



CYPEN & CYPEN
NEWSLETTER
for
AUGUST 11, 2016

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Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. FLORIDA'S PENSION FUND EKES OUT GAIN IN VOLATILE

YEAR: Despite a topsy-turvy year in the world financial markets, Florida's \$142 billion pension fund managed to show a gain for the seventh straight year according to The Gainesville *Sun*. Ash Williams, executive director of the State Board of Administration, which manages the Florida Retirement System, recently told Governor Rick

Scott and the Cabinet that FRS ended its state fiscal year on June 30, 2016 with a .061% gain. FRS pays retirement benefits for state workers, county employees, teachers and university personnel. The gain keeps alive a streak that began after a 19% drop in 2009. FRS, which is one of the largest public retirement systems in the country, has earned a positive return in 34 of the last 43 years. In 24 of those years, the return exceeded 10%. "The positive net returns show the value of diversification, our success in controlling costs, and the prudence and patience of sticking to the fund's long-term investment plan in a challenging year," said Williams. Measuring the fund's performance since January shows a slightly brighter picture, with the investments gaining 4.93% through this week. Those gains came despite a volatile time in the markets, which Williams described in March as a "circular roller coaster." Interest rates have been at historical lows, making investments in bonds and other traditional financial instruments much less attractive. Williams said since 1965, the average return on 10-year U.S. Treasury bond has been over 6%, although it is currently 1.5%. Governor Scott said, it makes it hard to get the returns you need to pay pensions. Against the backdrop of a challenging investment climate, Williams said the pension fund faced other challenges, including a "massive wave" of retirements by public employees enrolled in the Deferred Retirement Option Program, commonly known as DROP. DROP allows older employees to remain at their jobs but have their retirement benefits accumulate with interest up to five years. A series of pension reforms in 2011 cut the DROP interest rates from 6.5% to 1.3%, depending on whether employees

entered the DROP before or after July 1, 2011. Many public employees entered the DROP that year, but by July 1, 2016, most employees reached their five-year limit and retired, requiring the state to pay the DROP benefits. It resulted in 14,298 DROP employees retiring during the past fiscal year, requiring \$1.96 billion in retirement payments. The pension fund managers had long anticipated the financial hit and had prepared for it. Florida's pension fund remains one of the strongest public retirement systems in the country, with the ability to pay 87% of its long-term obligations, compared to a national average of 74%, according to a new study by the Mercatus Center at George Mason University. FRS's unfunded pension liability is estimated at \$21.5 billion, and that has prompted efforts, particularly in the state House, to limit the future growth of the system. In recent years, the House has backed proposals to encourage more workers to opt for a 401(k)-type investment plan rather than the traditional pension program, but the effort has not gained traction in the state Senate.

2. IRS PROVIDES GUIDANCE ON FUTURE DETERMINATION LETTER PROGRAM: In Rev. Proc. 2016-37, the IRS provides guidance on the determination letter program for individually designed qualified retirement plans. The guidance sets out a framework for the pared-down program, establishes a new remedial amendment period, and explains how required amendments should be handled by plan sponsors going forward. These changes to the determination letter program are generally effective January 1, 2017. According to Willis

Tower Watson, most large employers maintain individually designed defined benefit and/or defined contribution retirement plans. After the IRS announced its plan to curtail the determination letter program in 2015, industry groups and other stakeholders urged the agency to rethink its decision, but the IRS held firm. The staggered five-year remedial amendment cycle ends as of January 1, 2017. After that, individually designed retirement plans generally may not submit restated plans to the IRS for a determination of whether the plan meets the qualification requirements in the tax code and IRS regulations every five years. In 2017 and beyond, the IRS will accept determination letter applications for individually designed plans in the following circumstances:

- Initial plan qualification. This includes individually designed plans submitted on Form 5300 and volume submitter plans with minor modifications submitted on Form 5307.
- Plan terminations. Determination letters for plan terminations may be submitted under the same conditions that currently apply.
- “Other” circumstances. Each year, the IRS will announce in the Internal Revenue Bulletin whether it will accept determination letter applications for amended individually designed plans. For example, the agency might allow submissions following significant changes in the law or widespread adoption of new plan designs, or for plans that are unable to convert to preapproved plan document platforms. The IRS will also

consider whether its caseload and available resources allow for additional determination letters.

