

## SPECIAL REPORT: TAX AND FINANCIAL PLANNING FOR BABY BOOMERS



As we all know, an enormous number of individuals were born in the United States during the post-World War II era (mid-1946 through mid-1964). These so-called baby boomers began turning age 65 in 2011 and (according to the U.S. Census Bureau) by 2029, when all of them will be 65 years old and older, more than 20 percent of the total U.S. population will be over the age of 65. This huge wave of individuals will encounter many challenges as they approach retirement, including how to ensure their own financial security. But with proper planning, these challenges can become opportunities.

This special report focuses on three key tax and financial planning opportunities for these individuals as they move into retirement: planning for retirement plan distributions, maximizing Social Security benefits and planning for their children's and grandchildren's college costs.

### Planning for Retirement Plan Distributions

A fundamental aspect of an individual's financial state in his retirement years is income from his retirement accounts. Whether these consist of employer retirement plans, IRAs, annuities or a combination thereof, projecting income withdrawals over the expected retirement period and complying with the various tax rules are central to maximizing the benefits of these accounts.

### Avoiding Penalty Tax on Early Distributions

If an individual takes an early withdrawal from a qualified employer plan or IRA (traditional, SEP, SIMPLE or Roth), any amount not rolled over potentially is subject to a 10% (25% for certain withdrawals from a SIMPLE IRA) early distribution penalty tax. Early withdrawals are distributions of cash or property made before the taxpayer reaches age 59½ (unless an exception applies). The penalty tax applies to the part of the distribution that must be included in gross income and is in addition to any regular income tax on that amount.

Individuals wanting or needing to take distributions before age 59½ should pay particular attention to the penalty exceptions as a way to avoid paying the 10% penalty tax. It's important to realize that certain exceptions apply only to qualified plan or IRA distributions, but not both. See the table on next page for a summary of the exceptions.

### Key Retirement Plan Distribution Dates

- **Age 55:** An individual who permanently leaves his job for any reason can receive distributions from the former employer's qualified retirement plan(s) without being subject to the 10% premature withdrawal penalty tax. This is an exception to the general rule for taxable distributions from qualified retirement plans received before age 59½.
- **Age 59½:** An individual can receive distributions from all types of tax-favored retirement plans and accounts [IRAs, 401(k) accounts, pensions, and the like] and from tax-deferred annuities without being subject to the 10% premature withdrawal penalty tax. Before age 59½, the 10% penalty tax applies to the taxable portion of distributions unless an exception to the penalty tax applies.
- **Age 70½:** Individuals generally must begin taking annual required minimum distributions (RMDs) from tax-favored retirement accounts [traditional IRAs, SEP accounts, 401(k) accounts, and the like] and pay the resulting income taxes. However, RMDs are not required from Roth IRAs set up in the individual's name. The initial RMD is for the year the individual turns age 70½, but can be postponed until as late as April 1 of the following year. If that option is chosen, however, the individual must take two RMDs in that year: one by the April 1 deadline (the RMD for the year the individual reached age 70½) plus another by December 31 (the RMD for the current year). For each subsequent year, another RMD must be withdrawn by December 31.

## Exceptions to the 10% Early Withdrawal Penalty

Applies to distributions from:	Exception
Qualified plan	Distribution made to an employee after separating from service in or after the year he reaches age 55 (age 50 for qualified public safety employees).
Qualified plan or IRA	Distribution is part of a series of substantially equal periodic payments made over the life expectancy of the employee or account owner or joint lives of him and his beneficiary.
Qualified plan or IRA	Distribution made due to total and permanent disability.
Qualified plan or IRA	Distribution made due to death of the employee or account owner.
Qualified plan or IRA	Distribution to the extent the individual's unreimbursed medical expenses exceed 10% (7.5% if taxpayer or spouse reaches age 65 by year-end) of his AGI.
Qualified plan	Distribution made to an alternate payee pursuant to a qualified domestic relations order (QDRO).
IRA	Distribution to pay for health insurance premiums for certain unemployed individuals.
IRA	Distribution to the extent of the qualified higher education expenses for the year of the taxpayer, spouse, child or grandchild.
IRA	Distribution for first-time home purchases (no home ownership in prior two years). Distribution limited to \$10,000 (lifetime).
Qualified plan or IRA	Distribution due to an IRS levy on the qualified plan or IRA. The exception will not apply if funds are withdrawn to avoid a levy or to satisfy a levy on other property.
Qualified plan or IRA	Distribution to reservists while serving on active duty for at least 180 days.



