SSgA Upromise529
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Get Smart: Uniting Holistic Wealth Management Strategies with Flexible College Funding Solutions

You may have clients for whom college funding is not the financial worry it is for many parents. But did you know there is still plenty to gain by using a 529 college savings plan, even if that funding need already appears within reach? The tax-deferral of portfolio gains may make 529 Plans a better alternative to funding college than taxable accounts, but that's not all. The vehicles' tax-free qualified withdrawals also make it a valuable component in the tax-aware strategy of investment location as well as a flexible estate planning tool.[1]

While it may indeed serve as a tax-advantaged college savings account for many, the 529's tax advantages and high contribution limits combine to make it a unique and effective holistic wealth management tool for higher net-worth clients. In addition to delivering tax-free gains to pay for college, 529s can help more affluent clients achieve much broader goals, from enhancing their portfolio's total tax efficiency to accelerating gifting and establishing a legacy. Here are three strategies that may deliver significant benefits across the portfolio:

Enhance tax efficiency with 529s and investment location

Traditionally, higher net-worth clients choose not to use the 529 to save for college because taxable accounts often give them more investment choices and greater flexibility to manage their taxable portfolio gains by harvesting losses. Yet, while those objections are worth considering, the college savings plan's unique tax advantages can help enhance tax efficiency for smarter college savings through the holistic practice of investment location.

Investment location is a strategic process that seeks to optimize after-tax returns by placing stocks, bonds and other assets—according to the specific nature and timing of taxes they generate—in either taxable or tax-deferred accounts. "Maximizing after-tax returns requires viewing all investment accounts as extremely interrelated and astute investment location can create a source of tax alpha by minimizing clients' income and estate tax liabilities," explains Glenn Frank, CPA/PFS, Director of Investment Tax Strategy at Lexington Wealth Management in Lexington, Massachusetts. "Most investors look at their assets in various buckets—the retirement money is here and the college money is over there. Behavioral finance has shown it's easier to save when working toward a specific goal, but it's the advisor's job to evaluate the client's big financial picture to maximize the family's after-tax wealth."

To maximize the portfolio's tax efficiency, Frank suggests locating assets this way:

- **Taxable Accounts:** Buy-and-hold equities, most index funds, most ETFs, and tax-free municipal bonds.
- **Tax Deferred Accounts:** Taxable bonds, especially high yield bonds, REITs, and high turnover mutual funds.

He acknowledges that clients often balk at his advice to hold bonds in a 529 account.[2] "Anyone who views the 529 as college money would be inclined to invest in equities to take advantage of what they hope will be more than a decade of growth," he explains. "But, the younger the client, the more sense it makes to house the highest taxed investments in tax-deferred accounts. Decades of growth with zero tax interference can be tremendously beneficial."

While investment location is most attractive to clients who are focused on minimizing taxes, Frank says implementing the strategy also requires having the time to tell the "whole investment location story." He explains, "Some clients have the attention span to learn about investment location, and some don't. Therefore, you have to judge whether you have enough time to present the strategy and discuss the benefits."

Additionally, Frank says some clients will have a difficult time letting go of a return-oriented college portfolio. However, he has had good results when he sits down with clients and uses OptiTax, a software program he developed, to calculate the potential tax savings from the proposed investment location decisions that could be beneficial for college saving strategies. "Viewing the potential tax savings not only underscores the benefits of locating fixed income in a 529, but it can help clients to understand how important it is to take a holistic view of their portfolio," he notes.

(You can learn more about investment location and view Frank's calculations in our whitepaper, *How to Implement Investment Location to Generate Alpha*, available on spdru.com.)

While locating fixed income in a 529 can improve the overall portfolio's tax efficiency and be a real practice differentiator for you, the advisor, Frank admits not every client will be a candidate for the strategy. However, Frank says even taking the time to explore investment location and the tax advantages of a 529 is an effective exercise to get clients comfortable with the notion that the "portfolio's enhanced post-tax return will be more likely to support all their goals if they take a more holistic view of their portfolio rather than looking to fund specific expenses, such as college tuition, from one particular account."