Plan amendments required to comply with a change in the qualification requirements will no longer need to be adopted by the due date of the plan sponsor's tax return for the year of the amendment's effective date. Instead, the IRS will publish a Required Amendments List of all amendments that must be adopted to retain the plan's qualified status. Starting in 2017, the list will be published every year after October 1, and plan sponsors will need to adopt the required amendments by the end of the second year following the list year (unless legislation or other guidance states otherwise). The IRS intends to hold off on including required amendments in the list until related guidance and model amendments (if any) have been issued. Discretionary amendments (*e.g.*, plan design changes) still must be adopted by the end of the plan year in which the plan amendment takes effect. The IRS has the authority to delay the due date for plan amendments, but plans must still comply with changes to the qualification requirements as of the effective date of the change. To avoid confusion, the IRS plans to provide an Operational Compliance List to identify changes in qualification requirements that are effective during a calendar year. Expiration dates in past determination letters are no longer operative. A sponsor of a qualified plan that has received a favorable determination letter may continue to rely on its authority unless the provision at issue is amended or affected by a change in the law. To retain such reliance, all material facts must

have been disclosed at the time the determination letter request was submitted or reviewed. The six-year determination letter cycle for sponsors of preapproved plans (master and prototype, and volume submitter) to submit restatements to the IRS and obtain favorable opinion or advisory letters generally remains intact. The period for sponsors of preapproved defined contribution plans to submit for opinion or advisory letters during the third six-year cycle for such plans opens August 1, 2017. The IRS extended the due date for sponsors of individually designed defined contribution plans to adopt a preapproved platform from April 30, 2016, to April 30, 2017. The elimination of cycle-based determination letter submissions is a major change. For some plan sponsors, it might be welcome, as they will no longer need to prepare determination letter applications every five years, gather amendments, prepare a restated plan and respond to IRS inquiries about the submission. On the other hand, the new regime will present its own challenges. Sponsors still must demonstrate that they have amended their plans in a timely and compliant manner, but now in the less predictable context of an IRS examination. Differences of opinion between IRS agents and plan sponsors will inevitably arise and will have to be resolved through the IRS closing agreement program. Agents may impose monetary penalties for flaws in plan document language. Additionally, the predictable five-year submission cycle motivated sponsors to review their plans and confirm that all necessary amendments were adopted on time. Lacking that structure and motivation, plan sponsors might be more likely to miss an amendment, possibly for some time. Such

failures could incur IRS sanctions and possibility costly corrections. Sponsors might want to implement internal processes to make sure they remain in compliance. For example, they could conduct periodic reviews, such as every year or two, of the plan document to ensure that all changes in the IRS Required Amendments List were adopted on time. While preapproved plans may be a good choice for some sponsors, their limited menus of plan provisions will not work in every situation, and notice of a required amendment from a preapproved plan provider does not ensure timely adoption. Plan sponsors already deal with some of these challenges in the interim amendment process that has been in place for almost a decade, and the new IRS procedures may improve the plan amendment process. This will depend, at least in part, on whether the Treasury Department and the IRS issue timely guidance on changes to the tax law that require plan amendments, and whether the IRS applies some leniency in its examinations of plan documents.