**Separation from service after age 55.** Qualified plan distributions received after the employee reaches age 55 and separates from service are not subject to the penalty tax. This exception applies only to employees who separate from service during or after the year they reach age 55. Under a special rule, “age 50” rather than “age 55” applies to qualified public safety employees in governmental defined benefit pension plans.

**Example:** At age 57, Walter takes early retirement. He participated in his employer’s qualified plan and also has an IRA. He will receive monthly qualified plan distributions and wants to supplement this income with IRA distributions until he begins receiving Social Security.

The qualified plan distributions are not subject to the early distribution tax because Walter retired (that is, separated from service) after reaching age 55. However, the IRA distributions before age 59½ are subject to the 10% tax unless they meet the substantially equal periodic payments (or another) exception.



Qualified plan distributions received after the employee reaches age 55 and separates from service are not subject to the penalty tax.

**Substantially equal periodic payments.** The exception for substantially equal periodic payments (SEPPs) is particularly useful for individuals who want to access funds from their retirement accounts before age 59½ without incurring the 10% penalty. This exception applies to IRA and qualified plan distributions regardless of the participant’s age. However, qualified plan distributions are excepted from the 10% penalty tax only if the participant has separated from service.

The payments must be computed based on the individual’s life expectancy or the joint life expectancies of the individual and his designated beneficiary and be made at least annually, using a method prescribed by the IRS. The SEPP is the exact payment that must be made to qualify for the exception to the penalty tax. Changing the payment will trigger the penalty tax.

**Example:** Lola’s IRA balance on December 31, 2013, was \$200,000. Her daughter, Trixie, is the IRA beneficiary. Lola is 54; Trixie is 30. Lola wants to begin taking distributions from her IRA in 2014 and avoid the early withdrawal penalty by using the SEPP exception. Using one of the IRS prescribed methods to calculate the payment, her distribution in 2014 is \$6,557.

The SEPP exception does not require the individual’s IRAs to be aggregated when the SEPP amount is calculated. Thus, individuals with more than one IRA can calculate SEPPs from one account without considering the balance held in other IRAs. Similar SEPPs are not required to be made from the other IRAs. However, the entire balance in any one IRA must be considered.

Distributions made under the SEPP exception do not need to actually continue for the individual’s entire life. Payments may be altered (or stopped completely) after the later of:

- The date the individual turns age 59½ or
- The close of the five-year period beginning on the date the first payment was received.

### Required Minimum Distributions

The required minimum distribution (RMD) rules limit the time retirement plan assets can grow tax-deferred by forcing qualified plan participants and IRA owners to begin taking annual distributions generally no later than April 1 of the year following the year they reach age 70½. The RMD rules do not apply to Roth IRAs during the account owner’s life, which is a significant advantage for individuals who don’t need the Roth IRA funds during retirement and want to pass them on to their heirs.

The RMD for a defined-contribution plan or IRA is calculated by dividing the account balance as of December 31 of the preceding year by the applicable distribution period or life expectancy. For distributions during the participant’s lifetime, the distribution period normally comes from the IRS Uniform Lifetime Table.

If the individual’s annual retirement plan distribution is less than the RMD, the shortfall is subject to a 50% excise tax. However, the IRS can waive the penalty if the taxpayer can establish reasonable cause.



Individuals approaching retirement age must decide whether to begin taking reduced Social Security benefits early or wait until full retirement age (FRA) or later.

