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Spring is here, and not a moment too soon!

The snow finally melted, the flowers are blooming, and Karen and I are expecting our third grandson somewhere around June 2. The Bodnar Financial baby pool is predicting his birthday will fall on 5/29 Day...

Speaking of, enclosed are a few articles about 529 college savings plans, along with how they are affected by the new tax reform law.

Don't forget- Tax reform changes enacted this past January will affect your 2018 tax return NEXT year. Will this change your short-term financial plan? I give you my least favorite answer: It depends.

If it's been a while since your last annual review, call the office and visit us before next April 15.

Spring 2018

College Saving: How Does a 529 Plan Compare to a Roth IRA?

The College Landscape After Tax Reform

What are the gift and estate tax rules after tax reform?

How has tax reform affected the generation-skipping transfer tax?



BODNAR FINANCIAL ADVISORS INC *Client Quarterly Newsletter*

Government Report Details Household Finances



Every three years, the Federal Reserve sponsors the Survey of Consumer Finances (SCF), which collects information on the financial state of U.S. households. The survey is one of the nation's primary

sources of information on the financial condition of different types of households. Here are a few interesting observations gleaned from the most recent surveys conducted in 2013 and 2016, with the latter comparing changes during that timeframe.

Income

The typical household's median family income rose 10% between 2013 and 2016, from \$48,100 to \$52,700. During that same period, mean income (the average) increased 14%, from \$89,900 to \$102,700. Families at the top of the income distribution saw larger gains in income between 2013 and 2016 than other families, consistent with widening income inequality.

Across age groups, median and mean incomes show a life-cycle pattern, rising to a peak in the middle age groups and then declining for groups that are older and increasingly more likely to be retired. Income also shows a strong positive association with education; in particular, incomes for families headed by a person who has a college degree tend to be substantially higher than for those with lower levels of schooling.

Incomes of white non-Hispanic families are substantially higher than those of nonwhite (black or African-American non-Hispanic, Hispanic, or Latino, and other or multiple race) families. Income is also higher for homeowners and for families living in urban areas than for other families, and income is systematically higher for groups with greater net worth.

Wealth

Families near the bottom of the income and wealth distribution experienced large gains in mean and median net worth following large declines between 2010 and 2013. Families

without a college education and nonwhite and Hispanic families experienced larger proportional increases in net worth than other types of families, although more-educated families and white non-Hispanic families continue to have higher wealth than other families.

Overall, median and mean inflation-adjusted net worth — the difference between a family's gross assets and liabilities — rose between 2013 and 2016. Overall, the median net worth of all families rose 16% to \$97,300, and mean net worth rose 26% to \$692,100. Much of the increase in wealth was driven by the increased prices of homes and investments such as stocks and other securities.

The same patterns of inequality in the distribution of wealth across all families are also evident within race/ethnicity groups: For each of the race/ethnicity groups, the mean is substantially higher than the median, reflecting the concentration of wealth at the top of the wealth distribution. White families had the highest level of both median and mean family wealth: \$171,000 and \$933,700, respectively. Black families' median and mean net worth was less than 15% that of white families, at \$17,600 and \$138,200, respectively. Hispanic families' median and mean net worth was \$20,700 and \$191,200, respectively.

A few other interesting facts

Homeownership rates decreased between 2013 and 2016 to 63.7%, continuing a decline from their peak of 69.1% in 2004. For families that own a home, mean net housing values (value of a home minus outstanding mortgages) rose.

Retirement plan participation and retirement account asset values rose for families across the income distribution, with the largest proportional increases occurring among families in the bottom half of the income distribution.

Overall, many measures of debt and debt obligations indicate that debt has fallen, while education debt increased substantially between 2013 and 2016.





529 plan assets surpass \$300 billion mark

As of September 2017, assets in 529 plans totaled \$306 billion.

Source: Strategic Insight, 529 College Savings & ABLE, 3Q 2017 529 Data Highlights

Note

Investors should carefully consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. Specific information is available in each plan's official statement. Keep in mind that there is the risk that 529 plan investments may not perform well enough to cover costs as anticipated. Also consider whether your state offers any 529 plan state tax benefits and whether they are contingent on joining your own state's 529 plan. Other state benefits may include financial aid, scholarship funds, and protection from creditors.