3. BOOM AND BUST CYCLE: CAUSES & HISTORY: The boom and bust cycle is the alternating phases of economic growth and decline. It is how most people describe the business cycle or economic cycle. According to aboutmoney.com, in the boom cycle, growth is positive. If GDP growth remains in the healthy 2-3% range, it can stay in this phase for years. It is accompanied by a bull market, rising housing prices, wage growth and low unemployment. The boom phase does not end unless the economy is allowed to overheat. That is when there is too much liquidity in the money supply, leading to inflation. As

prices rise, irrational exuberance takes hold of investors. In 18 months or less, GDP turns negative, the unemployment rate is 7% or higher, and the value of investments fall. If it lasts more than three months, it is usually a recession. It can be triggered by a stock market crash, followed by a bear market. The cycle of boom and bust is caused by three forces: the law of supply and demand, the availability of capital, and future expectations. Strong consumer demand drives the boom phase. Families are confident about the future, so they buy more now, knowing they will get better jobs, higher home values, and rising stock prices later on. This demand means companies have boost supply, which they do by hiring new workers. Capital is easily available, so consumers and businesses alike can borrow at low rates. That stimulates more demand, creating a virtuous circle of prosperity. However, if demand outstrips supply, the economy can overheat. Also, if there is too much money chasing too few goods, it causes inflation. When this happens, investors and businesses try to outperform the market. They ignore the risk to achieve gain. Plummeting confidence causes the bust cycle. It can be triggered by a stock market correction or even a crash. Investors sell stocks, and buy safe-haven investments that traditionally do not lose value, such as bonds, gold and the U.S. dollar. As companies lay off workers, consumers lose their jobs and stop buying anything but necessities. That causes a downward spiral. The bust cycle eventually stops on its own when prices are so low that those investors that still have cash start buying again. However, this can take a long time, and even lead to a depression. Confidence can be restored more quickly by central

bank monetary policy and government fiscal policy. The history of boom and bust cycles is compiled by the National Bureau of Economic Research. It uses economic indicators to measure the boom and bust cycles. These include GDP statistics, employment, real personal income, industrial production and retail sales. Since 1854, there have been 33 cycles. On average, the booms last 38.7 months and the busts last 17.5 months. Here are a few of the U.S. Boom and Bust Cycles Since 1980:

Bust -- Jan. 1980 - Jul. 1980 -- 1980 Recession caused by interest rates to end stagflation.

Boom -- Jul. 1980 - Jul. 1981 -- Fed lowered rates.

Bust -- Jul. 1981 - Nov. 1982 -- Resumption of 1980 recession.

Boom -- Nov. 1982 - Jul. 1990 -- President Reagan lowered tax rate and boosted the defense budget.

Bust -- Jul. 1990 - Mar. 1991 -- Caused by 1989 Savings and Loan Crisis.

Boom -- Mar. 1991 - Mar. 2001 -- Ended with bubble in internet investments.

Bust -- Mar. 2001 - Nov. 2001 -- 2001 Recession caused by stock

market crash, high-interest rates.

Boom -- Nov. 2001 - Dec. 2007 -- Derivatives created housing bubble in 2006.

Bust -- Dec. 2007 - Jun. 2009 -- Subprime Mortgage Crisis, 2008 Financial Crisis, the Great Recession.

Boom -- Jun. 2009 - Now -- American Recovery and Reinvestment Act and Quantitative Easing.

4. A BIG FEAR FOR MANY: RUNNING OUT OF MONEY IN

RETIREMENT: According to the Employee Benefit Research Institute, 61% of those ages 44 to 75 say running out of money in retirement is their biggest fear. A basic question in financial planning is: how much cash can I withdraw each year from savings (including an IRA, 401(k), brokerage account, etc.) in order to pay bills and not run out of money? The answer is easy and straightforward. Almost all financial planners agree that a 4% to 4.5% withdrawal rate is “safe” and that your money will last 30 years or so if you maintain this withdrawal rate. This 4% to 4.5% withdrawal would increase each year for inflation so that you will have more money to spend each year as inflation takes its toll. Let’s work through an example. Say you have saved \$300,000, your portfolio averages a 5% rate of return, you think inflation is going to run 3%, and you feel comfortable with a 4.5% withdrawal rate. You can safely withdraw \$13,500 (\$300,000 times

