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AT WORK

Make the Grade:

Using Equity Compensation to Save for Education

Sticker Shock

Assuming an inflation rate of 6%,[2] a parent may need **$412,000 to pay for education expenses by 2031**[1]. Talk about sticker shock! With costs like that, it's never too early to start planning.

Plan for education costs the same as you would any other financial goal and think about how all your sources of income can contribute to your plan, including your equity compensation. The first step is understanding your equity compensation holdings, including the type(s) you've been granted, vesting schedules and more.

Let's run through some of your education funding options using equity compensation and some considerations to keep in mind.

Remember, helping pay for college isn't just about footing tuition bills. It's a way to pass on your values about the importance of education and help your loved one avoid debt that can follow them long after graduation.

[1] Morgan Stanley, "529 Plan: A Powerful Tool to Save for Education Expenses", August 5, 2022. 6% annual tuition inflation rate quoted by the College Board and used in their College Cost Calculator.

[2] Projected college costs in 2029 include 6% annual tuition inflation rate: https://bigfuture.collegeboard.org/pay-for-college/college-costs/college-costs-calculator.

1 529 Plan

What is it?

A tax-advantaged way to invest for future education expenses, including tuition, room and board, books and supplies.

Overview

- **Can be used for qualified education expenses** from kindergarten through graduate school.
- Although there is no annual limit on contributions, contributions on behalf of any beneficiary **cannot be more than the amount necessary** to provide for the qualified education expenses of the beneficiary.
- **No annual contribution limits**, and lifetime contribution limits can exceed $500,000.

Equity Compensation Considerations

529 plans can only be funded with cash contributions, not stock or other assets. But you can, if desired, fund using the proceeds from the sale of any shares resulting from vesting or exercise of the underlying equity compensation.

- **Anyone can open one**, and almost anyone can be named a beneficiary.
- **Transferable to certain family members** income tax-free.
- Generally, **money grows income tax-free** and can be distributed tax-free, if it's used for qualified education expenses, as defined by the IRS.
- **Withdrawals not used for qualified expenses** are subject to federal (and possible state and local) taxes, potentially including an additional 10% federal tax.

If you are coming into a large equity compensation payout in one year, **you can make a "5-year election" into a 529 plan** and contribute a larger cash lump sum in one year but treat the contribution as made across five years for gift tax purposes.

Learn more about 529 plans

2 Coverdell Educational Savings Account (CESA)

What is it?

A tax-advantaged trust or custodial account permitted under the federal tax code, formerly known as an education IRA.

Overview

- **Can be used for qualified education expenses** from kindergarten through college.
- **Earnings grow tax deferred**.
- **Contributions up to the amount of the beneficiary's qualified expenses** for the year are distributed tax-free if used for qualified education expenses.
- **More than one CESA** can be set up for a single beneficiary.
- **Contributions are subject to an annual contribution limit**, the annual

Equity Compensation Considerations

Only accepts cash contributions, not stock or other assets. But you can, if desired, fund using the proceeds from the sale of any shares resulting from the vesting or exercise of equity compensation.

contribution limit is applied to the total contributions made to all CESA accounts on behalf of a beneficiary.

- Contributions can only be made by individuals whose **Modified Adjusted Gross Income** is under the limit set for a given tax year.

3 UTMA/UGMA Accounts

What are they?

Uniform Transfers to Minors Act (UTMA) or Uniform Gifts to Minors Act (UGMA) accounts are custodial accounts used to hold and protect assets for minors until they reach age of majority in their state.

Overview

- **Funds can be used for any purpose**, not just education expenses.
- **Tax implications vary** based on the balance of the account and the parents' income, a tax professional can outline the considerations for your situation.
- UGMAs terminate and the assets are turned over to **the beneficiary at age 18**. UTMAs typically terminate **at age 21** but can go as late as age 25 in some cases.
- **You can fund a 529 plan** with UTMA or UGMA assets and use the contributions for education expenses.

Equity Compensation Considerations

UTMA and UGMA accounts may be funded with stocks, including holdings resulting from the vesting or exercise of equity compensation, plus bonds and mutual fund investments.

UTMA and UGMA accounts will not accept unexercised stock options, unvested restricted stock, or Restricted Stock Units; **all equity compensation contributions must be in fully vested company shares.**

Bottom Line and Next Steps

Today, there are so many ways to use your equity compensation for educational expense saving purposes: use share sale proceeds to contribute to an education savings account, hold onto the stock in an investment account to use for education expenses in the future or transfer stock resulting from the vesting or exercise of equity compensation into a UTMA/UGMA custodial account.

You don't need to choose just one option. A blended approach may be useful to take advantage of different features and potential tax benefits. No matter which path you take, consulting with financial and tax professionals along the way can help you build an approach that's best for your needs and financial situation.

Learn more about equity compensation

Sources

Morgan Stanley, "529 Plan: A Powerful Tool to Save for Education Expenses," August 5, 2022

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Disclosures

Investors should consider many factors before deciding which 529 plan is appropriate. Some of these factors include: the Plan's investment options and the historical investment performance of these options, the Plan's flexibility and features, the reputation and expertise of the Plan's investment manager, Plan contribution limits and the federal and state tax benefits associated with an investment in the Plan. Some states, for example, offer favorable tax treatment and other benefits to their residents only if they invest in the state's own Qualified Tuition Program. Investors should determine their home state's tax treatment of 529 plans when considering whether to choose an in-state or out-of-state plan. Investors should consult with their tax or legal advisor before investing in any 529 Plan or contact their state tax division for more information. Morgan Stanley Smith Barney LLC does not provide tax and/or legal advice. Investors should review a Program Disclosure Statement, which contains more information on investment options, risk factors, fees and expenses and possible tax consequences.

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