

# Briefly

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## College Savings Plan

# Oklahoma's 529 College Savings Plan

by Adam K. Marshall

**A** 529 college savings plan ("529 Plan")

is a college savings alternative that has become available in recent years to help you accomplish family education savings goals for higher education while providing other tax benefits. While numerous plans are offered in many states, and there is often no residency requirement to fund a 529 Plan in another state, state tax benefits may only be realized by state residents who fund 529 Plans in their home states. Therefore, the following focuses on the Oklahoma 529 Plan (officially known as the "Oklahoma College Savings Plan").



Adam Marshall

### General Benefits

A 529 Plan is similar to a 401(k) for college expenses. A 529 Plan allows an individual or entity (trust, corporation, partnership, etc...) (the "Account Owner") to regularly set aside money for the payment of college expenses on behalf of someone else. Earnings grow tax deferred and withdrawals are tax free if the money is used for qualified educational expenses. Contributions are not deductible on the contributor's federal income tax return, however, in Oklahoma a contributor may receive a tax deduction of \$10,000 per year, or \$20,000 for a joint return, and the

deduction can be carried forward up to five (5) years.

While there is an Oklahoma tax deduction maximum, there is no restriction on how much an Account Owner may contribute every year, unless the account is nearing the lifetime cap, which is \$270,000 in Oklahoma. However, annual contributions of more than \$11,000 (\$22,000 if contributing with a spouse) are subject to the gift tax. One caveat to the gift tax limit is that an Account Owner may contribute as much as \$55,000 tax free in one year (\$110,000 with your spouse), but such a contribution will be treated as if it were made in \$11,000 installments over the subsequent five (5) years.

### Investment Options

There are three investment options: (1) the Managed Allocation Option, (2) the 100% Equity Option, and (3) the Guaranteed Option. Each differs as to how much risk the Account Owner prefers to take, and the timeframe also varies until the beneficiary attends college.

The Managed Allocation Option is geared for people starting to save when the beneficiary is very young. The investment strategy is more aggressive while the child is younger, and grows more conservative as the child ages. This option is more appropriate for long term saving. The 100% Equity Option invests in various mutual funds. This is a higher risk option for the Account Owner, and

is recommended for long term investing. The Guaranteed Option offers a minimum annual return rate of 3%, with the opportunity for higher returns. This is a stable option appropriate for investors with a shorter investment period.

While the Account Owner selects an investment option upon opening the account, each time the Account Owner makes a deposit in the account, a different investment option can be selected, if desired. The investment option choice can also be changed for any portion of the account once per calendar year, or when the account beneficiary is changed.

### Investment Option Fees

Both the Managed Allocation Option and the 100% Equity Option charge an annual percentage fee for the maintenance of the accounts, while the Guaranteed Option does not charge a fee. The fee for the Managed Allocation Option is

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approximately 0.76%, and the fee for the 100% Equity Option is approximately 0.75%.

### Qualified Withdrawals

Qualified withdrawals are defined by law as college tuition, fees, cost of books, supplies and equipment, and in some cases, room and board. Room and board is included if it is incurred during an academic period where the beneficiary is enrolled at least half time. The amount allowable as a room and board expense is limited to the room and board allowance determined by the school for purposes of "cost of attendance" for financial aid purposes.

### Tax Benefits of the Account

For federal tax purposes, earnings from the account will not be included in the Account Owner's taxable income, and qualified withdrawals are exempt from tax. Qualified withdrawals do not count as income to the beneficiary for tax purposes.

Oklahoma tax benefits are the same as federal tax benefits listed above, with a few differences. For Oklahoma tax purposes, the account holder receives a tax deduction of \$10,000 per year, or \$20,000 for a joint return, and the deduction can be carried forward for up to 5 years.

### Tax Implications of

#### Non-Qualified Withdrawals

Non-qualified withdrawals are withdrawals that do not fall in a qualified withdrawal category. Non-qualified withdrawals subject the Account Owner to state and federal taxes for the earnings portion of the withdrawal, as well as a 10% additional tax. A partial exception to non-qualified withdrawals is withdrawing the money from the account because of the death or

disability of the beneficiary, receipt of a scholarship, or attendance at one of the U.S. military academies. In these instances, the additional tax will not be assessed, although the earnings on the withdrawal will still be taxed at the state and federal level.

If the beneficiary chooses not to go to school or drops out, the Account Owner may transfer the account to a new beneficiary in the family of the former beneficiary. If the account is transferred, there will be no penalty. However, if the account is not transferred to a new beneficiary, then any subsequent withdrawing of money from the account would be a non-qualified withdrawal subject to Oklahoma and federal taxes and the 10% penalty.

