opportunity Credit is refundable for a taxpayer having a zero tax liability.

   b. Lifetime Learning Tax Credit. This credit in Section 25A(c), applies to periods other than the first 4 years covered by the American Opportunity Tax Credit.

i. 20% tax credit for first $10,000 of tuition and fees paid each year.

ii. Maximum credit is determined on a per taxpayer (family) basis, regardless of the number of post-secondary students in the family.

iii. Phased out between $114,000-$134,000 for joint returns and $57,000-$67,000 for single filers.

iv. Student must be enrolled in school at least half-time for at least one academic period beginning in the year the credit is claimed.

v. Student cannot have been convicted of a federal or state felony drug offense.

2. Disadvantages. The drawbacks to these credits are:

a. A taxpayer may use only one credit per student.

b. Any claimed credits reduce the educational expenses used to determine the Series EE U.S. Savings Bond exclusion.

c. Financial aid officers consider these credits available to the family and adjust the entitlement for financial aid.

3. Deduction for Higher Education Expenses.

a. The 2001 Act allowed a limited above-the-line deduction for qualifying higher education expenses – only tuition and fees. (Code §222)

b. This provision was to sunset December 31, 2007, but was extended through December 31, 2017. NOTE: This has not yet been authorized for 2018.

c. Deductions must be coordinated with ESA, tax credits and Qualified Tuition Programs in order to avoid doubling up.

d. Disallowed if AGI above following amounts:

Deduction	Single AGI	Joint AGI
$4,000	$65,000	$130,000
$2,000	$80,000	$160,000

e. Deduction cannot be taken if taxpayer can be claimed as a dependent by another taxpayer.

G. Employer-Sponsored Educational Assistance

1. Under Section 127, employers may pay or reimburse employees for educational expenses with no tax ramifications for the employee. The 2001 Act made this provision permanent and applied it to both undergraduate and graduate school expenses.

2. The education need not be directly job-related.

3. Employers may deduct up to $5,250 annually for payment or reimbursement of educational costs of each employee, and no taxable income is imputed to the employee.

4. Education assistance payments **cannot** be used for:

a. meals, lodging, transportation, or tools or supplies other than text books; or

b. courses involving sports, games, or hobbies, unless they have a reasonable relationship to the business of the employer, and are required as part of the degree program.

5. Employer cannot provide more than 5 percent of the amounts paid or incurred for educational assistance during a year to a class of individuals who are shareholders or owners (or their spouse or dependents), each of whom, on any day during a year, own more than 5 percent of the stock or the capital or profits in such employer (with attribution rules).

6. Employers are required to maintain records pertaining to the administration of the plan and file information returns in accordance with Section 6039D. There must also be a written educational assistance plan.

7. Eligible employees must be given reasonable notice of the availability and the terms of the program.

8. Amounts paid to employees for non-qualifying education are to be reported as additional compensation on Form W-2.

9. Non-qualifying education under Section 127 may, however, qualify as a working condition fringe benefit, provided that the education is directly job related and the education does not qualify the employee for a another occupation.

10. The program may benefit only the employee and not the family of the employee.

11. The plan cannot offer the employee a choice between taxable income and educational assistance.

III. SECTION 529 PLANS

A. Background

The overhaul of the "transfer tax" rules under Section 529 in 1997 and again in 2001 has given birth to another methodology for tax deferred funding of college savings, "College Savings Plans." College Savings Plans permit after-tax dollars to be invested in tax deferred savings accounts for future educational needs.

B. Section 529

1. Section 529 of the Code provides tax-exempt status to "Qualified Tuition Programs" ("QTP"), meaning certain programs established and maintained by a State (or agency or instrumentality thereof) and private universities under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary ("prepaid tuition plan"), or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account (a "savings account plan"). Section 529 provides tax-exempt status to these QTPs and provides favorable federal tax treatment to participants in QTPs. These plans were previously known as Qualified State Tuition Plans ("QSTP").

2. Two Types of Plans.

   a. Prepaid Tuition Programs – Similar to a defined benefit pension plan. Prepaid Tuition Plans pay for tuition (and not room and board or other expenses) at a college (depending upon plan) regardless of amount of tuition necessary at the time. These plans permit the advanced purchase of tuition credits for future students, the goal being to lock in today's

prices for future education. Private universities may now create prepaid tuition plans, but not savings plans.

b. College Savings Plans – similar to a Roth IRA. The amount of the contribution to the plan is invested by the managers of the plan. At the time the child attends college, whatever the balance may be in the plan is available for use to pay college expenses. It may or may not be sufficient. Generally, the investment mix by the managers will change over the years as the child gets closer to attending college. Every state now has a college savings plan.

3. Michigan. Michigan was one of the first states to adopt a Section 529 educational savings plan - the Michigan Education Trust ("MET"). Through the "Michigan Education Trust" and "Michigan Education Savings Program" ("MESP") managed by the TIAA-CREF network, Michigan residents have both types of 529 plans available.

