By **Jeffrey J. Pritchard**

Creating a Family Education Legacy

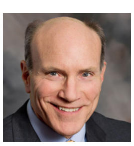
How Internal Revenue Code Section 529 savings plans can help

Centuries ago, Iroquois Native Americans developed a philosophy to guide the Iroquois Confederacy's most important decision making. That philosophy encouraged leaders to weigh the impact of their decisions seven generations into the future. It's since been called the "Seventh Generation Principle." Today, that forward-looking philosophy is praised for its wise stewardship in giving voice to unborn generations.

It's in that spirit of multigenerational wisdom that parents or grandparents, with the financial means to do so, are encouraged to create an educational fund intended for perpetuity and designated to support their heirs' higher education. It's what I call the creation of an "educational dynasty," and Internal Revenue Code Section 529 college savings plans (529 savings plans), in combination with a family trust, provide the ideal administrative structure in which to build this educational legacy.

The 529 savings plans are savings and investment vehicles, overseen by the individual states, which provide tax-free investment growth when distributions are ultimately used for qualified educational expenditures.

Creating a formal tradition of assisting family members with postsecondary education will enable future generations to achieve their fullest potential—whether that education entails trade school, international studies, an associate's degree from community college or a doctorate from a private university. Providing subsequent generations the opportunity to be all they're capable of being represents an invaluable legacy.



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Plans Inside a Family Trust

A legitimate concern in creating a long-term family 529 savings plan is succession. After your client's passing, or after your client's ability or willingness to oversee the 529 savings plan, how does your client safely and responsibly pass that mantle on to the next generation? This question is of particular importance because the subsequent owner of your client's 529 savings plan could legally withdraw all assets for his personal use, depriving your client's heirs of the education your client envisioned. Your client could always select her most business-savvy and responsible child or in-law to become the 529 savings plan account owner. As one might expect, that possibility can raise a host of troubling scenarios. Your client's newly assigned account owner might unexpectedly pass away, with the family's education fund now in the hands of a spouse with very different plans for the money. An unexpected emergency might tempt the new account owner to "borrow" from the fund without a viable means for repayment. Or, the new 529 account owner may find himself in a no-win situation of determining which family members receive how much for schooling.

One solution to ensure the continuity of an education fund is to create a formal family trust that would then be the account owner of subsequent 529 savings plans. IRC Section 529, the underlying foundation for all qualified tuition plans, states that any "person" can establish a 529 savings plan. The IRC defines "person" to include an individual, trust, estate, partnership or corporation.[1] States have the autonomy to determine their own 529 ownership guidelines. All states embrace the expanded IRC definition of what constitutes a "person," although some states accept trusts but not partnerships, or accept partnerships but not corporations, and so forth.

The real significance in creating a family educational

trust is that it can last for generations. And, in determining the underlying terms of the trust, founders can formalize policies and procedures, such as addressing which family members are eligible for educational support or the creation of a formal succession plan to pass trustee oversight from one generation to the next. A policy can also address how funds should be distributed in the event the educational trust is no longer necessary.

Trust Life Span

Unfortunately for farseeing parents or grandparents wishing to embrace the Seventh Generation Principle, private trusts can't last forever. While statutes vary from state to state, typically a trust can last no longer than the life span of a person alive when the trust is created plus 21 years. So, if your client creates a family educational trust when her grandson is first born, and the grandson lives a long and fruitful life, the trust's maximum lifetime will probably be between 100 and 120 years. However, that encompasses quite a few generations. If the family educational trust is still in existence after all those years, countless heirs of the client will have benefited, and those then acting as trustees can determine the best means of restructuring the fund for the future.

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Controlling Trust Taxation

A family education trust ensures long-term, multigenerational opportunities for higher education. Sounds great. But, it also presents a potential tax trap. While capital gains, dividends and interest within a family trust 529 savings plan are exempt from federal taxation, that same income occurring from non-529 funds inside a trust is subject to among the highest tax rates in the IRC. For example, in 2019, once long-term gains or qualified dividends surpass a mere $12,950, the trust pays the highest capital gains rate of 23.8%. Over the long term, that will take a significant bite from funds available for education.