4.5%) in year one, \$13,905 in year two (\$13,500 plus \$405 inflation increase) and so on. The math works out so that in year 20 your withdrawal would be \$24,383, in addition to your Social Security and other income sources. The academic research behind the above example, is based upon historical performance of stocks and bonds. The research assumes that about half of your portfolio is invested in stocks; many retirees are not comfortable having 50% of their investments allocated this way. If this is your situation, you need to change the amount you have invested in stocks and set a lower withdrawal rate. You also need to accept that you will be spending principal as the years roll by and will not be leaving anything to your heirs; or that you may outlive your money. Making the 4% to 4.5% rule work for you is the hard part. Many people want to spend more money between retirement and their mid- to late-70s They want to travel and enjoy this new season of life; they want to do things while they are healthy enough to enjoy them. It is important to try to figure out ways to spend more in the early season of retirement and spend less in the later years. Many people spend less after age 80 or so. Also, people adjust their spending down as they age and their circumstances change. Sometimes life throws you many curveballs and you are not guaranteed anything. Health issues may limit what many can do in retirement. World events will change life. Therefore, your advisor should never advocate that you live rigidly according to some withdrawal formula developed by a finance professor. Instead, take time to understand the math behind the formulas and develop a withdrawal strategy that works for you.

5. HELPING EMPLOYERS UNDERSTAND, ADDRESS

MUSCULOSKELETAL CONDITIONS: According to a piece in benefitnews.com, recent research published by the United States Bone and Joint Initiative, musculoskeletal disorders such as arthritis and back pain affect more than 50% of adults in the United States and are often the largest clinical cost driver for commercial employers, accounting for upwards of 20% of annual medical spend. To put this in perspective, most employers spend twice as much on musculoskeletal conditions as they do on cardiovascular disease. Yet, employers often focus less attention and resources on musculoskeletal conditions, making it challenging to control costs and improve outcomes for employees with these disorders. The high cost of musculoskeletal conditions is driven primarily by procedures and surgical interventions, but other areas of significant spend include diagnostic imaging and medications. Pain medications used for therapy are typically among the top five pharmacy cost and utilization drivers for employers. High rates of narcotic prescriptions are particularly concerning given increasing rates of substance abuse disorders involving opiates. Musculoskeletal conditions and their associated economic and social costs pose a significant challenge for the U.S. healthcare system, particularly for employers focused on managing population health and ensuring their employees are healthy, happy and engaged. Population-wide studies show that spending on back and joint pain increased significantly over the past two decades, despite stable prevalence of these conditions. A 2009

paper published in the Journal of the American Board of Family Medicine showed that in the decade leading up to 2005, rates of spine imaging (MRI) increased 307%, steroid injections increased 271%, opioid analgesic prescriptions increased 108%, and spine surgery increased 220%. This has resulted in a 62% increase in per capita spending on musculoskeletal treatments over the last decade. In addition to medical cost, treatments for musculoskeletal conditions can have a significant impact on employee productivity, absenteeism, mental health and overall well-being. Recovery times for the most invasive surgeries can last several months. Depression, psychiatric disorders and increased risk of prescription pain medication abuse are also common. In addition to higher treatment costs and risk, research shows that many invasive musculoskeletal interventions provide little or no long-term benefit. For example, a study published in the New England Journal of Medicine randomly assigned patients with sciatic back pain to either surgery or conservative treatment and found no difference in pain or perceived recovery one year later. Employers need to understand the clinical characteristics and risk drivers of musculoskeletal disorders in populations so they can implement strategies to manage these conditions. Musculoskeletal conditions can impact employees in every demographic and are not isolated to a specific job type, making effective identification and management even more critical. With the right analytical tools and knowledge, employers can follow a data-driven approach for effective condition management. Here are five strategies to get started:

- **Know your data and your population.** Healthcare claims data provides a comprehensive window into the cost and utilization trends of an employee population. Analyze claims data to understand the most prevalent musculoskeletal conditions in your population, as well as patient demographics and key cost drivers. Back pain is often the most significant medical cost for employers, and spouses often account for a disproportionate amount of spend, sometimes driven by elective surgeries. Analysis of pharmacy data can also help identify pain medication usage and potential abuse patterns.
- **Encourage alternative therapies.** Multiple studies have shown non-surgical therapies to be equally effective as surgery for certain musculoskeletal conditions. Design benefits to encourage use of physical therapy, medications, and complementary therapy. Further, provide employees and family members with access to behavioral management programs and counseling support to help manage stress and temporary discomfort.
- **Provide treatment decision support and care management services.** Equip employees and family members with services and tools to help them navigate the healthcare system and make informed treatment decisions. There are numerous services and tools that provide expert advice to help employees weigh the pros and cons of surgical intervention. Further,

implement care management programs to help patients more effectively manage pain, medication use, physical therapy and workplace absence.