C. College Savings Plans- The Fundamentals

1. The donor of a College Savings Plan contributes to an account in the name of the Beneficiary. The donor or "Account Owner" can change the Beneficiary at any time and for any reason. Invested funds are pooled with other investors' funds based on a predetermined investment strategy, with earnings credited to all Accounts based on the overall performance of the fund. The Account balance can then be used to fund the college education of the designated Beneficiary or of another qualified family member. Alternatively, the monies can be pulled out of the Account and back to the donor (or "Account Owner") if the Account Owner changes his mind.

2. College Savings Plans will be particularly attractive options where the donor's goals include:

   a. Funding the plan on a tax deferred or favored basis so that the investment will not be devastated by taxes and on a basis which may permit investment returns to outpace the pace of college tuition inflation; and/or

   b. Maintaining ultimate control of the assets so that the Beneficiary cannot freely dissipate the funds.

3. College Savings Plans are administered on a state-by-state basis with an independent institutional money manager to implement the program. The most attractive programs are available to residents and non-residents alike and allow the monies to be spent at any accredited college or university in any state or even in other countries. States may offer both an Prepaid Tuition Program and a College Savings Plan, and in fact, the latest trend is for states to implement both, as Michigan has done.

   Depending on location of the plan owner and the plan chosen, he or she might qualify for a state income tax deduction on contributions made. The majority of states and the District of Columbia now offer such write-offs for at least a portion of contributions. Michigan, for example, allows a married couple filing jointly to write off up to $10,000 in contributions ($5,000 for single taxpayers).

4. Michigan's College Savings Plan, the Michigan Education Savings Program (or "MESP"), permits both federal and state tax benefits.

D. QTP Terminology: The following are common terms used in this outline, or under the Internal Revenue Code (and in some cases under the MESP program materials) relating to College Savings Plans.

1. Account: A savings account established under the Michigan Education Savings Program ("MESP").

2. Account Owner: The Account Owner is the person entitled to exercise all rights and responsibilities relating to the Account, including the determination of the Beneficiary and the investment allocation for monies contributed to an Account and determination of the timing and amount of any withdrawals to be made with respect to an Account.

3. Beneficiary: A natural person for whose benefit the monies in an Account may be expended for Qualified Higher Education Expenses.

4. Earnings Portion: The value of the Account in excess of the amounts contributed to the Account.

5. College Savings Plan Program: A QTP described in Section 529(b)(1)(A)(ii) of the Internal Revenue Code under which a person may make contributions to an Account for the purpose of meeting the Qualified Higher Education Expenses of a Beneficiary. The MESP is an example of an College Savings Plan Program.

6. Educational Services Arrangement: A QTP described in Section 529(b)(1)(A)(i) of the Internal Revenue Code under which a person may purchase tuition credits or certificates on behalf of a Beneficiary which entitle the Beneficiary to waiver of payment of the Qualified Higher Education Expenses of a Beneficiary. The MET is an example of an Educational Services Arrangement.

7. Eligible Educational Institution: An accredited post-secondary educational institution offering credit toward a bachelor's degree, an associate's degree, a graduate level or professional degree or other recognized post-secondary credential, including certain proprietary

institutions and post-secondary vocational schools and certain institutions in foreign countries. The critical requirement is that the institution be eligible to participate in Department of Education student aid programs. To verify that a U.S. or foreign school is an "Eligible Educational Institution," visit the U.S. Department of Education Federal School Code search page at: www.fafsa.ed.gov. If U.S. students at a foreign school qualify for federal financial aid, a 529 Plan or ESA money can be used to pay the bills without worrying about losing the tax benefits.

New: Eligible Educational Institutions now include elementary or secondary public, private or religious schools.

8. Internal Revenue Code: The Internal Revenue Code of 1986, as amended.

9. Investment Options: The MESP provides the following investment options: Age Based Allocation Option (Moderate, Conservative or Aggressive); Guaranteed Investment Option, Multi-Fund Investment Options, or Single Fund Investment Option.

10. Maximum Account Balance Limit: The federal tax law requires that QTPs have adequate safeguards in effect to prevent contributions to an Account in excess of what is required to fund the Qualified Higher Education Expenses of the Account Beneficiary. In compliance with this requirement, the Maximum Account Balance Limit for the MESP is $500,000 (including any amounts in the MET).

11. Member of the Family: The natural persons described under Section 529 of the Code as to whom a change of Beneficiary may be made without triggering a Non-Qualified Withdrawal. These classes include persons related to the initially designated

Beneficiary in one of the following ways: a son or daughter (natural or legally adopted), or a descendent of either; a stepson or stepdaughter; a brother or sister (by whole or half-blood), or stepbrother or stepsister; the father or mother, or an ancestor of either; a stepfather or stepmother; a cousin; niece or nephew; an aunt or uncle; a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or the spouse of the designated Beneficiary or the spouse of any of the relatives listed above. (The 2001 Act added first cousins, who were previously not included in the class of persons qualifying as Members of the Family of the Beneficiary.)