There is no mention in the Oklahoma statutes regarding recapturing the prior tax deduction if there is a non-qualified withdrawal from the account. According to Oklahoma statutes, the Board of Trustees of the Oklahoma College Savings Plan ("Board") may withhold up to 5% of the account as a penalty for a non-qualified withdrawal. However, this penalty is not mentioned in the Oklahoma College Savings Plan's official Disclosure Booklet and Participation Agreement (found at [http://www.ok4saving.org/pdf/ok\\_discl.pdf](http://www.ok4saving.org/pdf/ok_discl.pdf)), therefore, it appears the Board has not chosen to exercise its authority at this time.

### Protection From Creditors

Pursuant to Oklahoma law, any interest in an Oklahoma College Savings Plan Account held by an Oklahoma resident shall generally be exempt from attachment or execution and any other type of forced sale for the payment of debts in Oklahoma.

Under the new changes to the bankruptcy laws, the account is protected if a certain number of

criteria are met. The account holder would have to file for bankruptcy after October 17, 2005, the beneficiary must be a child, stepchild, grandchild, or step-grandchild of the account holder and the funds must have been contributed at least 365 days before the filing. However, the account is not completely protected. Only \$5,000 of the amount contributed to the account between 365 and 720 days before filing is protected. Contributions made more than 720 days before the filing are protected, as long as the amount in the account is not greater than the maximum account limit, currently set at \$235,000.

### In & Out Strategy

An Oklahoma 529 Plan may be utilized to take advantage of the state tax deduction without necessarily isolating a large sum of money in the plan. Money could go "in" to the plan and immediately "out" to pay qualified college expenses and you could still claim the Oklahoma tax deduction. While this strategy obviously does not take advantage of the tax-free growth benefit of a 529 Plan, it demonstrates the flexible advantages offered by such plans.



### Important Announcement

Beginning June 1, 2006, we will begin destroying all litigation files in our possession for cases closed prior to 1995. If our Firm represented you in litigation that closed prior to 1995 and you would like to review any such files and/or obtain them for your personal records, please do not hesitate to contact us.

# Changes to the Oklahoma Property Exemptions and Major Overhaul of the Bankruptcy Code

by Brad Heckenkemper

2005 was a very busy year for Legislators at both the federal and state level regarding changes to the Bankruptcy Code and property exempt from creditors in Oklahoma. Some of the significant changes at both the federal and state level are highlighted below for your information.



Brad Heckenkemper

## Bankruptcy

After numerous attempts by large banks and credit card companies, the lobbying efforts were finally successful in the United States Congress, resulting in President Bush signing into legislation the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act"). Most of the provisions became effective October 17, 2005, and we have already seen the dramatic effect of its unintended consequences. Before the effective date of October 17, tens of thousands of individuals across the nation filed for bankruptcy to obtain a complete discharge of all their creditors' claims. What started as a raging river of bankruptcy filings, immediately reduced to a slow drip of new filings after October 17th. The new Bankruptcy Act has several provisions which we believe may impact our clients for estate and wealth preservation, as well as being creditors in future bankruptcy proceedings.

Significant changes occurred in the following areas: (1) Change in homestead exemption;

(2) Reaffirmation Agreements;

(3) Retirement savings accounts;

(4) Creditor Reclamation Claims;

(5) Protection of creditors from preference claims; and other areas.

Most notably, the change to homestead exemption is a substantial change from the past. The new Act now restricts your ability to elect your home state's homestead exemption. Generally, if you use the Oklahoma homestead exemption, the entire value of your home is exempt, and up to 160 acres, unless you live in the city limits on a lot that is more than one acre. Now, however, you will be forced to use the Bankruptcy Act's homestead exemption if you did not own your residence for more than 1,215 days before filing bankruptcy. The Act provides a very technical analysis to determine how much of an

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exemption a homeowner is entitled to receive. The least liberal exemption would limit most homeowners to a \$125,000 exemption of the value of their home. However, if you owned your home for more than 1,215 days prior to filing bankruptcy, you might be entitled to an unlimited exemption under the state's exemption's. Other considerations are also involved, capping the exemption at \$125,000 for individuals having violated securities laws or certain criminal conduct. Apparently, Congress was

bound and determined not to allow corporate executives to raid companies like MCI, Enron and others, just to pour millions of dollars into real property that would be totally exempt from creditors.