## Maximizing Social Security Benefits

### Deciding When to Start Receiving Benefits

Individuals approaching retirement age must decide whether to begin taking reduced benefits early or wait until full retirement age (FRA) or later. Generally, the goal is to maximize the lifetime benefits received. In addition to the amount of the Social Security benefit (which depends on when benefits are taken), factors such as how long the recipient lives after starting benefits, the extent to which benefits are taxed and whether the benefits are spent or invested affect the total amount that is actually available to the recipient. Also, in some cases, the decision about when to start receiving benefits depends on the recipient's immediate cash needs. Then maximizing the lifetime benefit may not be feasible.

Some individuals will delay receiving benefits and continue to work because of personal preference. Others will quit working early and will need to start receiving benefits as soon as possible.

Some individuals choose to take early Social Security benefits out of necessity — they are unemployed or underemployed or they have an immediate financial need. Unfortunately, in many cases, taking the early, reduced benefit ensures their continued financial predicament. Studies suggest that those who take early benefits out of necessity often find themselves in even more desperate straits in later years as they continue to struggle on their permanently reduced benefit. For these people, early retirement may be an undesirable but a necessary, option.

Individuals in a better financial situation often have the luxury of waiting to allow their benefits to increase, thus ensuring a more comfortable retirement.

**Note:** While individuals may choose to receive Social Security benefits as early as age 62, the eligibility age for Medicare remains at age 65. So, although they may be able to replace a sufficient amount of their earned income with Social Security benefits at age 62 — many individuals may not be able to adequately replace their employer-provided health insurance so working until age 65 may be necessary.

### Taking Reduced Benefits Before FRA

Even if the individual has sufficient funds to live without considering Social Security, some planners advise individuals to begin receiving benefits as soon as possible. Drawing early Social Security benefits may allow the individual to leave tax-deferred retirement accounts untouched and growing for longer periods. But, for individuals reaching age 62 in 2014, benefits are reduced by 25% of what they would be at age 66 (those individuals' FRA). See the Age 62 Benefit by Year of Birth table on the next page for the percentage reductions that apply to worker and spousal benefits taken at age 62, depending on the worker's year of birth.

#### Key Social Security Dates

- **Age 62:** Age at which individuals can choose to start receiving Social Security retirement benefits. However, their benefits will be lower than if they wait until reaching their full retirement age (FRA). In addition, if an individual chooses to receive benefits early and works before reaching his FRA, his benefits will be further reduced if his income from working exceeds an applicable threshold (for 2014, the threshold is \$15,480).
- **Age 66 – 67:** So-called full retirement age (FRA) is the age at which individuals can start receiving their full Social Security retirement benefits. For individuals born in 1943 – 1954, FRA is age 66; FRA gradually increases for those born after 1954 until it becomes age 67 for those born after 1959. Individuals won't lose any benefits for earnings beginning with the month they reach their FRA, regardless of how much money they make. However, there is an earnings threshold for the year FRA is reached, but it only applies for months up to FRA. For individuals reaching FRA in 2014, their Social Security benefits will be reduced if they earn more than \$41,400 in the months up to the month of their FRA.
- **Age 70:** Individuals can choose to postpone receiving Social Security retirement benefits until they reach age 70. By making this choice, their benefits will be higher than if started earlier.

**Age 62 Benefit By Year of Birth** (Benefits based on a \$1,000 benefit at full retirement age)

Year of birth <sup>1</sup>	Full retirement age (FRA)	Months between age 62 and FRA <sup>2</sup>	Worker		Spouse	
			Percent reduction <sup>3</sup>	A \$1,000 benefit would be reduced to:	Percent reduction <sup>4</sup>	A \$500 spouse's benefit would be reduced to:
1943–1954	66	48	25.00%	\$750	30.00%	\$350
1955	66 and 2 months	50	25.83	741	30.83	345
1956	66 and 4 months	52	26.67	733	31.67	341
1957	66 and 6 months	54	27.50	725	32.50	337
1958	66 and 8 months	56	28.33	716	33.33	333
1959	66 and 10 months	58	29.17	708	34.17	329
1960 and later	67	60	30.00	700	35.00	325

<sup>1</sup> If born on January 1, use the prior year of birth.

<sup>2</sup> For individuals born on the first day of the month, benefits are computed as if they were born in the previous month. Individuals must be at least 62 years old for the entire month to receive benefits.

