Expanded 529 plans offer unique estate planning benefits

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If you're putting aside money for college or other educational expenses, consider a tax-advantaged 529 savings plan. Also known as "college savings plans," 529 plans were expanded by the Tax Cuts and Jobs Act ("TCJA") to cover elementary and secondary school expenses as well. While these plans are best known as an educational funding vehicle, they also offer estate planning benefits.

What do 529 plans cover?

529 plans allow you to contribute a substantial amount of cash (lifetime contribution limits can reach as high as $350,000 or more, depending on the plan) to a tax-advantaged investment account. Like a Roth IRA, contributions are nondeductible, but funds grow tax-deferred and earnings may be withdrawn tax-free provided they're used for "qualified education expenses."

Qualified education expenses include tuition, fees, books, supplies, equipment, room and board and, under the TCJA, up to $10,000 per year in elementary or secondary school expenses. Earnings used for other purposes are subject to income tax and a 10% penalty.

What are the estate planning benefits?

These plans are unique among estate planning vehicles. Ordinarily, to shield assets from estate taxes, you must permanently relinquish all control over them. But contributions to a 529 plan are considered "completed gifts" — which means the assets are removed from your taxable estate, together with all future earnings on those assets — even though you retain considerable control over the money. For example, unlike most other estate planning vehicles, you can control the timing of distributions, change beneficiaries, move the funds into another 529 plan, or even cancel the plan and get your money back (subject to taxes and penalties).

As a completed gift, a 529 plan contribution is eligible for the annual gift tax exclusion (currently $15,000). But unlike other vehicles, you can bunch up to five years' worth of annual exclusions into one year. This allows you to contribute up to $75,000 in one year, without triggering gift or generation-skipping transfer (GST) taxes and without using up any of your lifetime exemption. There are implications, however, if you don't survive the five years.

Why does it matter?

You might think that these benefits are of little value now that the TCJA has temporarily doubled the lifetime gift and estate tax exemption to an inflation-adjusted $10 million ($20 million for married couples who design their estate plans properly). This year, the exemption amount is $11.4 million ($22.8 million for married couples).

After all, few families are currently affected by these taxes. But it's still a good idea to shield wealth from potential estate taxes and to make the most of your annual exclusion. This is because the new exemptions are scheduled to return to their previous levels after 2025 and there's nothing to stop lawmakers from reducing the exemption in the future. 529 plans and other traditional estate planning tools provide some insurance against future estate tax changes.

Please contact us to learn more about how a 529 plan can help achieve your estate planning and education goals.

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