12. MESP: The Michigan Education Savings Program, the Education Savings Account Program adopted by the state of Michigan.

13. MET: The Michigan Education Trust, the Educational Services Arrangement adopted by the State of Michigan.

14. Non-Qualified Withdrawal: Any withdrawal from an Account other than (1) a Qualified Withdrawal; (ii) a withdrawal because of the death or disability of, or scholarship award to, the Beneficiary; or (iii) a Rollover Distribution.

15. Participation Agreement: The application form for establishment of an Account.

16. Program Disclosure Booklet: The booklet summarizing the terms of the Participation Agreement and the MESP.

17. Program Manager: The Program Manager for the MESP is TIAA-CREF Tuition Financing, Inc., a subsidiary of TIAA-CREF.

18. Qualified Higher Educational Expenses ("QHEE"): Tuition, fees and the cost of books, supplies and equipment required for the

enrollment or attendance of a Beneficiary at an Eligible Educational Institution. If the student's enrollment qualifies as at least half-time, then room and board expenses are also eligible as a qualified higher education expense. Students living off campus are allowed the school's "cost of attendance" allowance for purposes of determining eligibility for federal education assistance for that year. The room and board cost of attendance amount will be allowed as a qualified higher education expense.

New: Qualified Higher Educational expenses include tuition (and no other expenses) in connection with enrollment at an elementary or secondary public, private or religious school up to $10,000 per year.

19. Qualified Withdrawal: A withdrawal from an Account used to pay the Qualified Higher Education Expenses of the Beneficiary.

20. QTP: A "Qualified Tuition Program" consisting of either an Educational Services Arrangement or College Savings Plan program established under the laws of any state complying with the requirement for such programs described under Section 529 of the Internal Revenue Code.

21. Rollover Distribution: Any of the following:

    a. An investment of funds withdrawn from an Account into another Account within 60 days following the withdrawal;

    b. The withdrawal of funds from an Account established pursuant to the laws of another state followed by the redeposit of such funds into an Account under the MESP program within sixty days following the withdrawal; or

c. The withdrawal of funds from an Account administered under MESP followed by the re-deposit of such funds into an Account established pursuant to the laws of another state.

E. Trust-Owned 529 Savings Accounts.

A pre-existing trust from which future distributions may be made to fund the beneficiary's higher education may wish to invest part or all of the trust assets in a 529 savings account to obtain the advantageous income tax treatment granted to 529 savings accounts, or to obtain other advantages listed below.

1. Advantages.

a. Prevents a successor account owner from diverting funds from the intended beneficiary.

b. Keeps nonqualified distributions out of the contributor's estate for estate tax purposes.

c. Unlike with *individually*-owned 529 savings accounts, fiduciary duties would prevent the trustee from making a distribution to himself or herself individually.

d. If not all of the 529 savings account funds are used for the beneficiary's higher education expenses, the trustee could direct a nonqualified distribution to the trust, and the trust could continue to hold the funds subject to the terms of the trust.

2. Disadvantages.

a. Contributor relinquishes the ability to take the funds back by taking a nonqualified distribution and ability to change the beneficiary.

b. Front-loading of contributions is not available.

c. Special drafting is required to qualify gifts to trusts for the gift tax and GST annual exclusions.

d. State income tax deduction (if available in contributor's state) may be lost and less favorable financial aid treatment may result.

e. If the 529 savings account is treated as an asset of the trust and the beneficiary's interest in the trust is treated as an asset of the beneficiary, the financial aid treatment is less favorable than with individually-owned 529 savings accounts.

3. Hybrid Planning: naming the individual contributor as the initial account owner and naming a trust as the successor account owner upon the contributor's death or incapacity.

   a. As long as contributor is living and not incapacitated, the contributor can still make a nonqualified distribution for his or her own benefit and can retain complete freedom to change the account beneficiary, subject to the tax rules of Section 529.

   b. Once contributor can no longer act as account owner, the new account owner will be a trust, and the trustee will have a fiduciary duty only to use the funds for the benefit of the trust beneficiary or beneficiaries.

   c. Note: Michigan does not allow a trust to be a successor account owner.

F. Tax Benefits and Features.

1. Income Tax Deferral: A College Savings Plan in many respects functions like a Roth Individual Retirement Account. Distributions to the beneficiary for QHEE are income tax free to the beneficiary. This provision was to sunset after December 31, 2010, but is now permanent.

2. Control: Another attractive feature of College Savings Plans is the donor's ability to change the Beneficiary at any time and for any reason. The Account Owner will normally determine when and if the funds will ever be used to pay for college education. The Beneficiary will have no enforceable right to the monies in an Account. Theoretically, the Beneficiary could attend college and run up college debts and never become entitled to the monies in an Account.

3. Simplicity: Unlike its traditional college funding counter-parts, the only paperwork necessary to implement an College Savings Plan is an application form and a check.

