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Federal Gift and Estate Taxes

Investments in accounts are considered completed gifts for federal estate and gift tax purposes. Generally, if the Account Owner dies while there is still money in his or her accounts, the value of the accounts would not be included in the Account Owner's estate (except in the situation described below relating to the gift tax election for investments exceeding $14,000 in any one year). However, amounts distributed on account of the death of a Student Beneficiary are included in the gross estate of that Student Beneficiary for federal estate tax purposes.

Account investments are potentially subject to federal gift tax payable by the contributing Account Owner. Generally, if an Account Owner's investments in an account or accounts for a Student Beneficiary, together with all other gifts by the Account Owner to the Student Beneficiary, are less than $14,000* per year $28,000 per married couple), no federal gift tax will be imposed on the Account Owner for gifts to the Student Beneficiary during that year. If an Account Owner's investment in an account for a Student Beneficiary in a single year is greater than $14,000 ($28,000 per married couple), the Account Owner may elect for federal gift tax purposes to treat the investments up to $70,000 ($140,000 per married couple) as having been made proportionately over a five year period. However, if the Account Owner dies before the five year period has elapsed, the portion of the investment allocable to years remaining in the five-year period (except for earnings on such investment) would be includable in the Account Owner's estate for federal estate tax purposes.

A withdrawal from an account, a permissible change of the designated Student Beneficiary, or a permissible transfer to an account for another Student Beneficiary will not be subject to federal gift or transfer tax, except that such a change or transfer will potentially be subject to gift tax if the new Student Beneficiary is of a younger generation than the Student Beneficiary being replaced and will potentially be subject to the generation-skipping transfer tax if the new Student Beneficiary is two or more generations younger than the Student Beneficiary being replaced. Because investments in an account are treated as completed gifts for federal transfer tax purposes, the Account Owner may also need to be concerned about the generation-skipping transfer tax. This tax may apply to investments in excess of the amount that may be elected to be proportionately spread over the five-year period discussed above if the Student Beneficiary is deemed to be a member of a generation that is two or more generations younger than the generation of the Account Owner.

In addition, as noted above, if a change is made in the designated Student Beneficiary such that the new Student Beneficiary is two or more generations younger than the former Student Beneficiary, the generation skipping transfer tax may also be triggered. Generally, taxpayers are eligible for a limited generation-skipping transfer tax exemption that will be allocated to transfers that are subject to generation-skipping transfer tax. Accordingly, this tax may not apply to many Account Owners and Beneficiaries. However, where it applies, it is imposed at a flat rate.

Beginning in taxable years after December 31, 2001, substantial changes have been made to the estate, generation-skipping, and gift tax rules under the 2001 Tax Act. In general, the 2001 Tax Act reduces tax rates, increases the exemption amounts, and repeals the estate and generation-skipping taxes. Account Owners and Beneficiaries should consult a qualified tax advisor regarding the specific application of these rules to their particular circumstances.