tions, which would avoid costly appeals. Additionally, discovery can be more limited in the arbitration setting, reducing costs and time. Also, by allowing technical disputes to be heard by arbitrators with specialized expertise, the time and expense involved with educating courts and juries on technical issues would be reduced, and the need for engaging attorneys to serve as expert witnesses would be limited.

LESSENS THE BURDENS ON COURTS

As the Ohio Supreme Court has recognized, an advantage of arbitration is that it relieves the burdens placed on the State's trial courts and appellate courts. *See Schaefer*, 63 Ohio St.3d at 712. The trust arbitration proposal would thus contribute to the unburdening of crowded court dockets. *See id.*

NEXT STEPS

For these and other reasons, Ohio trust law would be well served by the enactment of the arbitration proposal. After enactment, practitioners, especially estate planners with limited or no arbitration experience, will need to become more familiar with the particulars of arbitration. They will need to understand how it works, how it can be structured, and, ultimately, when it should, and when it should not, be required under a trust instrument. This education in the workings and uses of arbitration will allow practitioners to better serve clients who genuinely stand to benefit from this development in Ohio law.

ENDNOTES:

[1]Sleeth, 4 Estate Litigation Predictions for 2018, Private Wealth Magazine (Feb. 14, 2018), https://www.fa-mag.com/news/4-estate-litigation-predictions-for-2018-37174.html?section=66.

[2]For an overview of the proposal, see Clark, *Required Arbitration of Trust Disputes: Enforcing Settlor's Intent*, 24 No. 6 Ohio Prob. L.J. NL 2 (Jul/Aug 2014).

[3]The proposal that was adopted by the Council of Delegates would have codified the new statute as R.C. § 5802.04. In the meantime, however, an unrelated proposal was codified as R.C. § 5802.04. *See* 131 HB 432, § 1, eff. 4/6/2017. It is likely that the proposal, if adopted, would be codified as new R.C. § 5802.05.

[4]*See* Fla. Stat. Ann. § 731.401.

[5]*See* Ariz. Rev. Stat. Ann. § 14-10205.

[6]*See* Missouri Statutes § 456.2-205.

[7]*See* New Hampshire R.S.A. § 564-B: 1-111A.

[8]R.C. 2101.24(B)(1)(b).

BACK TO SCHOOL: EDUCATE YOUR CLIENTS ON FEDERAL AND STATE LAW CHANGES TO SECTION 529 PLANS

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Unlike self-made millionaire Thornton Melon (played by Rodney Dangerfield) in the 1986 movie *Back to School*, many of our clients have come to rely on Section 529 Plans, and the favorable federal and state tax benefits of those Plans, as a primary tool for saving for the skyrocketing higher education expenses of their children and grandchildren. However, your clients may not be aware that The Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") and Ohio Senate Bill 5, which ultimately became part of Ohio House Bill 49 (the "Ohio Budget Bill"), quietly made improvements to the many benefits that 529 Plans offer.

BACK TO SCHOOL: THE BASICS

Section 529, allowing the creation of a Qualified Tuition Program ("QTP"), was added to the Internal Revenue Code by the Small Business Job Protection Act of 1996. Proposed Treasury Regulations were issued on August 24, 1998 (the "1998 Proposed Regulations") and have remained in proposed form ever since. A QTP is a program established and maintained by a State or agency or instrumentality thereof, or by one or more educational institutions.

There are two types of QTPs. One is the prepaid tuition plan in which an individual can purchase tuition credits (and in some states, fees and room and board credits as well) for a designated beneficiary on a prepaid basis for a set number of academic periods or course units. The other type of

QTP is the savings plan whereby an individual makes cash contributions to an account on behalf of a designated beneficiary. The contributions to a savings plan are invested by the QTP in cash, fixed income and equity investment options with the intent being that the investment returns will be sufficient to cover the beneficiary's college expenses. A rate of return on the investments is not guaranteed. I.R.C. § 529(B)(1)(A)(i)-(ii). An educational institution may only offer a prepaid tuition plan. A state may offer a prepaid tuition plan, a savings plan, or both.