Another important area for clients to be concerned is their retirement savings accounts. The Act clarifies all retirement accounts which are tax exempt under the IRS Code, are exempt from creditors. HOWEVER, the Act caps the exemption for IRAs to \$1 million. Accordingly, if you are a participant in an employer-sponsored retirement account and leave the company's employment, you may wish to obtain advice of counsel before deciding whether to roll over your retirement account into an IRA, as you may be limited to the \$1 million exemption from creditors' claims.

Real estate leases for residential rental agreements have also been affected. Under certain conditions, landlords are protected from the automatic stay when a debtor files bankruptcy. In certain instances, the landlord may be able to proceed with eviction actions without first obtaining relief from the automatic stay in bankruptcy court, which in the past has caused a substantial delay and been very costly for landlords trying to evict tenants.

Additional relief may also protect creditors from preference actions filed by Bankruptcy Trustees. Under previous law, a creditor was required to perfect any security interest in collateral within 20 days of making a loan, regardless of what the state statutes provided. For instance, if a bank made a loan for a new car and failed to perfect its lien within 20 days, even

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if the state statute provided perfection was allowed within 30 days, the Bankruptcy Trustee could sue the Bank by filing a preference action to avoid the creditor's lien. If the lien was set aside, the collateral became property of the estate and the Bank became an unsecured creditor.

The new act extends the time for perfecting liens on collateral to 30 days. Hopefully, this will avoid a substantial amount of bankruptcy litigation and allow secured parties to retain their collateral.

Creditor's reclamation claims for inventory and goods delivered to someone filing bankruptcy soon after the goods were delivered have also been affected under the new Act. The new Act now extends the period for reclamation claims to goods delivered within 45 days of the bankruptcy being filed. A creditor has 20 days from the commencement of the case to file its reclamation claim.

The Act also provides changes to reaffirmation agreements. Commonly, debtors with leases

or secured loans will enter into reaffirmation agreements to cure any default and continue the agreement after the bankruptcy on a go-forward basis.

The new Act now contains extensive new disclosures which require setting out the details of the debtor's rights, specifying the amount of the debt reaffirmed, the interest rate, payment terms, and including a certification that the reaffirmation agreement does not impose an undue hardship on the debtor.

An unintended result of the new Bankruptcy Act will result in the unsecured creditors and credit card companies receiving less on their claims because more of the debtor's income will be applied to secured and lease payments under these reaffirmation agreements.

#### Oklahoma Exemptions

State exemptions have also undergone a change in Oklahoma. Generally, your principal residence

is exempt from creditors, except purchase money mortgages, taxes and materialmen's liens for work on the property. The legislature increased the size of residential lots inside the city limits which are generally exempt, from 1/4 acre to 1 full acre. However, for residential lots in the city limits, some additional restrictions may apply in determining the amount of exemption.

Other changes to the amount of exemptions individuals may claim to avoid payment to creditors, include: (1) placing a cap on value of a person's tools of the trade used in their profession at \$10,000; (2) a person's interest in wedding rings and anniversary rings not to exceed \$3,000; (3) increasing the exemption in the value of a motor vehicle to \$7,500; and (4) exempting the entire amount of a debtor's interest in individual retirement plans and other qualified tax-deferred retirement accounts from creditors.



## Estate Planning

# Estate Planning Under the New Tax Law

by William E. Farrior

The Tax Relief Act of 2001 made estate tax planning considerably more challenging. The federal estate tax exemption has increased to \$2,000,000 in 2006 and the estate tax rate has decreased slightly to 46%.

There will be another increase in the amount of the estate tax exemption to \$3,500,000 in 2009, and the federal estate tax will be repealed in 2010, but only for one year. Due to



Will Farrior

budget requirements, the rules on estate tax will revert in 2011 to those before enactment of the Tax Act (\$1,000,000 in 2011). Congress is expected to intervene with a permanent exemption.

Clients with "A and B" Trusts (also called Bypass or Credit Shelter Trusts) will need to review the size of their estates and the effect the increase in the federal exemption will have on formula clauses which use the maximum exemption. The objective will be to balance the marital share and the family share to take full advantage of the new estate tax

laws with proper planning for the special needs of the family.

Planning to save on Oklahoma estate taxes will still be a factor, even if federal estate taxes are avoided or eliminated. The Oklahoma estate tax exemption reached \$1,000,000 in 2006 for lineal heirs only, and there are no more scheduled increases for the state estate tax exemption. Your present estate plan, therefore, should not be discarded, but should be fine-tuned to take full advantage of the increasing federal estate tax exemption while providing for your heirs in the process.



# Oklahoma Capital Gains Tax Exclusion

by Chris A. Barrow

The Oklahoma personal income tax on capital gains resulting from a sale of Oklahoma based property that is held for five years or more (three years in the case of an Oklahoma company) was eliminated for tax years beginning in 2005. A deduction from the Oklahoma adjusted gross income of any individual taxpayer is allowed for qualifying gains receiving capital treatment and included in Federal taxable income of the taxpayer.