Got Series EE or Series I US Savings Bonds?

A 529 is a tax-free alternative.

As you and your clients take a holistic view of their assets, you may find that Series EE US savings bonds and Series I bonds are part of their college savings. While the interest earned is tax free when the bonds are redeemed to pay for qualified higher education expenses, in order to qualify for the tax-free treatment, the bond owner's modified adjusted gross income must be under the income phase outs.[3]

For tax year 2014, for single taxpayers, the tax exclusion begins to be reduced with a $76,000 modified adjusted gross income and is eliminated for adjusted gross incomes of $91,000 and above. (Income limits are adjusted annually and rounded to the nearest $50.) For married taxpayers filing jointly, the tax exclusion begins to be reduced with a $113,950 modified adjusted gross income and is eliminated for adjusted gross incomes of $143.950 and above. Married couples must file jointly to be eligible for the exclusion.[4]

If your clients' income exceeds the income phase outs, an alternative strategy would be to cash in the bonds and invest the proceeds into a 529 plan where earnings from interest are not taxed.

Note that the savings bonds cannot be directly transferred into the 529 plan account. Instead, the bonds must be redeemed and the proceeds deposited directly into the 529 plan account within 60 days and within the same tax year. The account owner must also file IRS Form 8815 to claim an exclusion from income for the interest earned on the bonds.

Additionally, to qualify for tax-free redemption, bonds must be issued in 1990 or later and the child must be listed as a beneficiary on the bonds, not as an owner or co-owner. Also, the bond owner, who must have been at least 24-years-old when the bonds were issued, must claim an exemption for the beneficiary on his/her federal income tax return.

Accelerate gifting: Good for clients—and a wise estate planning tool for grandparents

In addition to a 529's tax advantages for college funding, the college savings vehicle's high contribution limits also make it shine as an estate planning tool. For higher net-worth clients, a 529's flexible special gift tax exclusion allows them to contribute large amounts *into* their account maximizing gifting benefits to their beneficiaries while also reducing the size of their taxable estate.

Although the annual limitation for tax-free gifts to family members is $14,000 per individual ($28,000 for married couples) per year for each beneficiary, the 529's exclusion permits five years' worth of gifts to a beneficiary of a 529 plan, in a single year, without triggering the federal gift tax. That amounts to a $70,000 gift for individuals ($140,000 for married couples filing jointly), five times what clients could otherwise contribute free of gift taxes. For example, grandparents with eight grandchildren could transfer more than $1 million ($1,200,000) out of their estate in just one year with no impact on their lifetime gift tax exemption amount ($5.43 million in 2015) all while still keeping full control of the assets.[5]

And, if they wait five years, they could make additional 529 contributions, directing another five years' worth of gifts to their beneficiaries. Because the 529 plan providers, the individual states, set maximum contribution limits, many higher than $300,000 per beneficiary, clients have the luxury of many years of gifting. Of course, the immediate need to reduce the size of an estate by making large gifts may be less urgent because of the the current $5.43 million (to be adjusted annually for inflation) estate and gift tax lifetime exemption. However, many states have exemptions well below the federal level, so contributing assets into a 529 plan can still dramatically reduce a future estate tax burden.

No matter how large the estate, Frank says talking with grandparents about opening a 529 plan account for their grandchildren is a terrific way to broach the often difficult-to-approach topic of estate planning. "While clients often drag their feet when it comes to gifting money out of their estate, they warm up quickly to the idea of setting up an account to fund education for their grandchildren," he says. "Clients just light up when they realize what a significant contribution they can make."