Currently, the District of Columbia and every state except Wyoming offer a QTP, and some states still offer both prepaid tuition plans and savings plans. The Ohio Tuition Trust Authority began offering Ohio's College Advantage 529 Plan (the "Ohio Plan") on October 1, 2000. At that time, Ohio offered both a prepaid tuition plan option called the Guaranteed Savings Fund (which replaced the Ohio Prepaid Tuition Program, which had been in existence prior to that date), and a variable savings plan as investment options. Ohio stopped offering the Guaranteed Savings Fund as an investment option for contributions and new enrollments on December 31, 2003 and, since then, has offered only the variable savings plan.

Code Section 529 contains several other requirements that a QTP must meet. Contributions may only be made in cash. Further, a QTP must be established for the purpose of meeting the Qualified Higher Education Expenses ("QHEEs") of the account's designated beneficiary. Qualified Higher Education Expenses are defined in Code Section 529(e)(3) and Section 1.529-1(c) of the 1998 Proposed Regulations. Prior to the 2017 Tax Act, QHEEs meant (1) tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution (which basically is an institution of higher learning beyond secondary school as defined under federal law), (2) in the case of a special needs beneficiary, expenses for special needs services which are incurred in connection with such enrollment or attendance, (3) the cost of room and board (within certain limits and requirements), and (4) expenses for the purchase of a computer or peripheral equipment, computer software, or Internet access and related services if such equipment, software or services are to be used primarily by the beneficiary during any of the years the beneficiary is enrolled at an eligible educational institution. As we will see shortly, the 2017 Tax Act made a significant change to the definition of QHEEs.

A program shall not be treated as a QTP unless it provides that any contributor to or designated beneficiary of such a program may, directly or indirectly, change how contributions to the program (or any earnings thereon) are invested no more than two times in any calendar year. I.R.C. § 529(b)(4). Under the 1998 Proposed Regulations, a selection among investment options and strategies could only be made at the time of the initial contribution establishing the account. The IRS softened its position in 2001 during a severe downturn in the equity markets by allowing changes to investment options and strategies once per calendar year. At the end of 2014, Congress amended Section 529 to its current language, which allows changes in investments twice each calendar year.

The term "account owner" does not appear in Section 529. However, Section 1.529-1(c) of the 1998 Proposed Regulations defines the account owner as the person who, under the terms of a QTP, is entitled to select or change the designated beneficiary of an account, to designate any person other than the designated beneficiary to whom funds may be paid from the account, or may receive distributions from the account if no such other person is designated. The Ohio Plan, like many state plans, allows an account owner to designate a successor account owner in the event of the death or disability of the current account owner. You should also consider having your clients name a successor account owner in their Wills in the event they fail to file the proper designation form with the QTP.

Section 529 Plan accounts must be single beneficiary accounts. I.R.C. § 529 (b)(3). QTPs must prohibit the pledging of any interest in the account or the pledging of any portion of an account as security for a loan. I.R.C. § 529(b)(5). Finally, a QTP must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary which exceed those necessary to provide for the

QHEEs of such beneficiary. I.R.C. § 529(b)(6). Section 1.529-2(i)(2) of the 1998 Proposed Regulations provides a safe harbor that states that a QTP will meet this requirement if it bars additional contributions once the account reaches a specified balance limit applicable to accounts of designated beneficiaries with the same expected year of enrollment. Total contributions must stop once the account balance of a designated beneficiary reaches the amount, determined by actuarial estimates, that is necessary to pay tuition, required fees and room and board expenses of the designated beneficiary for five years of undergraduate enrollment at the highest cost institution allowed by the QTP. Many states currently permit contributions until account balances are in excess of $400,000. As of January 1, 2018, the account balance limit under the Ohio Plan is $462,000.

BACK TO SCHOOL: INCOME TAX TREATMENT

The investments inside a 529 Plan account grow on an income tax-deferred basis. *See* I.R.C. § 529(a). One of the big advantages of 529 Plans is the compound growth of contributions made over several years (perhaps 17 or 18 years if your client starts saving when the child or grandchild is an infant), and which are not subject to federal income tax and, where applicable, state or local income tax. The general rule for distributions is that a distribution from a QTP is includible in the gross income of the distributee in the manner provided in Section 72 of the Code. I.R.C. § 529 (c)(3)(A). However, a distribution will be excluded from the gross income of the distributee if (1) the distribution provides a benefit to the distributee which, if paid for by the distributee, would constitute payment of a QHEE or (2) the entire amount of the distribution is used to pay for the distributee's QHEEs. I.R.C. § 529(c)(3(B)(i) & (ii). Distributions that are includible in gross income are deemed to be made ratably from contributions and earnings under Section 529 of the Code, Section 72(e) of the Code, and the 1998 Proposed Regulations. The earnings portion of a distribution that is not used to pay QHEEs of the designated beneficiary is includible in the gross income of the distributee. In addition, there is a 10% additional tax imposed on any amounts of a distribution required to be included in gross income. I.R.C. § 529(c)(6). The amount of an individual's QHEEs must be reduced by the amount of any scholarships or grants received and by the amount of QHEEs taken into account in determining the amount of allowable American Opportunity Tax Credit and the Lifetime Learning Credit.