<sup>3</sup> Reduction applied to the benefit the worker would have received at FRA (\$1,000 in this table). The percentage reduction is 5/9 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.

<sup>4</sup> The spouse's maximum benefit is 50% of the benefit the worker would receive at FRA. The spouse's percentage reduction is applied after the automatic 50% reduction. The percentage reduction is 25/36 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.

Individuals may also want to receive benefits before their FRA if they have dependents under age 18. Such dependents may be eligible for benefits if the individuals are also receiving Social Security benefits.

**Tip:** While an individual receives a greater number of Social Security payments if benefits begin at age 62 (rather than the FRA), the amount of each payment is smaller. So, at a certain point in time, the total benefits received will be the same, regardless of whether a greater number of smaller payments, or a smaller number of larger payments are received.

If an individual waits until the FRA to draw benefits and the primary insurance amount (PIA), which is a function of his earnings history, remains the same, it will take around 12 years to reach the break-even point (that is, total benefits received after waiting until FRA equal the total benefits received starting at age 62). After that point, the total benefits received will be greater if the individual waits until FRA (or later) to begin taking them.

**Note:** This break-even analysis considers only the Social Security benefits. It does not consider any investment income that could have been earned from age 62 until FRA on early benefits (assuming they are invested, rather than spent) or the compounded future value of that sum.



Retirees should consider the advantages of waiting until their FRA before drawing Social Security benefits.

## Waiting Until FRA

Retirees should consider the advantages of waiting until their FRA before drawing Social Security benefits. Factors to consider include:

- Life expectancy
- Shortening the retirement period
- The earnings test
- Replacing earlier lower-wage years with later higher-wage years
- The compounding of inflation adjustments on a higher base
- Effect on the retiree's spouse

**Life expectancy.** The individual's life expectancy may be the biggest factor in deciding whether he should receive Social Security benefits early. While tables and averages are available, a 62-year-old individual should have a good idea of his own life expectancy. His current health and the longevity of his parents should be clearly established by that age. As previously noted, it takes roughly 12 years for total benefits received starting at FRA to equal the total benefits received starting at age 62.

**Shortening the retirement period.** A significant factor in retirement planning projections is the length of the retirement period, computed as follows:

$$\text{Length of Retirement Period} = \text{Life Expectancy} - \text{Age at Retirement}$$

**Example:** Nancy wants to retire at age 62 and has a life expectancy of 85. She has a 23-year retirement period to fund. By working past age 62, Nancy is shortening her retirement period and decreasing the resources needed to fund her retirement, regardless of her longevity.

**The earnings test.** Individuals who consider receiving Social Security retirement benefits before their FRA but who also intend to keep working must consider the earnings test. For 2014, the exempt earnings amount is \$15,480 (for years before reaching their FRA). This means that Social Security benefits are reduced \$1 for every \$2 in earnings above that exempt amount. In the year that FRA is reached, benefits are reduced \$1 for every \$3 in earnings above \$41,400 (in 2014) based only on the months up to the month of FRA. At FRA, benefits are no longer reduced due to earnings, regardless of the amount.

Individuals already facing a reduced benefit amount because they started receiving benefits before FRA would have their benefits reduced even further by exceeding the exempt earnings threshold. However, if a worker starts receiving benefits prior to his FRA and those benefits are reduced because of his excess earnings, when the worker reaches FRA, his benefit amount is recalculated to give him credit for the months that benefits were reduced because of his excess earnings.

**Example:** Charlie retired in 2013 at age 63. In 2014, he decides to work part-time and earns wages of \$16,480, \$1,000 over the exempt amount. Charlie has investment income and is in the 25% marginal tax bracket. His Social Security benefits are subject to tax, and 85% of the benefits are included in his gross income. Since Charlie is under FRA, his benefits are reduced \$1 for each \$2 he earns over the exempt amount. Charlie's additional spendable portion of the \$1,000 of wages after considering taxes and the loss of Social Security benefits is only \$279.75, shown as follows:

Earnings over the exempt amount .....	\$1,000.00
Payroll tax on \$1,000 (7.65%) .....	< 76.50 >
Income tax on \$1,000 .....	< 250.00 >
Loss of Social Security benefits (\$1,000 ÷ 2).....	< 500.00 >
Tax savings because of \$500 reduction in Social Security benefits (\$500 × 85% × 25%).....	106.25
Additional spendable amount.....	\$279.75

**Replacing lower-wage years.** An individual's Social Security benefits are based on his PIA. The PIA is based on the individual's highest earnings during a 35-year calculation period. If an individual can replace lower-wage years with higher-wage years after age 62, he can increase his PIA. This can lead to a higher retirement benefit when the individual retires. A higher PIA will also increase disability and survivor's benefits.

**Inflation adjustments.** Social Security benefits receive an annual inflation adjustment. Taking reduced benefits before FRA results in a smaller annual inflation increase because the inflation adjustment (even though the same for all benefit recipients) is applied to a smaller amount each year.



A higher PIA will also increase disability and survivor's benefits.

**Example:** Sam's PIA was \$1,000, but he began taking benefits at age 62, so his benefit was only \$750. Each year he will miss out on the compounded inflation adjustment to that \$250 in lost benefits. In other words, the gap between his early retirement benefit and the amount he would have received by waiting will continue to increase.

**The effect on the spouse.** The individual's decision to start receiving Social Security benefits before reaching his FRA may also affect a spouse's benefits. Unless the spouse has his own earnings record and is fully insured, he will be dependent on his working spouse's PIA for retirement benefits. A spouse who is not fully insured and who waits until his FRA is eligible to receive 50% of the worker spouse's retirement benefit. However, a worker who retires early may have a lower PIA than if he had waited until his FRA. Therefore, his spouse's benefit would be based on that lower PIA.

### Beginning Benefits after Reaching FRA

An individual who works past his FRA receives larger benefits because of the delayed retirement credit. A worker born in 1943 or later receives a credit of 8% per year for each year he delays receiving benefits after reaching his FRA until age 70.

### Making a Change after Benefits Begin

**Withdrawing the application.** If Social Security benefits started less than 12 months ago and the worker changes his mind about when they should start, he may be able to withdraw his Social Security claim and re-apply at a future date. A request for withdrawal of an application is made on Form SSA-521. If the request is approved, all of the benefits received by the worker and his family must be repaid. Only one withdrawal is allowed per lifetime.

**Suspending retirement benefit payments.** After reaching FRA but before age 70, an oral or written request can be made to the SSA to suspend benefits, including any retroactive benefits that might be due. Planning strategies utilizing the suspension of benefits are discussed below.

### Maximizing Lifetime Benefits for Married Couples

Married individuals are entitled to the higher of 1) the retirement benefit based on their own record or 2) a spousal benefit equal to 50% of their spouse's retirement benefit. Married individuals who file for retirement benefits before their FRA, based either on their own earnings record or on spousal benefits, are deemed to have filed for both benefits at the same time. However, after married individuals reach FRA, they can restrict the application to one type of benefit, allowing them to apply for one type of benefit at FRA and the other benefit later.

These filing options give rise to two planning strategies available to married couples. They enable married couples to maximize their combined benefits in certain situations.





**File and Suspend.** Under this strategy, a higher earning spouse who plans to delay receiving benefits past his FRA applies for and claims benefits at his FRA but at the same time, suspends the benefits. Claiming his benefits enables his lower earning or nonearning spouse to claim spousal benefits based on the higher-earning spouse's earnings record. The higher earning spouse then claims benefits at a later date, say at age 70, and receives a greater benefit than he would have at his FRA. In the meantime, his spouse has been receiving spousal benefits.

**Example:** Ed reaches his FRA of age 66 but plans to continue working until age 70. His retirement benefit at FRA is \$2,200 a month. His wife, Ann, is age 62, no longer working, and will receive \$750 a month at her FRA, based on her earning record. If she begins taking benefits at age 62, the benefit based on her own earnings record would be \$563 ( $\$750 \times 75\%$ ) while her spousal benefit amount would be \$770 [ $(\$2,200 \times 50\%) \times 70\%$ ].

