THE GIFT THAT KEEPS ON GIVING

WhittierTrust

How 529 Plans Can Benefit Your Estate Plan

A 529 Plan is a savings account for college and, in some cases, K-12 education, depending upon the state plan that is selected. With the cost of college and private schools soaring, creating a 529 Plan for kids to ease that financial burden is a wonderful way to assist family members and friends.

"For our clients, gifting to 529 Plans serves as a great estate planning tool and offers some unique benefits," says Alec Gard, client advisor at Whittier Trust. He outlines how below.

The Major Benefits of 529 Plans to Investors

The funds in these savings plans grow tax deferred, similarly to that of IRA's and 401(k) plans. Yet unlike IRAs and 401Ks, 529 plans have unique funding options, the most advantageous of which is the '5-year election' (often called "superfunding"), which allows you to contribute five years' worth of the current annual exclusion by prorating the amount contributed over 5 years. The annual exclusion is the amount of money one person may transfer to another as a gift without such gift counting against the lifetime exemption from federal gift and estate tax. The annual exclusion amount for 2023 is $17,000 per individual.

"For example, in 2023, you could fund a new 529 Plan with $85,000, which is $17,000 times five years of annual exclusion. If you and your spouse both elect to give, then you each can contribute up to $85,000 to that same 529 Plan, thus potentially superfunding it with $170,000 in the first year of being opened," Gard says.

The funds contributed to the 529 Plan, along with any future growth, will now be out of your estate. If you're able to superfund vs. gifting one year of annual exclusion, you can put more tax-deferred money to work faster. "You can quickly see the benefits, especially if you have a large family and are inclined to help," says Gard.

Another option available for individuals is contributing the maximum funding amount allowable for the selected 529 Plan. For example, some state plans allow for a maximum funding amount of $550,000. This means that a husband and wife could elect to give $275,000 each in the first year of funding. This strategy is also very effective; however, it will utilize a portion of each spouse's lifetime exemption. This is the amount of money each person in the U.S. can exclude from estate and gift taxes. In 2023, the lifetime exemption amount per person is $12.92 million. Each spouse receives the same amount of exemption for a total of $25.84 million. It is important to note that the lifetime exemption amount per individual is scheduled to sunset at the end of 2025. When this happens, the lifetime exemption amount per individual would drop to $5,000,000 (indexed for inflation). There have been no current legislation proposals to keep the current lifetime exemption amounts past 2025, so it appears the plan laid out in the 2017 Tax Cuts and Jobs Act may take effect.

He adds, "Using lifetime exemption is not necessarily a bad thing, especially at these high levels, but if you intend to preserve your exemption for larger future gifts, the '5-year election' may be the better option."

How Beneficiaries Benefit from 529 Plans

The first major benefit is that it's the most flexible savings plan for college, unlike other savings plans that have more restrictions around funding and use. When money is taken out of a 529 Plan to be used for qualified education expenses, such as college tuition, fees, books, equipment and room and board (if enrolled in college at least half-time), the funds are not subject to federal or state taxes. If a 529 Plan allows for K-12 education (not all do), the beneficiary can also withdraw up to $10,000 annually for qualifying expenses.

Each 529 Plan can only have one beneficiary. However, multiple 529 Plans can be opened by different individuals for the same person. For instance, a grandparent and a parent could have opened separate 529 Plans for their grandchild/child over time. It is worth noting that the plans are viewed as combined for funding and use purposes.

"If an individual does not utilize the funds in their 529 Plan, the funds may remain invested and can be used in several other ways," Gard says.

As the plan owner, you could elect to change the beneficiary to yourself and use the plan for your own education expenses. Alternatively, the plan owner could name a different beneficiary within his or her family (once the plan is established, it cannot be gifted to anyone outside of the family).

For instance, if a 529 Plan was opened by a mother to benefit her son, but the son decides not to attend college or goes to college but does not use the full balance of the 529 plan, the mother, as the owner, could name her grandchild as the new beneficiary. There may be generation-skipping tax implications with this change, so it is always best to consult your tax professional for advice.

Common Misconceptions About the Savings Plans

A common misconception is that 529 Plans can only be set up for family members. However, you can contribute funds to a 529 Plan for the benefit of anyone with a valid Social Security Number.

"This can be another great opportunity if you are feeling generous toward non-family members. You do not have to open the 529 Plan yourself but can coordinate with the person or parents of the person that you would like to benefit and either contribute to the newly established 529 Plan or one that has already been opened," says Gard.

The Potential Downside to This Financial Investment Strategy

There is a chance that a 529 Plan is created for someone who neither uses it for education (perhaps they don't go to college) nor has a child who can use it. If funds are withdrawn by the owner and are classified as "non-qualified withdrawals," the earnings will be assessed state and federal taxes, as well as an additional 10% penalty.

Disclaimer

It is important to note that rules, maximum contribution limits, investment options as well as fees vary per 529 Plan offered by the state. Most states offer a 529 plan, but to determine the best plan for you and your family, please consult with your financial advisor and tax professional.

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