A distribution (or a portion of a distribution) will not be included in the gross income of the distributee if, within 60 days of such distribution, it is rolled over to another QTP for the benefit of the same designated beneficiary or for the benefit of a new designated beneficiary who is a member of the family of the previous designated beneficiary. A rollover for the benefit of the same designated beneficiary may occur only once every 12 months. "Member of the family" is defined in Section 529(e)(2) and Section1.529-1(c) of the 1998 Proposed Regulations. Be aware that under Section 1.529-3(c)(1) of the 1998 Proposed Regulations, any other change in the designated beneficiary will be treated as a distribution to the account owner, and includible in the gross income of the account owner, so long as the account owner had the authority to change the designated beneficiary under the QTP (which is the case under the Ohio Plan).

BACK TO SCHOOL: GIFT TAX TREATMENT

Any contribution to a QTP on behalf of a designated beneficiary is treated as a completed gift to such beneficiary that qualifies for the federal gift tax annual exclusion under Section 2503(b), and will not be treated as a qualified transfer, i.e., a direct payment of tuition, under Section 2503(e). I.R.C. § 529(c)(2)(A). Section 1.529-5(b)(1) of the 1998 Proposed Regulations states that such contributions will also satisfy the requirements of Code Section 2642(c)(2) and, therefore, is also excludible for purposes of the generation-skipping transfer tax.

If the aggregate amount of contributions by a donor in a particular calendar year exceeds the annual exclusion amount for that year, the donor may elect to treat the aggregate contribution amounts as having been made ratably over the five-year pe-

riod beginning with the calendar year of the contribution. I.R.C. § 529(c)(2)(B). This is the popular "front-loading" of five years of annual exclusions contributed at one time. The donor reports one-fifth of the contribution amount on a Form 709 for each of the five years, beginning with the year of the contribution. No other annual exclusion gifts are permitted to be made to or for the benefit of the designated beneficiary during the five-year period unless the annual exclusion amount increases during that time period. Contributions in excess of this front-loading amount will require the donor to use some of his or her gift tax applicable exclusion amount or pay gift tax if no exclusion amount is available. A donor and the donor's spouse may elect to gift-split the contributions under Code Section 2513.

In 2018, based on the annual exclusion amount, a contribution of $15,000 (or $30,000 if gift-splitting is elected) may be made to a designated beneficiary's account free of federal gift tax. A client interested in the front-loading option (and with the cash available to do so) can contribute up to $75,000 (or $150,000 if gift splitting is elected) in 2018 to an account on behalf of a designated beneficiary and treat the contribution as having been made ratably over the next five years starting with this year. Assuming for a moment that the annual exclusion amount remains at $15,000 in 2019, a supercharged option for clients is to contribute $15,000 (or $30,000) on December 31, 2018, and then contribute $75,000 (or $150,000) on January 1, 2019, in effect boosting the front-loaded amount by an additional annual exclusion without using any applicable exclusion amount or paying gift tax.

BACK TO SCHOOL: ESTATE TAX TREATMENT

The general rule is that the gross estate does not include the value of any interest in a QTP of any individual. I.R.C. § 529(c)(4)(A). One exception to this general rule is if the donor elects to treat contributions in excess of the annual exclusion amount as having been made ratably over a five-year period and the donor dies prior to the end of the five-year period. In that case, the gross estate of the donor will include the portion of such contributions allocable to periods (i.e., years remaining in the five-year period) after the donor's date of death. I.R.C. § 529(c)(4)(C). Also, the gross estate of a deceased designated beneficiary will include the value in the beneficiary's account or accounts at the time of the beneficiary's death. I.R.C. § 529(c)(4)(B).