Chris A. Barrow

The "qualifying capital gains treatment" means the amount of net capital gains, as defined by the Internal Revenue Code, earned by the taxpayer from: (i) the sale of real or tangible personal property located within Oklahoma that has been owned by the taxpayer for at least five years prior to the date of sale, or (ii) the sale of stock or the sale of an ownership interest in an Oklahoma company, limited liability company, or partnership where the stock or ownership interest has been owned by the taxpayer for at least three years prior to the sale. The "holding period" means an uninterrupted period of time. An "Oklahoma company, limited liability company, or partnership" means an entity whose primary headquarters has been located in Oklahoma for at least three uninterrupted years prior to the date of the transaction from which the capital gains arise.

**EXAMPLE 1.** You purchased land in Oklahoma more than 5 years ago for \$150,000. If you sell the land in 2006 for \$300,000, you would not owe any Oklahoma income tax on the \$150,000 capital gain. The resulting

Oklahoma income tax savings would be approximately \$10,000.

**EXAMPLE 2.** You purchased stock in an Oklahoma company more than 3 years ago for \$100,000. If you sell the stock in 2006 for \$400,000, you would not owe any Oklahoma income tax on the \$300,000 capital gain. The resulting Oklahoma income tax savings would be approximately \$20,000.

Effective January 1, 2006, the elimination of capital gains tax was extended to apply to Oklahoma based property owned by the individual taxpayer indirectly, that is, through a pass-through entity (or chain of pass-through entities). However, certain conditions must be satisfied for the deduction to apply. With respect to the sale of real or personal property located within Oklahoma, the pass-through entity making the sale must have held the property for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gains, and each pass-through entity in the chain of ownership must have been a member, partner, or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than five (5) years. With respect to sales of stock or ownership interest in an Oklahoma company, limited liability company, or partnership, the pass-through entity making the sale must have held the stock or ownership interest for not less than three (3) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership must have been a member, partner or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than three (3) years.

**EXAMPLE 3.** You are a partner in ABC, L.P., an Oklahoma limited partnership, which purchased land in Oklahoma more than 5 years ago for \$150,000. If ABC, L.P. sells the land in 2006 for \$300,000, the partners would not owe any Oklahoma income tax on the \$150,000 capital gain. The resulting Oklahoma income tax savings would be approximately \$10,000.

**EXAMPLE 4.** You are a partner in ABC, L.P., an Oklahoma limited partnership, which purchased stock in an Oklahoma company more than 3 years ago for \$100,000. If ABC, L.P. sells the stock in 2006 for \$400,000, the partners would not owe any Oklahoma income tax on the \$300,000 capital gain. The resulting Oklahoma income tax savings would be approximately \$20,000.

Please let us know if we can assist you in determining whether you qualify for the new capital gains exclusion for individual taxpayers.



## Thought of the Day

"A fanatic is one who can't change his mind and won't change the subject."

— Sir Winston Churchill

*Briefly* is published for the clients and friends of Barrow & Grimm, PC. Its intent is to address current trends and issues as they relate to business, personal and legal concerns.

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## IN BRIEF...

- William R. Grimm is currently serving as the 2006 President of the Oklahoma Bar Association. Also, he recently was awarded two of the Sigma Chi International Fraternity's most prestigious and highest honors – the Significant Sig award for his achievements in the legal profession and induction into the Order of Constantine for his outstanding service to the fraternity.
- Robert B. Sartin is currently serving in his second year of a 3-year term on the Oklahoma Bar Association Board of Governors. He also serves as Chairperson of the Advisory Board of OU-Tulsa
- William E. Fariior is currently serving as Treasurer of the Tulsa County Bar Association. He was also named to the Board of Trustees of St. Simeon's Episcopal Home in Tulsa.
- Wm. Brad Heckenkemper has been appointed to serve on the Oklahoma Court of the Judiciary.
- Matthew S. Farris has passed the February 2006 Oklahoma Bar Exam and will join the firm as an associate upon his swearing in on April 21, 2006, before the Oklahoma Supreme Court. Mr. Farris received his J.D. from the University of Tulsa in August 2005. He has been serving as a full-time legal intern with Barrow & Grimm since his graduation. He received his B.S. in Finance, cum laude, from the University of North Carolina Greensboro in 1999.



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The articles presented in *Briefly* are not complete discussions of all legal issues. Because recommendations will vary in every situation, please request a personal legal consultation.



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