

## Trust Owned 529 Accounts- Basics (Part I)

**Take-Away:** If an irrevocable trust owns 529 accounts for some of its beneficiaries, the trust instrument should have specific powers to guide the trustee in its administration of the 529 accounts.

**Background:** A trustee can establish and own 529 accounts. As the owner of the 529 account, the trustee will possess the power: (i) to select the account's designated beneficiary; (ii) to change the designated beneficiary; (iii) to decide how the account funds are to be used; and (iv) to receive distributions from the account if there is no designated beneficiary. As the account owner, the trustee is responsible to make distributions, and if those distributions are for *qualified education expenses* [Regulation 1.529-2(e)(4)(ii)(A)] no federal income tax will be payable with respect to those distributions. In contrast, if distributions from the 529 account are not made towards *qualified education expenses*, the earnings portion of the withdrawal from the account are subject to income tax as ordinary income [IRC 529(c)(3)(A)] along with a 10% penalty. [IRC 529(c)(6).] Given the tax benefits associated with a 529 account, and the possible exposure to penalties for distributions not used to pay *qualified education expenses*, the trustee needs to proceed with some care and ask for exoneration for many of its decisions administering a 529 account

**Trust Owned 529 Accounts:** If a trust is intended to hold and control 529 accounts for its beneficiaries, the trust instrument should contain specific provisions to assure that the trustee has the necessary power to make decisions regarding the 529 accounts. In addition, the trustee should be exonerated for making many of the decisions that surround the 529 account 'investment.' Additionally, in some instances the trustee's decision concerning the account might benefit one beneficiary differently from another beneficiary, thus impacting the trustee's overriding fiduciary duty of impartiality among all trust beneficiaries. Some key trust provisions that will empower the trustee to use trust assets to fund a 529 account and make distributions from it include the following:

**Authorization to Invest:** This power would include not only the power to hold a 529 account as a trust asset, but also the power to reinvest cash held in trust in a 529 account.

This power should also relieve the trustee from investment diversification if the 529 account is a large portion of the entire value of the trust corpus.

**Selection of 529 Plan:** The trust instrument should give the trustee the sole discretion to select the state-sponsored 529 plan, and the trustee should be exonerated from any liability for having selected one state plan over another state's plan.

**Authorization to Hold:** The trustee should be given the authority to hold any 529 plan it receives as a successor owner from another account holder without any duty to review the plan prior to its acceptance by the trustee.

**Designated Beneficiaries:** The trustee must have the ability to select the designated beneficiary and to change the designated beneficiary of the 529 account. The trust instrument should identify the class of beneficiaries from which the trustee selects the 529 beneficiary. Additionally, the trustee should be given the authority to change the designated beneficiary at any time, and for any reason, with no liability for having selected one of the trust beneficiaries as the designated beneficiary over the other trust beneficiaries.

**Rollover to Successor Generations:** The trustee should have the ability to roll over the 529 plan to successor generations, with no liability for making the rollover. With the change in the SECURE 2.0 Act, the trustee should also be given the authority to roll over any balance of a 529 account into a Roth IRA or other investment option that is authorized by law without any liability for making the rollover.

**529 Investments:** The trustee should possess the authority, unless there is a trust director with express authority pertaining to the 529 account, to select any investment strategy or investment option offered by the 529 plan, as the trustee determines in its sole discretion, along with the authority to change any such investment selection in the manner that is allowed by the 529 plan.

**Distributions:** As the owner of the 529 account, the trustee will be making the decision with respect to distributions for *qualifying higher education* expenses. Consequently, the

trustee should also be allowed to make *non-qualified* distributions with no liability for having made such a distribution from the account, such as the expense incurred in travel to and from school or university, which expense is not a *qualifying higher education* expense. The trustee should also be given wide latitude as to manner in how the distribution from the 529 account is made, e.g., directly to the education institution or directly to the designated beneficiary, along with the authority to require in the trustee's absolute discretion from the beneficiary substantiation for any expense paid by the beneficiary with no liability for having selected one method of substantiation rather than another.

**Conclusion:** An irrevocable trust that owns 529 accounts for some of its beneficiaries is an effective strategy to pay for a trust beneficiary's higher education expenses, as well as provide effective income tax savings to the trust if it accumulates some of its income. The key will be to assure the trustee possesses broad powers to own and manage the 529 accounts and that the trustee is relieved of its fiduciary duty of impartiality among the class of trust beneficiaries.

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