4. Bankruptcy: Under new bankruptcy provisions, certain funds paid or contributed to a QTP will be exempt from creditor's claims (and available to the debtor.) The beneficiary of the account must be a child, stepchild, grandchild or step-grandchild of the individual during the year of the contribution, and the funds must have been contributed at least 365 days prior to the bankruptcy filing. However, the maximum amount entitled to the exclusion is $5,000.00 for payments during the period between 365 days and 720 days prior to the bankruptcy. Amounts contributed more than 720 days prior to the bankruptcy filing should not be part of the bankruptcy estate.

5. Portable: Investors can switch investment tracks within the plan twice a year. Plans are also open to residents and nonresidents alike. Savings can be rolled into another state's plan without penalty.

6. Gift Tax and Estate Tax Benefits: Contributions to a Section 529 qualify for special rules for gift tax and estate tax purposes. See the discussion in Section G9 below.

7. College Savings Plans for Retirement:

   a. QTP is not limited to a beneficiary under age 22. A QTP can be created for any beneficiary. A person can create a QTP for himself or herself.

   b. Suggestion – fund a 529 plan for yourself. The funds will earn tax free and can later be distributed to you for QHEE at a qualified educational institution.

   c. A qualified educational institution includes vocational schools, community colleges, universities or any post secondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.

   d. It is not necessary to work towards a degree, but you must enroll in classes for credit or be part of a technical certificate program to use 529 funds without penalty.

   e. Thus, funds can be used for classes for a new career or for any course of interest to the beneficiary.

8. New: Rollover to ABLE Account.

   a. A tax free rollover made after 12/22/17 can be made from a QTP to an ABLE account for the QTP beneficiary or to a family member of that beneficiary.

   b. An ABLE account is an account set up to assist persons with disabilities in accordance with IRC §529A. Distributions can be made to meet qualified disability expenses of the designated beneficiary of the account.

   c. The sum of the rollover contributions and any other contributions to the ABLE account in any year are limited to the annual gift tax exclusion amount (currently $15,000).

G. Technical Requirements.

The following requirements under Section 529 apply to all Educational Saving Account QTPs:

1. Cash Contributions Required: Only cash can be contributed to an Account. If the donor wants to fund a College Savings Plan with appreciated securities, a capital gains tax will be incurred upon the sale of the securities and funding the Account. Many plans permit custodianship assets to be transferred into an Account. However, a capital gains tax will be incurred upon funding, and the plan must prohibit the donor from changing the Beneficiary of an Account funded with custodianship assets.

2. Investment Options.

a. The various state programs offer a view array of investment choices for the Account. Currently available investment options include the following choices:

i. Cash/guaranteed return throughout the life of the contract: Contributions are invested in cash, money market funds or a guaranteed return fund and stay there throughout the life of the investment.

ii. Age Banded Portfolios: According to the age of the Beneficiary, contributions are invested in a different portfolio. As the Beneficiary gets older and closer to college years, the investment shifts from equity mutual funds, which offer greater growth potential but increased volatility, to more stable bond and money market funds. This option was designed for children who plan on attending college upon completing high school.

iii. Years to Enrollment Portfolios: Similar to the Age-Based option, contributions are invested in a series of portfolios that shift from equity mutual funds to bond and money market funds as the Beneficiary approaches the targeted school years.

iv. Balanced Portfolios: Contributions are invested in equity mutual funds and bond funds (e.g.,

50%/50%) throughout the life of the investment. This option may be appropriate for Account Owners who wish to maintain a more consistent level of risk throughout the life of the investment.

v. Equity Portfolios: Contributions are invested in equity mutual funds throughout the life of the investment. This option may be appropriate for Account Owners who wish to maximize return and risk throughout the life of the investment. Recently aggressive growth portfolios have emerged as an option.

vi. Programmed Re-Allocation: Investment in stock, bond or mixed portfolio with one or more re-allocations at specified time designated when the Account is established.

3. Smorgasbord

Each state may offer one or more of the above options to investors, and in fact, numerous plans offer different investment choices. However, all options are generally not available under any one plan.

4. Tax Free Rollover Distributions

Tax-free Rollover Distributions may be made between Accounts as long as the new Beneficiary is the original Beneficiary or is a "Member of the Family" of the original Beneficiary.

5. Prohibition Against Investment Direction

A donor must be prohibited from directing the investment once the initial investment has been chosen. However, Notice 2001-55 permits a QTP to change investment options annually. Notice 2009-1 liberalized this to two changes of investment per year.

6. Qualified Higher Education Expenses

a. Only withdrawals for the Beneficiary's QHEEs will be Qualified Withdrawals. The Earnings Portion of all distributions other than (a) Qualified Withdrawal, or (b) distributions made on Account of the death of disability of the Beneficiary, or (c) distributions made on Account of a scholarship (or other qualified payment), will be treated as Non-Qualified Withdrawal.

b. The Earnings Portion of any distribution or refund not used for QHEE will be taxed as a Non-Qualified Withdrawal and subject to income tax to the Beneficiary and to the penalty described below.

