PLANNING FOR YOUR FUTURE

Elder Law Planning with 529 Plan Accounts

By Bernard A. Krooks, Certified Elder Law Attorney

Qualified Tuition Programs, also known as 529 Plans, are offered by all 50 states. These plans provide a tax-effective way for parents and grandparents to make gifts for the education of their children and grandchildren. However, many people are unaware that these accounts could have an adverse effect on an individual's eligibility for Medicaid benefits should the need arise in the future.

Section 529 of the Internal Revenue Code provides that a 529 Plan is a program established and maintained by a state pursuant to which a person may create and make contributions to an account established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account. For the purpose of Section 529, the term "person" includes an individual or a trust. The person creating the account, the contributor, establishes the account in a state's 529 Plan and names a beneficiary. Contributions to the 529 Plan qualify for the annual gift tax exclusion, which is currently $13,000 for a single individual and $26,000 for married couples. In addition, it is permissible to frontload five years' worth of gifts, thereby transferring $130,000 ($26,000 x 5) into the 529 plan. No tax is paid on the income generated by the account funds. When the beneficiary needs funds to pay for higher education expenses, the contributor authorizes the release of funds from the account to pay these expenses. No tax is paid on the distributions for qualified higher education expenses, including tuition, room, and board. The contributor can change the beneficiary of the account; or revoke the account and reclaim the funds, subject to a 10% penalty payment and payment of tax on the deferred income. Contributions to the account are deductible, subject to certain limits, for New York State income tax purposes. Moreover, the assets of a 529 Plan are not included in the contributor's estate for estate tax purposes.

However, the news on 529 Plans is not all good. Because the contributor can revoke the 529 Plan accounts and reclaim the funds in the account, 529 Plan accounts would be considered available resources for purposes of determining the Medicaid eligibility of the account owner. Often, individuals wish to make transfers of their assets in order to qualify for Medicaid payment of nursing home expenses and to benefit their minor grandchildren. Since a 529 Plan is an available resource, the state would treat the change of ownership of a 529 Plan account as a transfer resulting in a period of ineligibility for Medicaid purposes.

Fortunately, there is a solution to this problem. A 529 Plan Trust can protect the assets against the cost of long-term care, while preserving the tax benefits as well. A 529 Plan Trust is an irrevocable spendthrift trust created by an individual for the benefit of his or her grandchild. The contributor initially funds the Trust. The Trustee of the Trust then creates the 529 Plan Account, designates a grandchild as the beneficiary of the account, and contributes Trust funds to the 529 Plan Account. Care must be taken, however, when gifts are made to the trust to ensure that the annual gift tax exclusion applies. When properly done, the 529 Plan Trust provides an effective tool for the management and protection of the assets of a 529 Plan.

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