Frank stresses that the real beauty of using a 529 to accelerate gifting for grandparents—or parents, aunts and uncles, or even older siblings, for that matter—is that while 529 contributions remove assets from the taxable estate, the gifting family member retains control of the assets. Therefore, the option exists for the "529 owner" to change the beneficiary to an eligible family member of the beneficiary, or even to cash out the account, subject to taxes and a 10% penalty on any earnings if their circumstances change.

"There is no other investment vehicle that permits investors to make an accelerated gift that removes assets from the taxable estate, and allows donors to maintain control of those assets," says Frank.

For instance, with the Coverdell Education Savings Account (ESA), assets are not revocable. "The account must be established for the sole benefit of the child, which to me sounds like an UGMA or UTMA account. In fact, an ESA has a custodian—the bank or other financial institution you use to open the account, much like the way you open an IRA," explains Joe Hurley, CPA, founder and CEO of Savingforcollege.com, a company that provides information and consulting services relating to 529 plans and author of The Best Way to Save for College—A Complete Guide to 529 Plans.

Additionally, the Coverdell's $2,000 annual contribution limit, made permanent by the American Taxpayer Relief Act of 2012, does not work as well as an estate planning tool for grandparents and other relatives. Moreover, Hurley notes that the low contribution limit could cause some administrative headaches.

"If you invest $2,000 into an ESA for your child this year, and a grandparent opens another ESA with $1,000, the annual contribution limit has been breached and your child owes a 6% excise tax on the $1,000 excess," he explains. "Most, but not all, ESAs protect against this unfortunate result by requiring that a parent or legal guardian, and not the grandparent, be named as the responsible individual on any ESA. So at least the parent will get a chance to notice the excess contribution and take it back out of the ESA before May 31st of the following year, thereby avoiding penalties."

To learn more about the different college savings vehicles, read our whitepaper, *College Funding Solutions: What's Best for Your Clients?* available on spdru.com.

Families saving for college should also know that the 529 has advantages when it comes to qualifying for financial aid. If someone other than the parent opens and funds a 529 account, those assets are not currently included in the calculation to determine a student's eligibility for federal financial aid. It is only when a student takes a qualified distribution for college from the account that the amount must be reported as student income on federal financial aid forms.

For that reason, many families view grandparent-funded 529s as the last asset to be tapped for college. That is, students who might be eligible for financial aid should use the 529 to fund their senior year expenses, because they will not be applying for aid in the following year.

Interestingly, the flexibility of a 529 allows parents who don't yet have children to open an account with themselves as the beneficiary and transfer the beneficiary designation to their future child at a later time.[6] 529 Plan beneficiaries can be changed at any time to an eligible family member, but note that current law stipulates that plan assets can only be rolled over to another 529 account for the same beneficiary once in a 12-month period.

Making contributions to 529 plans can also help grandparents effectively manage their tax brackets once they begin taking required minimum distributions (RMDs) from their retirement plans. Remember, account owners of traditional IRAs and employer-sponsored retirement plans such as 401(k)s who are older than age 70½ must make annual RMDs or face an IRS penalty on missed withdrawals.

If your clients do not need assets distributed from their retirement plans to meet expenses, they could re-invest their RMDs in a 529 plan rather than in certificates of deposit or brokerage accounts where they would face additional taxes on any earnings. Invested in a 529, those assets could begin to grow tax deferred for college.

Create a legacy with 529s

Because 529s must be opened for one beneficiary and withdrawals are tax-free only if they are used for qualified higher education expenses, high net-worth clients who may fund close to the account limits have the ability to re-name beneficiaries. This can transform a 529 into a legacy tool. That is, if one child fails to use all the 529 assets, the parent or grandparent can re-assign the 529 plan to a sibling or another member of the family, tax- and penalty-free.[7] Or, the child could continue to hold the 529 in their name with the intent of funding graduate school, or even to passing the account along to their own yet-to-be-born children.

"Grandparents, in particular, love the idea of establishing an education legacy with a 529 and it's much easier to work with than a trust" says Frank.