7. Penalty On Non-Qualified Withdrawals

The Earnings Portion of any monies taken out of a plan for purposes other than the QHEE of a qualifying Beneficiary or for the other limited purposes described above (e.g., on Account of receipt of scholarship monies) will be subject to income tax to the recipient and a penalty will also be imposed by the IRS. The current minimum penalty is 10%, but states can set a higher penalty if they choose. Prop.Reg. 1.529-2(e).

8. Maximum Account Balance Limits

a. The tax law requires College Savings Plans to implement safeguards to ensure that contributions will not be made in excess of QHEE of the Beneficiary. IRC Section 529(b)(7). A safe harbor is available if the program bars additional contributions when the Account reaches the specified Maximum Account Balance Limit, as long as the limit is actuarially determined not to exceed the necessary tuition, required fees and room and board expenses of the designated Beneficiary for five years of undergraduate enrollment at the highest cost institution allowed by the program. Proposed Treas. Regs. Section 1.529-2(i)(2).

b. The states have set limitations of varying amounts on the total contributions per Account. Michigan's limit is $500,000 (including balances in the MET).

c. While no further contributions can be made to the Account once the maximum balance has been achieved, the Account can continue to increase through the continuing growth of the investments.

9. Annual Exclusion Gifting

a. Revocable gifts. A common estate planning technique is to take advantage of the annual exclusion which permits donors to gift up to $15,000 per year per donee free of transfer taxes. Generally, a gift will not qualify for the annual exclusion unless the donee has at a minimum an optional right to

receive the monies immediately; and under no circumstances may the donor receive the monies back. Further, a donor normally cannot pre-fund annual exclusion gifts for future years.

b. Notwithstanding the normal rules, Section 529 provides special rules by which a donor may make annual exclusion gifts to a College Savings Plan, but retain the right to change the Beneficiary or even reclaim the monies. Further, a donor can "prefund" her annual gifts-- a gift in excess of $15,000 can be treated as if made ratably over the 5 year period beginning with the year of the. IRC Section 529(c)(2)(B).

c. The transfer tax treatment of Accounts stands in stark contrast to the estate inclusion rules of Sections 2036 and 2038. These tax sections force a donor to include funds in her estate if she retains any direct or indirect control or other "strings attached" to the transfer. For example, the ability to revoke a transfer will normally result in estate inclusion of the revocable transfer valued at the death of the donor. Similarly, the ability to control beneficial enjoyment of a gift will normally result in estate inclusion. The revocability of a 529 plan, however, makes it a countable asset in determining Medicaid eligibility. To avoid such an unpleasant surprise, grandparents owning 529 plans for the benefit of their grandchildren should make contributions to a 529 account owned by one of the grandchildren’s parents or establish the 529 account

as a custodial plan that transfers direct ownership to the beneficiary at the age of 18 or 21.

d. Notwithstanding the Account Owner's ability to revoke an Account transfer (by obtaining a non-qualified refund) or to change the Beneficiary and thereby affect the beneficial enjoyment, the Account balances are exempted from the estate inclusion rules. The gifts are treated as completed gifts which are not includable in the donor's or Account Owner's estate for gift or estate tax purposes and qualify for the annual exclusion for federal gift tax purposes.

e. While the account balance is not included in the estate of the donor, there may be circumstances where the account balance will be included in the estate of the beneficiary, upon the death of the beneficiary. The IRS will be proposing regulations to provide that this will only occur where the account balance is actually distributed to the estate of the beneficiary within 6 months of the death of the beneficiary.

10. 5-Year Forwarding Election

a. A special election is available which permits a donor to pre-fund up to five (5) years of "annual exclusion." The election is made by checking Box B on Schedule A (page 2 of Form 709) on a timely-filed gift tax return. The election requires that the contribution be averaged over the 5-year period. Form 709 must be filed for the year of the election even when the effect of the election is to eliminate an otherwise-taxable

gift. Form 709 does not have to be filed for years subsequent to the election year provided no taxable gifts need to be reported in those subsequent years.

b. If the donor dies during the calendar year of the gift or in any of the next succeeding four (4) years, then the gross estate of the donor will include the portion of contributions properly allocable to periods after the date of death of the donor.

c. Thus, a married couple can currently gift up to $150,000 per Beneficiary without using any portion of their applicable exclusion amounts (of $11,180,000 each).

d. For high net worth individuals, it may not always be prudent to make contributions to Accounts because of the ability to pay tuition directly when the beneficiary attends college without triggering a taxable gift. **See** IRC Section 2503(e)(2)(A). However, as noted above, there is nothing preventing the parent from making the payment directly to the college, and not using the QTP funds.

11. Multiple Averaging Elections

An example in the Proposed Regulations implies that once the election is made, another averaging election may not be made until expiration of the initial 5 year period.

12. Indirect And "Forced" Gifting.

If the Account Owner changes the Beneficiary and undertakes a Rollover Distribution with respect to the

Account naming a new qualifying Beneficiary who is assigned (for generation skipping transfer tax purposes) to a lower generation than the original named Beneficiary, the Rollover Distribution is treated as a gift by the original Beneficiary. This planning technique effectively permits married donors to currently remove more than $150,000 per Beneficiary on a transfer-tax exempt basis from their estates for estate tax purposes.