College Saving: How Does a 529 Plan Compare to a Roth IRA?

529 plans were created 22 years ago, in 1996, to give people a tax-advantaged way to save for college. Roth IRAs were created a year later, in 1997, to give people a tax-advantaged way to save for retirement. But a funny thing happened along the way — some parents adapted the Roth IRA as a college savings tool.

Tax benefits and use of funds

Roth IRAs and 529 plans have a similar tax *modus operandi*. Both are funded with after-tax dollars, contributions accumulate tax deferred, and qualified distributions are tax-free. But in order for a 529 plan distribution to be tax-free, the funds *must* be used for college or K-12 education expenses. By contrast, a qualified Roth distribution can be used for anything — retirement, college, travel, home remodeling, and so on.

In order for a distribution from a Roth IRA to be tax-free (i.e., a qualified distribution), a five-year holding period must be met *and* one of the following must be satisfied: The distribution must be made (1) after age 59½, (2) due to a qualifying disability, (3) to pay certain first-time homebuyer expenses, or (4) by your beneficiary after your death.

For purposes of this discussion, it's the first condition that matters: whether you will be 59½ or older when your child is in college. If the answer is yes (and you've met the five-year holding requirement), then your distribution will be qualified and you can use your Roth dollars to pay for college with no tax implications or penalties. If your child ends up getting a grant or scholarship, or if overall college costs are less than you expected, you can put those Roth dollars toward something else.

But what if you'll be younger than 59½ when your child is in college? Can you still use Roth dollars? You can, but your distribution will not be qualified. This means that the earnings portion of your distribution (but not the contributions portion) will be subject to income tax. (Note: Just because the earnings portion is subject to income tax, however, doesn't mean you'll necessarily have to pay it. Nonqualified distributions from a Roth IRA draw out contributions first and then earnings, so you could theoretically withdraw up to the amount of your contributions and not owe income tax.)

Also, if you use Roth dollars to pay for college, the 10% early withdrawal penalty that normally applies to distributions before age 59½ is waived. So the bottom line is, if you'll be younger than 59½ when your child is in college and you use Roth dollars to pay college expenses, you might owe income tax (on the earnings portion of the distribution), but you

won't owe a penalty.

If 529 plan funds are used for any other purpose besides the beneficiary's qualified education expenses, the earnings portion of the distribution is subject to income tax *and* a 10% federal tax penalty.

Financial aid treatment

At college time, retirement assets aren't counted by the federal or college financial aid formulas. So Roth IRA balances will not affect financial aid in any way. (Note: Though the aid formulas don't ask for retirement plan *balances*, they typically do ask how much you *contributed* to your retirement accounts in the past year, and colleges may expect you to apply some of those funds to college.)

By contrast, 529 plans do count as an asset under both federal and college aid formulas. (Note: Only parent-owned 529 accounts count as an asset. Grandparent-owned 529 accounts do not, but withdrawals from these accounts are counted as student income.)

Investment choices

With a Roth IRA, your investment choices are virtually unlimited — you can hold mutual funds, individual stocks and bonds, exchange-traded funds, and REITs, to name a few.

With a 529 plan, you are limited to the investment options offered by the plan, which are typically a range of static and age-based mutual fund portfolios that vary in their level of risk. If you're unhappy with the market performance of the options you've chosen, under federal law you can change the investment options for your *existing* contributions only twice per calendar year (though you can generally change the investment options on your *future* contributions at any time).

Eligibility and contribution amounts

Unfortunately, not everyone is eligible to contribute to a Roth IRA. For example, your income must be below a certain threshold to make the maximum annual contribution of \$5,500 (or \$6,500 for individuals age 50 and older).

By contrast, anyone can contribute to a 529 plan; there are no restrictions based on income. Another significant advantage is that lifetime contribution limits are high, typically \$300,000 and up. And 529 plan rules allow for large lump-sum, tax-free gifts if certain conditions are met — \$75,000 for single filers and \$150,000 for married joint filers in 2018, which is equal to five years' worth of the \$15,000 annual gift tax exclusion.





Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans and ABLÉ plans before investing. Specific information can be found in each plan's official statement. Participating in a 529 plan or ABLÉ plan may involve investment risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Investments may not perform well enough to cover college costs as anticipated. As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan, and each plan has its own rules and restrictions, which can change at any time. Before investing in a 529 plan or an ABLÉ plan, consider whether your state offers residents favorable state tax benefits, and whether those benefits are contingent on joining the in-state plan. Other state benefits for 529 plans may include financial aid, scholarship funds, and protection from creditors.

The College Landscape After Tax Reform

College students and their parents dodged a major bullet with the Tax Cuts and Jobs Act of 2017. Initial drafts of the bill included the elimination of Coverdell Education Savings Accounts, the Lifetime Learning Credit, and the student loan interest deduction, along with the taxation of tuition waivers, which are used primarily by graduate students and college employees. In the end, none of these provisions made it into the final legislation. But a few other college-related items did. These changes take effect in 2018.

529 plans expanded

The new law expands the definition of 529 plan "qualified education expenses" to include K-12 tuition. Starting in 2018, annual withdrawals of up to \$10,000 per student can be made from a 529 college savings plan for tuition expenses related to enrollment at a K-12 public, private, or religious school (excluding home schooling). Such withdrawals are now tax-free at the federal level.

At the state level, some states automatically update their state 529 legislation to align with federal 529 legislation, but other states will need to take legislative action to include K-12 tuition as a qualified education expense. In addition, 529 plan institutional managers will likely further refine their rules to accommodate the K-12 expansion and communicate these rules to existing account owners. Parents who are interested in making a K-12 contribution or withdrawal should understand their plan's rules and their state's tax rules.

The expansion of 529 plans may impact Coverdell Education Savings Accounts (ESAs). Coverdell ESAs let families save up to \$2,000 per year for a child's K-12 or college expenses. Up until now, they were the only option for tax-advantaged K-12 savings. But now the use of Coverdell ESAs may decline as parents are likely to prefer the much higher lifetime contribution limits of 529 plans — generally \$350,000 and up — over the \$2,000 annual limit for Coverdell accounts. In addition, Coverdell ESA contributions can only be made for children under age 18.

Coverdell ESAs do have one important advantage over 529 plans, though: investment flexibility. Coverdell owners have a wide variety of options in terms of what investments they hold in their accounts, and may generally change investments as often as they wish. By contrast, 529 account owners can invest only in the investment portfolios offered by the plan, and they can change their existing plan investments only twice per year.

In addition, the new tax law allows 529 account owners to roll over (transfer) funds from a 529 account to an ABLÉ account without federal tax consequences if certain requirements are met. An ABLÉ account is a tax-advantaged account that can be used to save for disability-related expenses for individuals who become blind or disabled before age 26. Like 529 plans, ABLÉ plans allow funds to accumulate tax deferred, and withdrawals are tax-free when used for a qualified expense.

New calculation for kiddie tax

The tax reform law changes the way the "kiddie tax" is calculated. Previously, a child's unearned income over a certain amount was taxed at the parents' rate. Under the new law, a child's unearned income over a certain amount (\$2,100 in 2018) will be taxed using the compressed trust and estate income tax brackets. This change may make the use of UTMA/UGMA custodial accounts less attractive as a college savings vehicle due to the reduced opportunity for tax savings.

New tax on large college endowments

The tax law creates a new 1.4% tax on the net investment income of large college endowments. Specifically, the tax applies to institutions with at least 500 tuition-paying students and endowment assets of \$500,000 or more per student. Approximately 30 colleges are expected to be swept up in this net in 2018, including top-ranked larger universities and smaller elite liberal arts colleges. Some affected colleges have publicly stated that the tax will limit their ability to fund certain programs, including financial aid programs.