Whereas trusts are typically expensive to establish and often carry high maintenance and administrative fees, 529s have relatively low costs, especially plans that invest in cost-effective index funds and ETFs. 529s also help you avoid the high taxes of a trust. Remember, the 3.8% net investment income tax applies to certain trusts and, significantly, in 2015, trusts reach the highest tax bracket (39.6%) at just $12,300 of retained investment income.[8]

Further, if clients have an existing trust, you could enhance the returns by setting up a 529 plan with the trust as the account owner. That way, assets invested in the 529 plan can grow tax-deferred and qualified withdrawals will be tax-free. Together, with the 529's lower fees, that can result in more money to fund their heirs' education.

529 College Savings Plan: Just the Facts

Year 2015 Rules	529 Plan
Federal Income Tax	Non-deductible contributions; withdrawn earnings excluded from income to extent of qualified higher education expenses
Federal Gift Tax Treatment	Contributions treated as completed gifts; apply $14,000 annual exclusion, or up to $70,000 with 5-year election
Federal Estate Tax Treatment	Value removed from donor's gross estate; partial inclusion for death during a 5-year election period
Maximum Investment	Established by the program; many in excess of $300,000 per beneficiary
Qualified Expenses	Tution, fees, books supplies, equipment, special needs; room and board for minimum half-time students
Able to Change Beneficiary	Yes, to another member of the beneficiary's family
Time/Age Restrictions	None unless imposed by the program
Income Restrictions	None
Federal Financial Aid	Counted as asset of parent if owner is parent or dependent student
Investments	Menu of investment strategies as developed by the program
Use for Nonqualifying Expenses	Withdrawn earnings subject to federal tax and 10% penalty
Source:SavingforCollege.com, Accessed on 01/13/15. http://www.savingforcollege.com/compare_savings_options/?assigned_to%5B%5D=0&assigned_to%5B%5D=5&hiddenField=vehicles&mode=Submit	

Learn more about the SSgA Upromise 529 Plan with ETFs

The SSgA Upromise 529 Plan is the largest 529 plan featuring an investment lineup predominately composed of portfolios that invest in exchange traded funds (ETFs).* Launched in April 2012, the SSgA Upromise 529 plan is designed to lower costs and simplify investment choices for families saving for college. The plan offers static portfolio options where the underlying funds are individual SPDR® ETFs and college-date and risk-based portfolio options managed by SSgA's Investment Solutions Group, a dedicated team of investment professionals who develop customized solutions tailored to specific needs. The group specializes in managing and advising investors on asset allocation, risk management, portfolio construction and plan implementation. The plan also offers a Savings Portfolio that invests in the Sallie Mae High Yield Savings Account.

With the convenient, low-fee SSgA Upromise 529 plan, you can:

- Open an account without an enrollment fee for as little as $50 per month or an initial contribution of $15
- Set up a payroll deduction plan for $15 or more per paycheck
- Continue to make contributions until the account balance reaches the maximum account balance limit of $370,000
- Save even more with Ugift®—Give College Savings and the Upromise® rewards service.

To learn more about the SSgA Upromise 529 plan visit: ssga.upromise529.com

* Although they invest in ETFs and/or mutual funds, the SSgA Upromise 529 Plan Portfolios are not ETFs or mutual funds themselves. As an SSgA Upromise 529 account owner, you will own units of the portfolio. Which are municipal fund securities, not shares of the ETFs or mutual funds.

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Connecting goals and generations with the 529

In recent years, 529 product innovations, combined with college costs that continue to surpass the rate of inflation, have accounted for significant growth in the 529 market. College Savings Plan Network reports that since the beginning of the recession in 2008, national assets under management in 529 plans more than doubled to exceed $244 billion through June 30, 2014. Over the same period, the average 529 account size increased from $10,690 to $20,671. This growth underscores that, even when facing economic challenges, American families remained committed to saving for college.[10]

While the 529 is an effective college savings vehicle, its tax advantages and high contribution limits can have residual positive affects for the portfolio when you integrate college funding with your high net-worth clients' other wealth management goals. The 529 can be the key that opens the door to productive discussions about the often technical, and sometimes stressful, topics of after-tax returns and estate planning. That is, the often unpopular subjects of taxes and planning for heirs may be easier to broach with clients if you connect them to educational funding.

