Family Education Trusts
Leave A Lasting Legacy For Your Heirs

Providing for the educational needs of your children, grandchildren and even future generations is an honorable estate planning objective. What are your options for achieving this goal? A 529 plan can be a highly effective tool for funding tuition and other educational expenses on a tax-advantaged basis. But after your death, there's no guarantee that subsequent plan owners will continue to use it to fulfill your original vision. An alternative strategy is to create a family education trust that invests in one or more 529 plans.

529 Plan Flexibility

529 plans are state-sponsored investment accounts that permit parents, grandparents or other family members to make substantial cash contributions (up to $400,000 or more, depending on the plan). Contributions are nondeductible, but the funds grow tax-free and earnings may be withdrawn tax-free for federal income tax purposes (plus state tax breaks in some cases) provided they're used for qualified education expenses.

Qualified expenses include tuition, fees, books, supplies, equipment, and some room and board at most accredited colleges and universities and certain vocational schools. In addition, 529 plans can be used to pay up to $10,000 per year per student for elementary and secondary school tuition. Note that there may be state tax implications with using plan funds for items unrelated to higher-education expenses.

Contributions to 529 plans are removed from your taxable estate and shielded from gift taxes by your lifetime gift and estate tax exemption (currently $11.7 million) or annual exclusions ($15,000 per recipient). If gift taxes are a concern, you can accelerate up to five years' worth of annual exclusions into a single year, allowing you to make nontaxable contributions up to $75,000 per beneficiary in year one rather than spreading them over five years.

529 plans offer the owner a great deal of flexibility. For example, depending on the plan's terms, owners have control over the timing of distributions, can change beneficiaries from one family member to another and can roll the funds over into another state's plan tax-free (limited to once a year). It's even possible to recover funds that won't be used for education expenses (subject to taxes and, in most cases, a 10% penalty).

In addition to the risk that a subsequent owner will use the funds for noneducational purposes, disadvantages of 529 plans include relatively limited investment choices and an inability to invest assets other than cash.

Transfer A 529 Plan To A Trust

Establishing a family education trust to hold one or more 529 plans provides several significant benefits:

- It permits you to maintain tax-advantaged education funds indefinitely (depending on applicable state law) to benefit future generations and it keeps the funds out of the hands of those who would use them for other purposes.
- It allows you to establish guidelines on which family members are eligible for educational assistance and direct how the funds will be used or distributed in the event they're no longer needed for educational purposes. You can also appoint trustees and successor trustees to oversee the trust.
- It can accept noncash contributions and hold a variety of investments and assets outside 529 plans. For example, the trustees might invest in hedge funds, private equity funds, life insurance or other alternative investments if they conclude that the increased returns would outweigh the tax cost.

A family education trust can also use funds held outside of 529 plans for purposes other than education, such as paying medical expenses or nonqualified living expenses.

Turn to the professionals

Leaving an education legacy for your loved ones and future heirs requires considerable planning but can be incredibly fulfilling for you and beneficial for your family. Turn to your estate planning advisor for guidance in creating a family education trust.

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