Loss of personal exemptions

Starting in 2018, the tax law eliminates personal exemptions, which were \$4,050 in 2017 for each individual claimed on a tax return. So on their 2018 tax returns (which will be completed in 2019), parents of college students will lose an exemption for each college student they claim. However, this loss may be at least partially offset by: (1) a larger standard deduction in 2018 of \$24,000 for joint filers (up from \$12,700 in 2017); \$12,000 for single filers (up from \$6,350 in 2017); and \$18,000 for heads of household (up from \$9,350 in 2017); and (2) a new family tax credit of \$500 in 2018 for each dependent who is not a qualifying child (i.e., under age 17), which would include a dependent college student. The income thresholds to qualify for this credit (and the child tax credit) are significantly higher: up to \$400,000 adjusted gross income for joint filers and up to \$200,000 for all other filers.



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What are the gift and estate tax rules after tax reform?

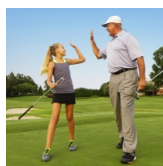
The Tax Cuts and Jobs Act, signed into law in December 2017, approximately doubled the federal gift and estate tax basic exclusion amount to

\$11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exclusion is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, federal gift and estate taxes remain the same.

Gift tax. Gifts you make during your lifetime may be subject to federal gift tax. Not all gifts are subject to the tax, however. You can make annual tax-free gifts of up to \$15,000 per recipient. Married couples can effectively make annual tax-free gifts of up to \$30,000 per recipient. You can also make unlimited tax-free gifts for qualifying expenses paid directly to educational or medical service providers. And you can make deductible transfers to your spouse and to charity. There is a basic exclusion amount that protects a total of up to \$11.18 million (in 2018) from gift tax and estate tax. Transfers in excess of the basic exclusion amount are generally taxed at 40%.

Estate tax. Property you own at death is subject to federal estate tax. As with the gift tax, you can make deductible transfers to your spouse and to charity; there is a basic exclusion amount that protects up to \$11.18 million (in 2018) from tax, and a tax rate of 40% generally applies to transfers in excess of the basic exclusion amount.

Portability. The estate of a deceased spouse can elect to transfer any unused applicable exclusion amount to his or her surviving spouse (a concept referred to as portability). The surviving spouse can use the unused exclusion of the deceased spouse, along with the surviving spouse's own basic exclusion amount, for federal gift and estate tax purposes. For example, if a spouse died in 2011 and the estate elected to transfer \$5 million of the unused exclusion to the surviving spouse, the surviving spouse effectively has an applicable exclusion amount of \$16.18 million (\$5 million plus \$11.18 million) to shelter transfers from federal gift or estate tax in 2018.



How has tax reform affected the generation-skipping transfer tax?

The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the federal generation-skipping transfer

(GST) tax exemption to \$11.18 million in 2018 (adjusted for inflation in later years). After 2025, the exemption is scheduled to revert to its pre-2018 level and be cut approximately in half. Otherwise, the federal GST tax remains the same.

The federal GST tax generally applies if you transfer property to a skip person. A skip person is someone who is two or more generations younger than you (for example, a grandchild). The GST tax may apply in addition to any gift or estate tax. Similar to the gift tax provisions, annual exclusions (up to \$15,000 per recipient in 2018) and exclusions for qualifying educational and medical expenses are available for GST tax. You can protect up to \$11.18 million (in 2018) with the GST tax exemption. Transfers in excess of the GST tax exemption are generally taxed at 40%.

A GST generally occurs on a transfer that is subject to federal gift or estate tax and made to

a skip person, or a transfer to a trust if all the beneficiaries with an interest in the trust are skip persons. A GST may also occur on certain distributions from trusts to skip persons. Additionally, a GST may occur when an interest in a trust terminates, and skip persons then hold all interests in the trust.

Unlike with the gift and estate tax applicable exclusion amount, the GST tax exemption is not portable between spouses. The estate of a deceased spouse cannot transfer any unused GST tax exemption to the surviving spouse.

Note: An early version of the legislation proposed approximately doubling the gift and estate tax basic exclusion amount and the GST tax exemption for 2018 to 2024. After 2024, the estate tax and the GST tax would have been repealed. The gift tax would not have been repealed, although the top gift tax rate would have been reduced from 40% to 35% after 2024. However, the only provision that made it into the final legislation was the doubling of the gift and estate tax basic exclusion amount and the GST tax exemption for 2018 to 2025.