BACK TO SCHOOL: ASSET PROTECTION

The Ohio Plan is one of nearly 30 QTPs that protect the assets held in plan accounts from the claims of creditors. Ohio Revised Code Section 2329.66 provides that every person domiciled in Ohio may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order as to the assets, interests and rights detailed in that Section. Section 2329.66(A)(1)(c)(10) was amended by the Ohio Asset Management Modernization Act of 2012, which took effect on March 27, 2013. Among other things, this Section provides that (1) a person's rights or interests in the assets held in, or a person's rights to directly or indirectly receive any payment or benefit under any 529 plan, and (2) contributions by any person into any plan, fund or account that is formed, created, or administered pursuant to or otherwise subject to Code Section 529, is exempt from creditors. These provisions appear to protect account assets from the creditors of the donor, the account owner, and the designated beneficiary.

CHANGES IN THE 2017 TAX ACT

The 2017 Tax Act made two significant changes to Section 529 of the Code. First, although beyond the scope of this article, I note that Section 529(c)(3)(C) of the Code was amended to permit 60-day tax-free rollovers from a 529 Plan account to an Achieving a Better Life Experience (ABLE) account as long as the ABLE account has the same designated beneficiary as the 529 Plan account or the ABLE account beneficiary is a member of the family of the designated beneficiary of the 529 Plan account. The rollover amount has to be accounted for in determining the contribution limits for ABLE accounts.

The second significant change is that the 2017 Tax Act added new Section 529(c)(7), titled "Treatment of Elementary and Secondary Tuition." This

new Section provides that the term "qualified higher education expense" shall include expenses for tuition for enrollment or attendance at an elementary or secondary public, private, or religious school. I.R.C. § 529(c)(7). The definition of QHEEs has also been modified to provide that the amount of distributions for tuition for elementary or secondary school tuition expenses is limited to $10,000 in each taxable year. I.R.C. § 529(e)(3). As long as these distributions are used for these tuition expenses, they will be tax-free up to the $10,000 limit.

There are a couple of points to consider when advising clients regarding taking distributions from a 529 Plan to pay for tuition at elementary or secondary schools. First, as mentioned earlier, one of the benefits of 529 Plans is the tax-deferred compounded growth in the account assets over time. Many clients choose one of the age-based investment options that start with a more aggressive asset allocation when the designated beneficiary is younger that automatically shifts to a more conservative allocation as the beneficiary approaches college age. A client may not wish to use assets of an existing 529 Plan account to pay for elementary or secondary school expenses because it will interrupt the tax-deferred compounded growth of the account assets. In addition, the account may be invested in an allocation mix that is still somewhat aggressive when the assets are needed for these tuition expenses. Instead, clients may want to consider establishing a separate 529 Plan account to cover elementary and secondary school tuition expenses because of the shorter time horizon before the funds are needed. Such an account would necessarily have a much more conservative investment strategy. Mutual fund rating company *Morningstar* suggests that target-based portfolios that have a fixed asset allocation may be more appropriate for these accounts. A target-based option that has an allocation mix similar to what an age-based portfolio would have when the beneficiary is 12-14 years old could provide a more conservative investment strategy.

The second point to consider is state related. Every state that sponsors a QTP has enacted its own laws governing that state's program and any related state tax benefits such as state income tax deductions or credits for contributions. Thirty-one states and the District of Columbia offer a state income tax deduction in varying amounts for contributions to their QTP. Indiana, Utah and Vermont, offer a state income tax credit for contributions. Nineteen states and the District of Columbia have state laws that conform the definition of QHEEs for state law purposes with the federal law definition. Thus, in these states and the District of Columbia, distributions to pay tuition for elementary and secondary school attendance are permitted, and the new federal law does not create any issues. For the remaining states that sponsor a QTP, including Ohio, state law does not conform with federal law in the definition of QHEEs. Thus, in these states, a distribution for elementary or secondary school tuition may be a nonqualified withdrawal for state law purposes. The consequences of such a nonqualified withdrawal in these states would likely be a recapture of any previous state income tax deduction (or in the case of Vermont, a recapture of a previous state income tax credit) claimed in addition to the earnings portion of such nonqualified withdrawal being subject to state income tax and, perhaps, a 10% additional tax or penalty as well. States are currently wrestling with this issue and how to address it.

