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Giftng With A 529 Plan

Section 529 of the Internal Revenue Code provides an excellent mechanism for saving for the costs of higher education for our children and grandchildren. Funds put away when a child is young are likely to grow significantly especially as the income generated escapes federal income tax and many states, including New York, allow deductions for contributions to a 529 Plan. 529 Plans are offered in all 50 fifty states and there is no residency requirement for the establishment of a 529 Plan. Investment minimums are usually very low and must be made in cash. Contributions in excess of the amount that is reasonably necessary to provide for the higher education expenses of the beneficiary are prohibited. Because state plans vary so widely, it is important to shop for the best plan for your family.

Often, clients are concerned that they may save money for a particular child who later does not, for whatever reason, continue with his or her schooling, or that money will remain in the account after the beneficiary completes his or her education. 529 Plans are very flexible. The beneficiary can be changed at any time and for any reason as long as the new beneficiary is a “member of the family” of the current beneficiary, a term which is very broadly defined and includes: the mother or stepmother, father or stepfather, grandparents, son, daughter, stepchildren, siblings or step-siblings, nieces or nephews, spouse or spouses of any of the above!

The money in the 529 Plan may be withdrawn at any time. However, if the withdrawal is not used for a “qualified higher education expense,” the earnings are taxed as ordinary income to the distributee, either the account owner or the beneficiary, and a ten percent (10%) penalty is imposed on the amount withdrawn. This penalty is waived if the withdrawal follows the death or disability of the beneficiary. “Qualified higher education expenses” include tuition for college or vocational training, fees, books, supplies and equipment. If the beneficiary is an “eligible student,” one who carries at least half of the normal full-time work load, room and board may also constitute a qualified expense.

From an estate planning standpoint, the funds contributed to a 529 Plan are generally not includible in the estate of either the donor or the beneficiary for federal estate tax purposes. Moreover, contributions qualify for the annual \$11,000 gift tax exclusion and, to maximize the potential growth of the account, the donor can “pre-fund” the 529 Plan by making a gift of up to \$55,000 in any one year provided that no further gift is made to the beneficiary during the next four years. It is very important to coordinate gifts to a 529 Plan with other annual gifting.

For Medicaid planning purposes, the funds that are contributed to a 529 account are considered available resources of the donor because the donor has the continuing ability to withdraw funds, albeit with a penalty. Even funds contributed many years before a nursing home placement may not be protected and may cause an applicant to be disqualified for Medicaid benefits. Instead, a 529 Trust can be created as part of the planning strategy. By its terms, a 529 Trust prohibits the contributor from withdrawing the contribution. This can make the assets unavailable for Medicaid purposes.