By uniting goals from college funding to estate planning, a 529 can lay the foundation for a holistic view of the portfolio and can ultimately enhance your client relationships. Further, because establishing a 529 often involves parents, grandparents and the children, it enables you to establish and solidify the multigenerational relationships that can result in long-term growth for your practice.

All this makes the tax-advantaged 529 an even smarter way to save for college.

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STATE STREET GLOBAL ADVISORS
State Street Financial Center
One Lincoln Street
Boston, MA 02111

866.787.2257
spdrs.com

[1] Earnings on non-qualified withdrawals are subject to tax and may be subject to a 10% federal penalty tax, as well as state and local income taxes. The availability of tax or other benefits may be contingent on meeting other requirements.

[2] Although they invest in ETFs and/or mutual funds, the SSgA Upromise 529 Plan Portfolios are not ETFs or mutual funds themselves. As an SSgA Upromise 529 account owner, you will own units of the portfolio. Which are municipal fund securities, not shares of the ETFs or mutual funds.

[3] Qualified higher education expenses are different for this benefit than for 529 Plans. Only includes tuition and fees (for bond owner, bond owner's spouse or dependent.

[4] https://www.treasurydirect.gov/indiv/planning/plan_education.htm

[5] In the event the donor does not survive the five-year period, a pro-rate amount will revert back to the donor's taxable estate.

[6] There may be gift tax or generational skipping tax consequences for this kind of beneficiary change.

[7] There may be generational skipping tax consequences for this kind of beneficiary change if new beneficiary is a different generation.

[8] http://www.aicpa.org/publications/taxadviser/2013/may/pages/nuckolls_may2013.aspx

[9] http://www.frcnet.com/documents/SI_529_Quarterly_Data_Update_3Q13.pdf

[10] College Savings Plan Network, 529 Report, September 2014.

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IMPORTANT RISK INFORMATION

ETFs trade like stocks, fluctuate in market value and may trade at prices above or below the ETFs' net asset value. Brokerage commissions and ETF expenses will reduce returns.

For more information about the SSgA Upromise 529 Plan ("the Plan") download the Plan Description and Participation Agreement or request one by calling 1-800-587-7305. Investment objectives, risks, charges, expenses, and other important information are included in the Plan Description; read and consider it carefully before investing. Ascensus Broker Dealer Services, Inc. ("ABD") is distributor of the Plan.

Before investing in the Plan, you should consider whether your or the beneficiary's home state offers a 529 plan that provides its taxpayers with favorable state tax and other benefits that are only available through investment in the home state's 529 plan.

The SSgA Upromise 529 Plan (the "Plan") is administered by the Board of Trustees of the College Savings Plans of Nevada (the "Board"), chaired by Nevada State Treasurer. Ascensus Broker Dealer Services, Inc. (ABD) serves as the Program Manager. ABD has overall responsibility for the day-to-day operations, including distribution of the Plan and provision of certain marketing services. State Street Global Advisors (SSgA) serves as Investment Manager for the Plan except for the Savings Portfolio, which is managed by Sallie Mae Bank, and also provides or arranges for certain marketing services for the Plan. The Plan's Portfolios invest in either (i) Exchange Traded Funds and mutual funds offered or managed by SSgA or its affiliates; or (ii) a Federal Deposit Insurance Corporation (FDIC)- insured omnibus savings account held in trust by the Board at Sallie Mae Bank. Except for the Savings Portfolio, investments in the Plan are not insured by the FDIC. Units of the Portfolios are municipal securities and the value of units will vary with market conditions.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise bond values and yields usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

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