TAX, TRUSTS & ESTATES LAW MONITOR
UPDATES AND COMMENTARY ON BUSINESS AND INDIVIDUAL TAX AND ESTATE PLANNING

PUBLISHED BY
COLE SCHOTZ
COLE, SCHOTZ, MEISEL, FORMAN & LEONARD, P.A.

529 Plan or General Gifting Trust - Which is the Right Vehicle for Your Gifts?

Posted at 8:27 AM on June 6, 2011 by Gary A. Phillips & Steven M. Saraisky

Gifting is an integral part of estate planning and the incredible rise of education costs has made gifting to fund educational expenses an important consideration for many families.

One common technique implementing this planning is the creation of a 529 Plan for a benefit of a child or grandchild. After-tax dollars are contributed to these accounts which then grow federal income tax free for the benefit of the beneficiary of the account. The funds must be used for college tuition and related expenses. If the beneficiary does not use all the funds, the beneficiary can be changed to another child. To the extent funds are used for non-educational purposes, they are subject to income tax and a 10% penalty on the earnings of the account. The penalty can be avoided if the beneficiary dies, becomes disabled or receives a scholarship.

529 Plans are limited in that they only can provide for higher education expenses. An alternative to a 529 Plan is the creation of an irrevocable gifting trust to be the recipient of gifts for your beneficiaries. The gifting trust can permit the trustee to make distributions to the beneficiary (i.e. a child or grandchild) not

only for college, but for other educational needs, health, maintenance, support or any other legitimate reasons, such as a down payment on a house or to start a business. The trust could extend out for a term of years (i.e., until the beneficiary attains age 35), or can even be for the lifetime of the beneficiary. While the trust is irrevocable so that it is not included in the donor's estate, it can be drafted in a very flexible manner to permit distributions over a longer period of time. In this way, the donor (through the trustee) maintains control over the distribution of the assets

The major disadvantage to the gifting trust when compared to the 529 Plan is that the funds in the trust do not grow income tax free. Each year, to the extent income is not distributed, the trust will be required to pay income tax on its earnings.

Lastly, it is also important to note that a donor can pay for a child or grandchild's educational expenses directly as a tax-free gift, which is in addition to (and not limited by) the $13,000 per donee per year gift tax annual exclusion.

When considering gifts to minors and other beneficiaries for educational purposes, it is important to consider 529 Plans and their tax benefits and compare this to the advantages of a gifting trust and its flexibility to make a wider range of distributions to make an informed decision as to which approach is more appropriate.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone: (201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone: (212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone: (302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone: (410) 230-0660

301 Commerce Street
Suite 1700
Fort Worth, TX 76102
Phone: (817) 810-5250