

Creating an education legacy using a family education trust

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For many people, an important goal of estate planning is to leave a legacy for their children, grandchildren and future generations. What better way to do that than to help provide for their educational needs? A 529 plan can be a highly effective tool for funding tuition and other educational expenses on a tax-advantaged basis. But when the plan's owner (typically a parent or grandparent) dies, there's no guarantee that subsequent owners will continue to use it to fulfill the original owner's vision.

To create a family education fund that lives on for generations, a carefully designed trust may be the best solution. But trusts have a significant drawback: Unlike 529 plans, the earnings of which are tax-exempt if used for qualified education expenses, trusts are subject to some of the highest federal income tax rates in the Internal Revenue Code.

One strategy for gaining the best of both worlds is to establish a family education trust that invests in one or more 529 plans.

Plan basics

529 plans are state-sponsored investment accounts that permit parents, grandparents and other family members to make substantial cash contributions. Contributions are nondeductible, but the funds grow tax-free and earnings may be withdrawn tax-free for federal income tax purposes provided they're used for qualified education expenses.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. Contributions to 529 plans are removed from your taxable estate and shielded from gift taxes by your lifetime gift and estate tax exemption or annual exclusions.

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.

Holding a 529 plan in a trust

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

- It allows you to maintain tax-advantaged education funds indefinitely (depending on applicable state law) to benefit future generations and 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, direct how the funds will be used or distributed in the event they're no longer needed for educational purposes, and 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.

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

Plan carefully

If you're interested in setting up a family education trust to hold 529 plans and other investments, contact us. We can help you design a trust that maximizes educational benefits, minimizes taxes and offers the flexibility you need to shape your educational legacy.

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