The Ohio Legislature is addressing this issue. Senate Bill 22 is the annual bill that the Legislature passes to conform Ohio tax law with federal tax law. The original version of the Bill passed the Senate unanimously on February 8, 2018, but the Bill did not include conformity for the changes to Section 529 of the Code. The House amended the Bill to add conformity for the changes to Section 529 and passed the amended Bill on February 28, 2018. The amended Bill needs concurrence from the Senate before it can be presented to Governor Kasich for signature. The Senate's concurrence is expected soon. The Bill contains an emergency clause, so it will become effective immediately upon the Governor's signature.

CHANGES TO STATE LAW

Since the enactment of the Ohio Plan in 2001, Ohio Revised Code Section 5747.70 has provided for an Ohio income tax deduction for contributions to an account under the Ohio Plan. The deduction is limited to $2,000 per beneficiary per year. Sec-

tion 5747.70 further provides that if the combined annual contributions for a beneficiary exceed $2,000 in any taxable year, the excess may be carried forward and deducted in future taxable years until the contributions have been fully deducted. The Ohio Budget Bill provided some good news to Ohio residents who make contributions to accounts with the Ohio Plan by raising the annual deduction limit for contributions from $2,000 to $4,000 per beneficiary. In addition, the deduction in future years for annual contributions in excess of $4,000 per beneficiary remains in effect.

ADVISORS, PROTECTORS, DIRECTORS, OH MY: AN OVERVIEW OF THE UNIFORM DIRECTED TRUST ACT

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In 2017, the Uniform Law Commission (the "ULC" or the "Commissioners") approved the Uniform Directed Trust Act (the "UDTA" or the "Act"), intended to provide states with a framework to regulate the interrelationship between certain types of concurrently-serving fiduciaries of irrevocable trusts. Increasingly, certain duties and powers over the trust administration which were traditionally held by the trustee or given up entirely are, instead, granted under the terms of the governing trust instrument to additional officeholders who are neither trustees nor beneficiaries. They are referred to as "trust advisors," "trust protectors," "special trustees," "administrative trustees," and, in the nomenclature of the UDTA, "trust directors." For the balance of this article, I follow the Commissioners' terminology and refer to these auxiliary trust administrators as trust directors.

The ability to bifurcate the various duties required for a successful trust administration, or to provide additional authority to an independent third party that the settlor does not wish to grant to the trustee or to the beneficiary, has developed into a widely-accepted and powerful tool. It provides clients with structural flexibility in their trusts and increased assurance that their intentions will continue to be safeguarded for the life of the trust. The authorities granted to trust directors vary widely, including amending the terms an irrevocable trust in a variety of ways; altering beneficiaries' rights in the pursuit of income and transfer tax efficiency; increasing flexibility in distributions by restricting distributions when creditor concerns lurk or widening the gates under appropriate circumstances or both; overseeing the trustee's relationship with the beneficiaries; and any other power available under applicable law to settlors, trustees, or beneficiaries, limited only by the complexity of the settlor's wishes and the creativity of the drafting lawyer.

Section 808 of the Uniform Trust Code (the "UTC") contemplates the role of the trust director, but does not provide much in the way of substantive guidance to directed trustees and trust directors in navigating their complementary responsibilities, providing only that trustees are shielded from liability when acting pursuant to the instruction of a trust director unless doing so is "manifestly contrary" to the trust terms or the trustee knows that following the instruction would result in a "serious breach" of the trust director's fiduciary duty.[1] Moreover, the ULC itself found that no states have implemented that section of the UTC as proposed, and instead have imposed more objective standards.[2] This includes Ohio, which completely shields trustees from liability when acting pursuant to the instruction of a trust director, and vice versa.[3] Presumably in light of the fact that states have rejected the UTC approach, and considering the proliferation in the practice generally with regard to these segmented fiduciary relationships, the Commissioners undertook to reconsider the standard set forth in the UTC and to flesh out the mutual obligations and liabilities of directed trustees and trust directors in proposing the UDTA. Except where the UDTA supplants the existing law, the same background principles of fiduciary law apply to the directed trustee and to the trust director.[4]

Significantly, trust directors are fiduciaries under the UDTA, and therefore are subject to the same standards of performance as trustees charged with the same powers.[5] Likewise, the settlor may reduce