- **Guide patients toward high performance networks and providers.** The cost and quality of musculoskeletal treatments and surgeries can vary widely. Consider developing value-based care programs and benefit designs to more appropriately align cost, quality and outcomes. For example, several large retailers have partnered with leading medical facilities to develop Centers of Excellence for joint replacement and spine surgery, including bundled payments, waived out-of-pocket costs and covered travel expenses.
- **Help employees appropriately manage pain medications.** Pain medications are often an important component of a broader treatment plan for musculoskeletal disorders. Due to the risk of opiate addiction and the link between pain and mental health disorders (e.g., stress and anxiety), employers should work with medical carriers to ensure physicians monitor medication usage and provide employees access to Employee Assistance Programs and community-based support.

Musculoskeletal disorders are challenging to manage due to the breadth of conditions, variety of treatment protocols, and lack of predictable, long-term outcomes. With the right data-driven approach, employers can understand the prevalence and cost of

musculoskeletal disorders across their eligible populations, and implement focused initiatives to help employees navigate treatment options, manage pain and return safely to work.

6. WORST STATES FOR STUDENT DEBT: Location, location, location are the three most important words in real estate -- and in education. Indeed, where you live does not just affect the value of your property; it also reflects the worth of your college degree, the same degree that may have put you in debt. And with 11% of all student-loan debts in delinquency or default, graduates need to be selective with where they apply their degrees. New York City, for instance, might boast a high average salary for a certain profession, but the high cost of living could still outweigh the gains, leaving little to pay off student debt. Student loans constitute the largest component of household debt for Americans. And our collective debt keeps growing. At the end of the first quarter of 2016, total outstanding college-loan balances disclosed on credit reports stood at \$1.26 trillion, according to the Federal Reserve Bank of New York. The latest figure represents an increase of \$29 billion from the previous quarter and \$72 billion from a year ago. Despite the evidence that income potential rises and chances of joblessness decline with more schooling, many graduates entering the labor market are learning the hard way that a college degree cannot guarantee financial security. Post-college success depends on numerous factors, including where a graduate chooses to put down roots. Student-loan borrowers generally fare better in strong-economy states with low college-debt-

to-income ratios. In order to identify the worst states for student-loan debtors, WalletHub's analysts compared the 50 states and the District of Columbia based on nine key metrics. The author's data set ranges from average student debt to unemployment rate for people aged 25 to 34 to percentage of students with past-due loan balances. Here are the ten worst states for student debt:

- **Ohio** -- Student Indebtedness Rank: 43; Grant and Work Opportunities Rank: 20. Ohio ranks in the upper half when it comes to work and grant opportunities for students and recent graduates. Unfortunately, students graduated with about \$29,000 in student loan debt.
- **Mississippi** -- Student Indebtedness Rank: 40; Grant and Work Opportunities Rank: 34. Mississippi has the second-highest rate of student loan borrowers with past due balances or defaults. About 60% of its graduates leave school with student loan debt.
- **New Hampshire** -- Student Indebtedness Rank: 47; Grant and Work Opportunities Rank: 8. New Hampshire lands in the Bottom 10 despite a very good economy, including the fourth-lowest unemployment rate for young adults. It also has the third-highest percentage of people aged 50 and older who still carry student debt.
- **South Carolina** -- Student Indebtedness Rank: 44; Grant and Work Opportunities Rank: 42. South Carolina residents have the fourth-highest debt as a percentage of income, and their relatively weak economy. The average student there graduates

with a bit more than \$29,000 in student loan debt.

