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Permission to post provided by columnist Holly Nicholson, certified financial planner, Raleigh, NC.

Ms. Nicholson also offered an additional comment pointing out that the tax deduction is available to grandparents too – not limited only to the account owner. In fact, any NC taxpayer contributing to an NC 529 account is currently eligible for the tax deduction.

## **Switch to NC 529 plan will cut parents' taxes**

Q: My wife and I are in a fairly high tax bracket, and our only child is a junior in high school.

We have custodial accounts to help fund her college expenses. We now realize that the laws have changed and all earnings will be taxed at our tax rate, not hers. On the plus side, the earnings aren't substantial because of the low rates on money markets and savings accounts.

We are wondering if it makes any sense to transfer this money to the NC 529 plan and/or start the plan for future contributions.

Since she is so close to entering college, it seems like a hassle to start a new plan just to avoid taxation on our custodial accounts - which are barely earning 1 percent. Do you think it is worth the effort? If you give me half of your tax savings, I'll prepare all of the paperwork and have it ready for your signature. I'll explain my generous offer, but first, your question makes it sound as if you just recently discovered the change in the taxation for custodial accounts.

This is a concern because this change was enacted on May 17, 2006. Perhaps the earnings have been low enough in previous years that the money was still taxed at your child's rate. Custodial vehicles such as Uniform Gift to Minor Act (UGMA) and Uniform Transfer to Minor Act (UTMA) accounts were very popular college savings vehicles before Section 529 plans came into existence.

With the signing of the Tax Increase and Prevention Reconciliation Act, UGMAs and UTMAs have lost nearly all of their appeal. The act changed the kiddie-tax rules.

Before the act, passive income from these custodial accounts was taxed at the child's assumed lower tax bracket once the child reached age 14. Now the first \$950 of unearned income is tax-free, the next \$950 is taxed at the child's rate, and the rest will be taxed at the parent's rate until the child is age 18 - or until age 24 if the child is a dependent and a full-time student.

The NC 529 plan allows for a state tax deduction for plan contributions. A married couple can deduct up to \$5,000, and a single filer can deduct up to \$2,500. Currently, there are no income limitations to qualify for this deduction, but limitations are scheduled to be imposed in 2012.

Setting up and funding the NC 529 plan with \$5,000 before Dec. 31 will provide you with a tax savings of almost \$400. If you make another contribution to the plan in 2011, you'll save another \$400. This amount of tax savings should be enough of an incentive for you to complete the paperwork.

In addition to the tax deduction, some other reasons to move money to be used for college from custodial accounts to a 529 plan follow:

Assets in a 529 plan owned by the parent with the child as beneficiary are counted as the parent's asset for purposes of calculating financial aid, while assets in a custodial account are counted as the child's asset, which can be a significant advantage if applying for aid.

Growth and income earned in the plan are tax-deferred.

All earnings are tax-free if used for qualifying higher education expenses.

If the funds will be needed in the near future and you want to invest them safely, you may be able to achieve a higher rate of return within the 529 plan.

One option in the NC 529 plan is the Federally Insured Deposit Account offered by the State Employees' Credit Union. The current interest rate is 2.25 percent.

Consult your tax professional before making any changes if you have substantial gains in your custodial accounts.

Go to [www.cfnc.org](http://www.cfnc.org) or call 866-866-CFNC (2362) for enrollment forms, contribution deadlines and more information on the NC 529 plan.

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