13. Costs Associated with 529 Plans

Costs associated with 529 Plans included administrative fees to oversee the plan, as well as management fees for investment options. Some plans keep total fees extraordinarily low with as little as 0.5% or less, while others charge 2% or more in annual fees on your assets. Over 10 to 15 years, these costs can take a high bite out of college savings.

14. Cannot Pledge the Account

No portion of the Account can be used as security for a loan. This includes, but is not limited to, a prohibition on the use of any interest in the account as security for a loan used to purchase such interest in the program.

H. Private College 529 Plan

1. The State sponsored prepaid tuition plans are geared towards each state's public universities.

2. Allows you to target tuition prepayment to the sponsoring institution (or group of institutions)

3. Private universities can now offer their own prepaid tuition plans.

4. Various private universities have joined together to form the "Private College 529 Plan". See information at www.private college529plan.com.

5. Works similar to the state prepaid tuition plan, but can be used at any of the participating colleges. Currently approximately 300 colleges are participating.

6. Sample participating colleges:

   Michigan:

   - Albion College
   - Hope College
   - Kalamazoo College

   Other States:

   - American University
   - Boston University
   - Brandeis University
   - Carnegie Mellon
   - Duke University
   - Emory University
   - Pepperdine University
   - Princeton University
   - Syracuse University
   - University of Miami

I. Features of MESP Program

1. Investment Options

a. Fund Choices: The MESP currently invests in the following mutual funds:

i. TIAA-CREF International Equity Index Fund;

ii. TIAA-CREF Bond Index Fund;

iii. TIAA-CREF High Yield Fund;

iv. TIAA-CREF Equity Index Fund;

v. TIAA-CREF Inflation Linked Bond Fund;

vi. TIAA-CREF Emerging Markets Equity Index Fund.

vii. Vanguard REIT Index Fund.

b. Moderate Age-Based Allocation Option

The Moderate Age-Based Allocation Option was formerly known as the Managed Allocation Option. The objective of this Investment Option is to earn a rate of return that is greater than the rate of increase in the costs of higher education while limiting the risk of losing principal. Under this approach, the funds are invested among the above mutual funds. The investment of the monies is an Age Banded Portfolio which becomes increasingly conservative as the Beneficiary approaches age 18. For example, the funds invested in an Account for a beneficiary age 1-3

would have the following investment allocation: 72% equities; 8% real estate; 16% bonds; and 4% inflation linked bonds. Every three years, the fund will become increasingly conservative.

c. Aggressive Age-Based Allocation Option

The Aggressive Age-Based Allocation Option concentrates more investments in stock and real estate, aiming to produce higher returns but brings more volatility and risk with it. Also, this Investment Option also invests in the same underlying Funds as the Moderate Age-Based Allocation Option. However, the initial contributions to this Investment Option are more heavily invested in equities and real estate than in the Moderate Age-Based Allocation Option.

The Aggressive Age-Based Allocation Option has a higher risk of losing principal than the Moderate Age-Based Allocation Option, but is more likely to keep pace with rising tuition rates.

Allocations for all investments in this Option for beneficiaries age 1-3 were divided among equities (90%) and real estate (10%).

d. Conservative Age-Based Allocation Option

This Investment Option invests in the same underlying Funds as the Moderate Age-Based Allocation Option. However, the initial contributions to this Investment Option are less heavily invested in equities and real estate than in the Moderate Age-Based Allocation Option. While the Conservative

Age-Based Allocation Option maintains the investment objective of earning a rate of return that is greater than the rate of increase in the costs of higher education while limiting the risk of losing principal, it is less likely to keep pace with rising tuition rates because with less risk and lower volatility the investment returns are generally lower.

Allocations for all investments in this Option for beneficiaries age 1-3 were divided among equities (58.5%), bonds (35%) and real estate (6.5%).

e. 100% Fixed Income Option

Invests solely in bond funds, which can have a lower but more stable rate of return, usually less than stocks. MESP allocates the contributions together with any return on the contributions under this Investment Option between the TIAA-CREF Bond Fund, the TIAA-CREF Inflation-Linked Bond Fund and the TIAA- CREF High Yield Fund.

f. Risk Based Investment Options

These Investment Options are for Account Owners who prefer a fixed risk level rather than a risk level that changes as the Beneficiary ages. The MESP offers the following Risk Based investment Options:

i. International Equity Index Option. This invests in the TIAA-CREF International Equity Index Fund and the TIAA-CREF Emerging Markets Equity Index fund.

ii. Global Equity Index Option. This invests in the TIAA-CREF Equity Index Fund, the TIAA-CREF International Equity Index Fund, and the TIAA-CREF Emerging Markets Equity Index Fund.

iii. U.S. Equity Index Option. This invests in the TIAA-CREF Equity Index Fund.