However, Ann can claim a spousal benefit only if Ed has claimed his benefits. Therefore, Ed claims and suspends his benefits, which enables Ann to draw a spousal benefit, which is greater than the benefit based on her own earnings record. In the meantime, Ed waits until age 70 to begin receiving benefits, which enables him to receive delayed retirement credits so his monthly benefit beginning at age 70 is \$3,000.

**Claim Now, Claim More Later.** This strategy works when both spouses will claim benefits based on their own earnings records. Here, one spouse can delay benefits past FRA (to as late as age 70) while the other claims benefits at FRA (or as early as age 62). The spouse delaying benefits files a restricted application at his FRA, claiming only a spousal benefit. His own benefit continues to grow until he reaches age 70, at which time he applies for and switches from a spousal benefit to the benefit based on his own earnings record. This strategy can maximize the couple's lifetime benefits, particularly when each is in good health and has a longer than normal life expectancy.

**Example:** Jack and his wife, Jill, both reach their FRA in 2014. Based on their own earnings records, Jack's monthly benefit is \$2,200 and Jill's monthly benefit is \$2,000. They decide it makes sense for Jill to begin receiving her benefits now but for Jack to delay his benefits until age 70, when his monthly benefit is expected to increase to \$2,900.

Even though he delays his own benefits, Jack can apply for benefits in 2014 by restricting his application to spousal benefits (50% of Jill's benefits). Therefore, Jack will receive a \$1,000 per month spousal benefit until age 70, when he switches over to benefits based on his own earnings record.

**CAUTION:** An individual must be at least FRA to file a restricted application.





## Funding College Accounts for Children and Grandchildren

According to The College Board's Annual Survey of Colleges, the average full-time undergraduate cost of tuition, fees, room and board rose more than 3% from the 2012–13 to the 2013–14 school years (see table). Although this was a decline from previous years' rates of increase, the cost of a college education continues to rise much faster than the general rate of inflation.

Individuals who want to save for their children's and grandchildren's future college education and have the means to do so should consider Qualified Tuition Programs (QTPs) as the vehicle of choice. QTPs are typically state-sponsored programs that enable a person to:

- Prepay a beneficiary's tuition, entitling the beneficiary to a waiver of some or all of certain qualified education expenses (prepaid plans) or
- Contribute to a savings account established for paying a beneficiary's qualified education expenses (savings plans).



### Average Undergraduate College Costs Total Charges for Tuition, Fees, Room and Board

Type of College	2013–2014	2012–2013	Increase	% Change
Public 2-Year In-State	\$10,730	\$10,496	\$234	2.2%
Public 4-Year In-State	18,391	17,817	574	3.2
Public 4-Year Out-of-State	31,701	30,704	997	3.2
Private Nonprofit 4-Year	40,917	39,447	1,470	3.7

Source: The College Board

### Advantages of QTPs

Congress designed QTPs specifically for the purpose of getting people to save and plan for future college costs. Thus, these plans are packed with advantages, including the following.

#### Favorable income tax rules.

- There are no income tax consequences while funds remain in a QTP.
- Distributions are tax-free if used for qualified education expenses such as tuition and room and board.
- Many states allow state income tax deductions for contributions to in-state programs.
- Tax benefits are not phased out for wealthy taxpayers.
- The QTP account does not have to be distributed by the time the beneficiary turns 30 (like an education savings account must).

**Substantial contributions allowed.** A QTP must limit contributions to the amount necessary to provide for the qualified higher education expenses of the beneficiary. However, this amount is typically substantial (often more than \$300,000) so individuals can contribute large amounts to a QTP, without an annual limit (but see Gift and Estate Tax Rules on next page).

**Owner control.** Account owner (typically parents or grandparents) normally maintains control over the funds in the account.

Congress designed QTPs specifically for the purpose of getting people to save and plan for future college costs. Thus, these plans are packed with advantages.

**Favorable estate and gift tax rules.**

- QTP account is normally excluded from the account owner's estate even though he can a) name a new account beneficiary, b) roll the funds over to a QTP for a different beneficiary and c) withdraw the funds (subject to income tax and a 10% penalty on the earnings).
- If a contribution exceeds the annual gift tax exclusion, the contributor can elect to spread it over a five year period (see Estate and Gift Tax Rules below).