- **Vermont** -- Student Indebtedness Rank: 48; Grant and Work Opportunities Rank: 4. You can say this about Vermont: they pay their bills. The state has the lowest overall percentage of borrowers with past due balances or defaults. That may be due in part to their strong economic scores. However, the state also has the highest percentage of borrowers over the age of 50.
- **Pennsylvania** -- Student Indebtedness Rank: 45; Grant and Work Opportunities Rank: 29. Pennsylvania has the third-highest average student debt and the fourth-highest proportion of students with debt. The Institute for College Access and Success says the average student had more than \$33,000 in student loan debt.
- **Maine** -- Student Indebtedness Rank: 46; Grant and Work Opportunities Rank: 40. Maine graduates had about \$31,000 in student loan. The state is keenly aware of the problem. It recently passed a law that created a new tax credit for students who graduated from a Maine college or university and continue to live in the state.
- **Oregon** -- Student Indebtedness Rank: 50; Grant and Work Opportunities Rank: 15. Oregon has the highest student debt as a percentage of income of any state.
- **West Virginia** -- Student Indebtedness Rank: 49; Grant and Work Opportunities Rank: 50. West Virginia has the third-highest unemployment rate for people ages 25-34. In fact, according to the Bureau of Labor Statistics, only 49.7% of the

state's population was working last year, the lowest rate of any state. It also has the highest percentage of student loan borrowers with past due balances or defaults.

- **Washington, DC** -- Student Indebtedness Rank: 51; Grant and Work Opportunities Rank: 6. Though Washington, DC has plenty of opportunities to find work and grants, the district's residents have racked up some of the highest student loan balances of anywhere in the U.S. In fact, despite the district's relatively high salaries, Washington, DC, has the highest debt-to-income ratio of any area on the list.

(Florida -- Student Indebtedness Rank: 29; Grant and Work Opportunities Rank: 25.)

7. HOW IDENTITY THEFT CAN AFFECT YOUR TAXES: Tax-related identity theft normally occurs when someone uses your stolen Social Security number to file a tax return claiming a fraudulent refund. Many people first find out about it when they do their taxes. The IRS is working hard to stop identity theft with a strategy of prevention, detection and victim assistance. Here are nine key points:

- **Taxes. Security. Together.** The IRS, the states and the tax industry need your help. They cannot fight identity theft alone. The Taxes. Security. Together, awareness campaign is an effort to better inform you about the need to protect your personal, tax and financial data online and at home.
- **Protect your Records.** Keep your Social Security card at home

and not in your wallet or purse. Only provide your Social Security number if it is absolutely necessary. Protect your personal information at home and protect your computers with anti-spam and anti-virus software. Routinely change passwords for internet accounts.

- **Do not Fall for Scams.** Criminals often try to impersonate your bank, your credit card company, even the IRS in order to steal your personal data. Learn to recognize and avoid those fake emails and texts. Also, the IRS will not call you threatening a lawsuit, arrest or to demand an immediate tax payment. Normal correspondence is a letter in the mail. Beware of threatening phone calls from someone claiming to be from the IRS.
- **Report Tax-Related ID Theft to the IRS.** If you cannot e-file your return because a tax return already was filed using your SSN, consider the following steps: file your taxes by paper and pay any taxes owed; file an IRS Form 14039 Identity Theft Affidavit. (Print the form and mail or fax it according to the instructions. You may include it with your paper return). File a report with the Federal Trade Commission using the FTC Complaint Assistant; and contact one of the three credit bureaus so they can place a fraud alert or credit freeze on your account.
- **IRS Letters.** If the IRS identifies a suspicious tax return with your SSN, it may send you a letter asking you to verify your identity by calling a special number or visiting a Taxpayer Assistance Center. This is to protect you from tax-related

identity theft.