iv. Balanced Option. This invests in the TIAA-CREF Equity Index Fund, the TIAA-CREF International Equity Index Fund, the TIAA-CREF Emerging Markets Equity Index Fund, the Vanguard REIT Index Fund, the TIAA-CREF Bond Index Fund, the TIAA-CREF Inflation-Linked Bond Fund and the TIAA-CREF High Yield Fund.

g. Principal Plus Interest Option – formerly called the Guaranteed Option

i. Assets in the Principal Plus Interest Option will be allocated to a funding agreement issued by TIAA-CREF to the MESP.

ii. The funding agreement will guarantee the MESP (but not the Account Owner) a guaranteed return of principal plus a minimum rate of return not less than 1% or more than 3% per annum with opportunity for additional returns as declared in advance by TIAA-CREF Life.

iii. Effective January 1, 2018, accumulations under the Funding Agreement for the Principal Plus Interest Option as of December 31, 2017 will be credited to MESP with an effective annual interest rate of 1.85%, and are guaranteed to earn this rate through December 31, 2018, subject to the claims-paying ability of TIAA-CREF Life Insurance Company.

2. Investment Procedures

a. A Participation Agreement and other forms relating to the MESP may be obtained by:

i. Calling the Program Manager toll-free at (877) 861-MESP (6377); or

ii. Visiting MESP's website at www.misaves.com:

b. Account Owners may opt to invest monies in more than one of the Investment Options and/or to change or alter contribution percentages with respect to future contributions or change investments twice per year.

c. Contributions to an Account may be made by check, money order, cashier's check, automatic contributions plan, payroll deduction (if permitted by employer), electronic funds transfer (including telephone purchase option), a transfer from another state's QTP or any similar method. Payments should be made to the "Michigan Education Savings Program."

d. The transfer of all or a portion of an Account balance to an Account for a different Beneficiary will

necessitate the completion of a Participation Agreement for the new Account, assuming that no Account has previously been established for the new Beneficiary.

e. Credit card contributions are not currently permitted.

f. Enrollment can be accomplished online.

3. Account Statements

a. The Program Manager is required to maintain separate records for each Account and to mail quarterly and annual statements to the Account Owner with the following information included:

i. Contributions and matching grants to each selected investment option for the period and for the year to-date.

ii. Withdrawals from the Account made during the period.

iii. The total value of the Account at the end of the period.

iv. The annual statements will include the following additional information:

- The rate of return on assets invested in each "ageband" in the Managed Allocation Option.

- The rate of return on Risk Based Option investments.

- Rate of return on Principal Plus Interest Option investments.
- Information regarding the Maximum Account Balance Limit.

4. Management Fees

   a. For its services as Program Manager, including expenses and payment to subcontractor, the Program Manager will be paid an aggregate management fee at an annual rate of .05% of the average net assets of MESP. Total fees including estimated expenses of the investment options underlying the investments range from .15% to .24%

   b. The Program Manager does not receive a management fee from Accounts invested in the Principal Plus Interest Option. Instead, TIAA-CREF Life will pay the Program Manager an expensed fee for distribution, and other administrative and reasonable expenses.

5. Account Ownership

   a. Currently, the Account Owner of an MESP account must be an individual, custodial account, estate, or Trust.

   b. Under Michigan law, upon the Account Owner's death, the contingent Account Owner should automatically become the Account Owner. Because assets from the Account should not be considered assets of the decedent's probate estate, it should not

be subject to probate. The contingent Account Owner will succeed to the original Account Owner's rights upon providing the social security number and a certified copy of the deceased Account Owner's death certificate.

c. An account owned by a trust cannot name a contingent Account Owner.

6. Michigan Income Tax Provisions

a. State of Michigan Income Tax Deduction.

i. Single Michigan taxpayers may deduct up to $5,000 for annual contributions to Accounts.

ii. Married Michigan taxpayers filing a joint return may deduct up to $10,000 for annual contributions to Accounts.

iii. Contributions must be reduced by qualified withdrawals during the year for purposes of determining the amount that can be deducted.

b. Qualified Withdrawals Not Subject to Michigan Income Taxation.

i. Qualified Withdrawals will not be subject to Michigan income tax. See MCLA 206.30f

ii. Query: if a former Michigan resident attends an out of state college and earns income "sourced" to that other state, will that state attempt to subject Qualified Withdrawals from a MESP Account to state income tax?

c. Withdrawals for pre-college.

While Section 529 Plans now allow withdrawals tax free up to a maximum of $10,000 for use in primary and secondary schools, the State of Michigan has not passed a law conforming the Michigan statute to the federal statue. Therefore, distributions for a primary or secondary school will be tax free for Federal income taxes, but taxable for Michigan taxes.

J. Financial Aid Issues

In past years, there was an issue as to whether assets in a Section 529 plan would be treated as the parents' assets or the student's assets for purposes of determining a student's eligibility for financial aid. However, the Deficit Reduction Act of 2005 provides that both prepaid tuition plans and educational savings plans will be considered parental assets effective July 1, 2006. It has recently been decided that earnings on money taken out of a 529 plan owned by either parents or students are no longer treated as income for financial aid purposes.