**Affordability and simplicity.**

- Minimum investment amounts are low.
- These funds offer professionally managed investment options designed specifically for college savings.

**Favorable impact on financial aid calculations**

- QTPs owned by grandparents are not considered when computing a student's eligibility for financial aid until the funds are withdrawn and used for the student's education costs.

Individuals are not required to use their own state's QTP, although there may be state tax benefits that make that the best option. In some instances, another state's plan may offer better investment options and lower fees, so it's wise to consider other state plans when choosing a QTP.

**Nonqualified Withdrawals**

Provided the QTP funds are used for college costs when withdrawn, there are no income tax consequences. However, if the funds are not used for college costs, the earnings portion of the withdrawal is subject not only to income tax but also a 10% penalty (subject to certain exceptions). The income is taxed as ordinary income even though it might have been capital gain or qualified dividends had it been held outside the QTP account.

**Estate and Gift Tax Rules**

The estate and gift tax rules may be of particular interest to grandparents, and they are quite favorable. Contributions to a QTP for the benefit of someone other than the contributor are treated as taxable gifts, eligible for the \$14,000 (for 2014) annual gift tax exclusion. Because the gift occurs when funds are contributed rather than when distributed to or for the beneficiary, any appreciation or earnings on contributed amounts escape transfer tax.

If a contribution exceeds the annual gift tax exclusion, the contributor can elect to spread it over a five-year period. This may be particularly attractive to grandparents who want to make a large contribution to a grandchild's account. The election to spread the gift over five years is made on the gift tax return (Form 709); thus, it is critical to file the return even if there is no tax due. The amount in excess of five times the annual exclusion (for 2014, \$70,000 or \$140,000 for married couples in community property states or electing to gift-split) is a taxable gift in the year the funds are transferred to the QTP. Also, a contribution cannot be spread over fewer than five years.

**Example:** Astrid, who is single, contributes \$70,000 to a QTP for the benefit of her granddaughter, Susan, in 2014.

Astrid elects to spread the contribution to the QTP (for gift tax purposes) over five years.

Amount contributed .....	\$70,000
Eligible amount to spread over 5 years (5 × \$14,000).....	< 70,000 >
Taxable gift in excess of the combined annual exclusions .....	\$0
Allocated to 2014: [(1/5 of \$70,000)].....	\$14,000
Less: annual exclusion .....	< 14,000 >
Taxable gift in 2014 .....	\$0

The remaining \$56,000 (\$70,000 – \$14,000) is recognized for gift tax purposes in years 2015–2018 at a rate of \$14,000 per year.

There are generally no gift tax consequences to rollovers and beneficiary changes if the old and new designated beneficiaries are members of the same generation. However, if the new beneficiary is one generation lower, the transaction is treated as a taxable gift made by the old beneficiary. Generation-skipping rules apply when the new beneficiary is two or more generations lower.

**Conclusion.** QTPs provide a great way to set aside funds specifically for college costs. Of course, the younger the beneficiary when contributions are made, the better, but because generous contributions are allowed, substantial amounts can be put into a QTP in a relatively short time. Therefore, even those who wait can still take advantage of QTPs. In addition, favorable estate and gift tax rules make them particularly attractive to some grandparents wanting to help fund their grandchildren's college costs.

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Tools relevant to the topics discussed in this Special Report include:

- Required Minimum Distributions
- Retirement Plans – Equal Periodic Payments for Early Distributions
- Retirement Income Planner
- Social Security Benefits – Starting at Age 62 versus FRA
- College Savings Planner (new for 2014)

### Tax Planning for Individuals Quickfinder Handbook

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The tax rules for IRAs and retirement plans can be confusing, often differing from plan to plan with important amounts changing from year to year. The IRA and Retirement Plan Quickfinder Handbook provides quick answers to questions involving eligibility, making contributions, limits on contributions and elective deferrals, covering employees, how distributions are taxed and when they are required, penalties and selecting beneficiaries, just to name a few.

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