- **IP PIN.** If you are a confirmed ID theft victim, the IRS may issue an IP PIN. The IP PIN is a unique six-digit number that you will use to e-file your tax return. Each year, you will receive an IRS letter with a new IP PIN.
- **Report Suspicious Activity.** If you suspect or know of an individual or business that is committing tax fraud, you can visit IRS.gov and follow the chart on How to Report Suspected Tax Fraud Activity.
- **Combating ID Theft.** In 2015, the IRS stopped 1.4 million confirmed ID theft returns and protected \$8.7 billion. In the past couple of years, more than 2,000 people have been convicted of filing fraudulent ID theft returns.
- **Service Options.** Information about tax-related identity theft is available online. The IRS has a special section on IRS.gov devoted to identity theft and a phone number available for victims to obtain assistance.

IRS Tax Tip 2016-16 (August 2016.)

8. HOW GRANDPARENTS CAN HELP GRANDCHILDREN WITH

COLLEGE COSTS: As the cost of a college education continues to climb and student debt continues to mount, many grandparents are stepping in to help. This trend is expected to accelerate as baby boomers, many of whom went to college, become grandparents and start gifting what is predicted to be trillions of dollars over the coming

decades according to Marcum Financial Services, LLC. Helping to pay for a grandchild's college education can bring great personal satisfaction and is a smart way for grandparents to pass on wealth without having to pay gift and estate taxes. So what are some ways to accomplish this goal?

- **Outright Cash Gifts.** A common way for grandparents to help grandchildren with college costs is to make an outright gift of cash or securities. But this method has a couple of drawbacks. A gift of more than the annual federal gift tax exclusion amount-- \$14,000 for individual gifts and \$28,000 for gifts made by a married couple --might have gift tax and generation-skipping transfer tax consequences (GST tax is an additional gift tax imposed on gifts made to someone who is more than one generation below you). Another drawback is that a cash gift to a student will be considered untaxed income by the federal government's aid application, the FAFSA, and student income is assessed at a rate of 50%, which can impact financial aid eligibility. One workaround is for the grandparent to give the cash gift to the parent instead of the grandchild, because gifts to parents do not need to be reported as income on the FAFSA. Another solution is to wait until your grandchild graduates college and then give a cash gift that can be used to pay off school loans. Yet another option is to pay the college directly.
- **Pay Tuition Directly to the College.** Under federal law, tuition payments made directly to a college are not considered taxable

gifts, no matter how large the payment. So grandparents do not have to worry about the \$14,000 annual federal gift tax exclusion. But payments can only be made for tuition -- room and board, books, fees, equipment, and other similar expenses do not qualify. Aside from the obvious tax advantage, paying tuition directly to the college ensures that your money will be used for the education purpose you intended, plus it removes the money from your estate. And you are still free to give your grandchild a separate tax-free gift each year up to the \$14,000 limit (\$28,000 for joint gifts). However, colleges will often reduce a student's institutional financial aid by the amount of the grandparent's payment. So before sending a check, ask the college how it will affect your grandchild's eligibility for college-based aid. If your contribution will adversely affect your grandchild's aid package, particularly the scholarship or grant portion, consider gifting the money to your grandchild after graduation to help him or her pay off student loans.

- **529 Plans.** A 529 plan can be an excellent way for grandparents to contribute to a grandchild's college education, while simultaneously paring down their own estate. Contributions to a 529 plan grow tax deferred, and withdrawals used for the beneficiary's qualified education expenses are completely tax free at the federal level (and generally at the state level too). There are two types of 529 plans: college savings plans and prepaid tuition plans. College savings plans

are individual investment-type accounts offered by nearly all states and managed by financial institutions. Funds can be used at any accredited college in the United States or abroad. Prepaid tuition plans allow prepayment of tuition at today's prices for the limited group of colleges -- typically in-state public colleges -- that participate in the plan. Grandparents can open a 529 account and name a grandchild as beneficiary (only one person can be listed as account owner, though) or they can contribute to an already existing 529 account. Grandparents can contribute a lump sum to a grandchild's 529 account, or they can contribute smaller, regular amounts. Regarding lump-sum gifts, a big advantage of 529 plans is that under special rules unique to 529 plans, individuals can make a single lump-sum gift to a 529 plan of up to \$70,000 (\$140,000 for joint gifts by married couples) and avoid federal gift tax. To do so, a special election must be made to treat the gift as if it were made in equal installments over a five-year period, and no additional gifts can be made to the beneficiary during this time.