The federal formula counts the following resources as being available to pay college expenses:

20% of a student's assets (money, investments, business interests, and real estate).

50% of a student's income (after certain allowances).

5.64% of a parent's assets (money, investments, business interests, and real estate, based on a sliding income scale and after certain allowances)

22% - 47% of a parent's income (based on a sliding income scale and after certain allowances).

IV. DIVORCE

A. Now that your client has created a college fund of some type, don't forget to include provisions regarding the college fund in any divorce for that client.

1. Who will be the owner and contingent owner of any Section 529 plans?

2. Will the Section 529 plan be split into separate plans created by husband and wife?

3. Who will have the burden (or privilege) of paying college expenses for the children?

4. What expenses will be covered (who pays for flights to the out of state school?)

B. Divorce can also have an effect on college financial aid. Only one parent's information is required on the Free Application for Federal Student Aid (FAFSA). The custodial parent for FAFSA purposes is the parent who has provided more support.

C. Some schools require financial information from both parents.

D. Remarriage can also have an effect on financial aid by including the income of the new spouse, even though a pre-nuptial agreement may provide otherwise.

V. REBATES AND CREDIT CARDS

Upromise, Inc. offers its customers a vehicle by which certain purchases will be credited toward a College Savings Plan. The premise of UPROMISE is that if a consumer purchases from preferred vendors of automobiles, insurance, clothes, etc., a rebate amount will be deposited into a College Savings Plan.

A number of credit cards also provide a rebate to be deposited into certain State Section 529 plans. For example, the Fidelity Visa Card earns a 2% rebate, and can be linked to plans for the states of Arizona, New Hampshire, Delaware and Massachusetts. A similar credit card is the Upromise Mastercard.

VI. RESOURCES ON COLLEGE SAVINGS ACCOUNTS

A. The premier website on College Savings Plans is www.savingforcollege.com. This website summarizes, evaluates and provides links to all of the College Savings Plans through the country. In addition, www.savingforcollege.com contains links to numerous articles discussing Section 529 in detail. The www.savingforcollege.com website also provides information regarding recent developments under all of the state plans currently in effect, and monitors a message board facilitating the exchange of ideas and information relating to College Savings Plans. Joe Hurley, the creator of the website, has also published a comprehensive book on College Savings Plans which can be purchased from his website.

The website has a 529 Selection Checklist to enable a client to choose which of the many available 529 savings plans is best for the client.

B. College planning information can be found on many websites on the internet, including the following:

1. Student Guide – Financial Aid from the U.S. Department of Education.

   http://studentaid.ed.gov
   A comprehensive guide on student financial aid from the U.S. Department of Education.

2. US News Online.

   www.usnews.com/best-colleges
   Comprehensive site. College and graduate school rankings, best values, financial aid information.

3. College Savings Plans Network.

   www.collegesavings.org
   Website run by the National Association of State Treasurers. Provides comprehensive information on prepaid tuition plans and college savings programs.

4. Fidelity Investments.

   www.fidelity.com/529-Plans/overview
   Information about savings for college, including information about the QTP programs operated by Fidelity. Other Brokerages and Mutual Funds have similar websites.

APPENDIX I

EDUCATIONAL EXPENSES INCLUDED UNDER VARIOUS TAX PROVISIONS

	2503(e) gift exclusion	**QHEE (1) §529(e)(3)**	**QTRE (2) §25A(f)(l)**	**QESEE (3) §530(b)(3)**
HIGHER EDUCATION				
Tuition	If paid directly.	Yes	Yes, but not for sports, games or hobbies.	
Required Fees	No	Yes	If paid to school.	
Required Books	No	Yes	If paid to school.	
Required Supplies & Equipment	No	Yes	If paid to school	
Computer or peripheral equipment	No	Yes, but not for sports, games or hobbies	No	
Special Needs Services	No	Yes		
Room & Board	No	Subject to limitations	No	
Transportation	No	No	No	
Health Fees	If paid directly.	If required.	No	
ELEMENTARY AND SECONDARY				
Tuition	Yes	Yes, up to $10,000	No	Yes
Required Fees	No	No	No	Yes
Required Books	No	No	No	Yes

Required Supplies & Equipment	No	No	No	Yes
Academic Tutoring	No	No	No	Yes
Special Needs Services	No	No	No	Yes
Required Room & Board	No	No	No	Yes
Required Transportation	No	No	No	Yes
Computer Equipment & Internet Access	No	No	No	Yes, but not for sports, games or hobbies

1. Qualified Higher Education Expenses are relevant for QTPs, Coverdell ESAs, and IRA penalty exception.

2. Qualified Tuition Related expenses are relevant for American Opportunity Credit, Lifetime Learning Credit, and deduction for Higher Education Expenses.

3. Qualified Elementary and Secondary Education Expenses are relevant for Coverdell ESAs.