Dynasty 529 Plans

FUNDING EDUCATION FOR GENERATIONS TO COME

PATHSTONE
THE FAMILY OFFICE℠

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SEPTEMBER 2023

The academic year has begun, and with the new season it's a logical time to reassess planning for educational expenses. Typically, 529 plan funding is handled by a parent or grandparent with the goal of simply covering the costs of each of their children or grandchildren. For those with the means and interest in doing so, however, a relatively new concept referred to as Dynasty 529 Planning can be used to cover qualifying expenses for extended family and across multiple generations.

While there are limitations and risks, a Dynasty 529 strategy can be a very attractive wealth planning tool with the potential to create a powerful family legacy.

This note provides a simplified overview of the Dynasty 529 concept. For extended or multigenerational families, discussions of goals, strategy, reach, and the like can be quite complex and entail considerations much deeper than financial objectives. Our goal in sharing this information is to stimulate conversations around those complexities.

How Dynasty 529 Planning Works

TAX HIGHLIGHTS:

- There are no gift tax consequences when changing beneficiaries of a 529 plan if the change is to an eligible family member of the same generation.
- It is considered a taxable gift if the beneficiary is changed to a family member one generation or more removed from the current beneficiary.
- The "Generation-Skipping Transfer Tax" (GSTT) applies when transfers are made to family members who are at least two generations younger than the current beneficiary.
- Ownership of a 529 plan can be changed to anyone, not just immediate family members (in most states), and there are no transfer tax consequences for change of ownership.

OWNERSHIP CONSIDERATIONS:

An individual who wants to cover the education costs for multiple generations will open 529 plans with themselves as the owner. There are a number of things to consider when opening these plans:

- The owner should name the youngest possible beneficiary. This is because of the gift tax consequences if the beneficiary is changed to a family member one or more generations younger than the original beneficiary – this is in addition to the GSTT noted above if they are two or more generations younger. The beneficiary can be changed later to a family member in an older generation without any gift tax consequences.

- Opening and contributing to multiple 529 plans for eligible family members can help to minimize taxable gifts. The owner can later combine the accounts as needed within the guidelines cited above.
- However, owners must be mindful of the “step transaction” doctrine, which may view separate actions designed to achieve a single result as a single transaction. For example, if you fund two separate 529 accounts for different beneficiaries and immediately combine the accounts, the IRS may deem this as funding one account, resulting in a taxable gift if the total amount exceeds that year’s gift tax exclusion.
- 529 plan rules and policies differ by state. When choosing which 529 plan to open:
  - look for plans with higher maximum contribution limits,
  - consider the plan’s policies around a change in ownership, and
  - place more emphasis on investment options and fees versus any state tax benefits.

Risks

- Higher education could be made available at low to no cost (unlikely, but possible).
- The rules and regulations for 529 plans could change.
- Once the plan owner is changed from the original owner, it is difficult to enforce how the funds in the 529 plan are used. The new owner could decide that they would rather withdraw some or all the funds. This would result in taxes and penalties to the new owner, but they would still have more money than they started with.

The Role of Trusts in Dynasty 529 Planning

Trust-owned 529 plans are a way for the original owner to ensure that the funds are used for education only. The owner would create the new trust with themselves as the current trustee and can designate the future trustees. The trustee is the owner of the 529 plan. Since the trustee is a fiduciary bound to act by the terms of the trust, this eliminates the risk of the funds being used for something other than education. There should be language in the trust to specifically authorize 529 plan duties such as 529 plan selection, investment decisions, beneficiary designation, etc. Using a trust also allows the trustee to transfer funds to other beneficiaries without transfer tax implications. While the creation of the trust would be costly upfront, it would eliminate the worry that the funds will not be used in the way the original owner intended.

Next Steps

As with any significant decision regarding legacy planning, the design and execution of a Dynasty 529 Strategy requires thoughtful analysis. For clients, your Pathstone advisor can facilitate those discussions in the context of your overall strategy, calling upon the expertise of our tax and wealth planning teams.

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