Example: Mr. and Mrs. Brady make a lump-sum contribution of \$140,000 to their grandchild's 529 plan in Year 1, electing to treat the gift as if it were made over 5 years. The result is they are considered to have made annual gifts of \$28,000 (\$14,000 each) in Years 1 through 5 ($\$140,000/5$ years). Because the amount gifted by each grandparent is within the annual gift tax exclusion, the Bradys will not owe any gift tax (assuming they do not make any other gifts to this

grandchild during the 5-year period). In Year 6, they can make another lump-sum contribution and repeat the process. In Year 11, they can do so again. Significantly, this money is considered removed from the grandparents' estate, even though in the case of a grandparent-owned 529 account the grandparent would still retain control over the funds. There is a caveat, however. If a grandparent were to die during the five-year period, then a prorated portion of the contribution would be "recaptured" into the estate for estate tax purposes. Example: In the previous example, if Mr. Brady were to die in Year 2, his total Year 1 and 2 contributions (\$28,000) would be excluded from his estate. But the remaining portion attributed to him in Years 3, 4, and 5 (\$42,000) would be included in his estate. The contributions attributed to Mrs. Brady (\$14,000 per year) would not be recaptured into the estate. If grandparents want to open a 529 account for their grandchild, there are a few things to keep in mind. If you need to withdraw the money in the 529 account for something other than your grandchild's college expenses -- for example, for medical expenses or emergency purposes -- there is a double consequence: the earnings portion of the withdrawal is subject to a 10% penalty and will be taxed at your ordinary income tax rate. Also, funds in a grandparent-owned 529 account may still be factored in when determining Medicaid eligibility, unless these funds are specifically exempted by state law. Regarding financial aid, grandparent-owned 529 accounts do not need to be listed as an asset on the federal government's financial aid application, the FAFSA. However, distributions/withdrawals from a grandparent-owned 529

plan are reported as untaxed income to the beneficiary (grandchild), and this income is assessed at 50% by the FAFSA. By contrast, parent-owned 529 accounts are reported as a parent asset on the FAFSA (and assessed at 5.6%) and distributions from parent-owned plans are not counted as student income. To avoid having the distribution from a grandparent-owned 529 account count as student income, one option is for the grandparent to delay taking a distribution from the 529 plan until any time after January 1 of the grandchild's junior year of college (because there will be no more FAFSAs to fill out). Another option is for the grandparent to change the owner of the 529 account to the parent. Colleges treat 529 plans differently for purposes of distributing their own financial aid. Generally, parent-owned and grandparent-owned 529 accounts are treated equally because colleges simply require a student to list all 529 plans for which he or she is the named beneficiary. Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits. As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated.

9. SIGNS TO GET YOU THROUGH THE DAY: A clear conscience is a sign of a fuzzy memory.

10. AGING GRACEFULLY: Why do I have to press one for English when you are just going to transfer me to someone I cannot understand anyway?

11. TODAY IN HISTORY: In 1866, world's 1st roller rink opens (Newport, Rhode Island.)

12. KEEP THOSE CARDS AND LETTERS COMING: Several readers regularly supply us with suggestions or tips for newsletter items. Please feel free to send us or point us to matters you think would be of interest to our readers. Subject to editorial discretion, we may print them. Rest assured that we will not publish any names as referring sources.

13. PLEASE SHARE OUR NEWSLETTER: Our newsletter readership is not limited to the number of people who choose to enter a free subscription. Many pension board administrators provide hard copies in their meeting agenda. Other administrators forward the newsletter electronically to trustees. In any event, please tell those you feel may be interested that they can subscribe to their own free copy of the newsletter at <http://www.cypen.com/subscribe.htm>.

14. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED

RETIREMENT BENEFIT.