As a result, you should advise families considering creation of an educational trust to maintain as much of those funds as possible in tax-insulated 529 saving plans within the trust, as opposed to excess funds accumulating in the trust outside a 529 savings plan. Because the designated beneficiary or future student can easily be changed, it makes sense to hold as much of the funds as possible within 529 savings plans inside the trust.

Creating the Trust

A family educational trust provides formal group oversight so your client's long-term legacy has greater continuity and sustainability. In creating such an entity, your client will need to decide:

- Will the trust begin immediately or be established through her estate?
- Will the trust be irrevocable or revocable? (tax implications).
- Which family members will qualify for educational support? Only lineal descendants? Step-children? Adopted children?
- Which family members or what entity will serve as trustee? This is a particularly important decision. In the interest of oversight, it's recommended that more than one family member assume the trustee role, or the family should consider a corporate trustee.
- What future circumstances would merit dissolution of the trust, and should that occur, which family members will receive the proceeds?
- If trustees are individuals, how will successor trustees be appointed?

"Surplus" 529 Savings Plans

To build educational funds for future generations, the

trust is encouraged to create one or more surplus 529 savings plans beyond those established for current children, grandchildren or even great-grandchildren. While the surplus 529 savings plan or plans will be owned by the trust, the current beneficiary (student) would be a family member who's completed her postsecondary education. In essence, that beneficiary would be a placeholder for the 529 savings plan until the next generation arrives. At that point, the 529 account beneficiary can be changed to the new family member without adverse tax consequences, so long as the family member fits within the IRC's expansive family definition.

Trust Investment Flexibility

A frequent complaint in using 529 savings plans is that the investment options, typically menus of mutual funds and pre-allocated portfolios, are relatively vanilla without breakout performance opportunities found in more esoteric investments, such as private equity.

If trustees believe the investment returns from private equity, hedge funds or commodities will outweigh the resulting taxation, the family education trust can simply purchase said investments and hold them within the trust but outside the 529 savings plans, thereby combining the best of both financial entities.

Jones Family Education/529 Trust

The following is a conceptual illustration of how the hypothetical Jones family created an educational/529 trust and, by so doing, were able to fund private ivy league educations for five grandchildren, 10 great-grandchildren and 20 great-great-grandchildren. The scenario below simplifies a host of factors for illustrative purposes.

Assumptions and simplifications to create the Jones family illustration:

- Bill and Betty Jones implement this strategy in 2020, during which time their five grandchildren are all eight years old. (Remember, this is just hypothetical.)
- All descendants will attend a private university for four years.
- The total 4-year cost of private college is $250,000 in 2020 and increases 4% per year thereafter.
- Funds invested in the 529 savings plans appreciate, after fees, at an annual rate of 7.2%, thereby doubling every 10 years (simplifies our computations).
- All grandparent descendants have two children per couple.
- Maximum state 529 contributions increase with the rate of tuition inflation.
- Because funds can be freely transferred among 529 savings plans within the trust, differences among descendants' educational costs can easily be accommodated.

A family educational fund can provide commonality, mutual purposefulness, a generational transfer of responsibilities and a formal purpose for widely dispersed generations gathering together.

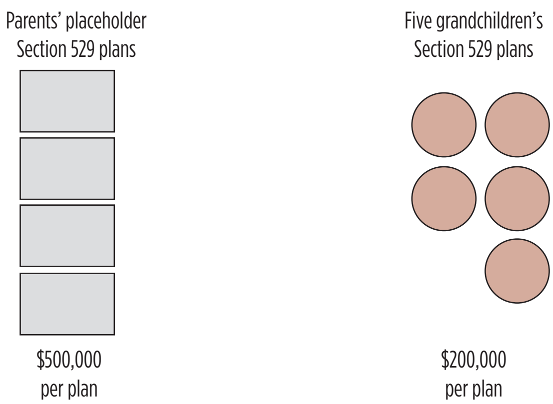
Let's walk through our highly hypothetical scenario:

Year 2020: Bill and Betty Jones have five grandchildren—all eight years old. They establish an educational trust with guidance and drafting from their estate-planning attorney. They've appointed their children as trustees of the trust. The trust is funded with $3 million. Immediately after funding the trust, the trustees open and fund a 529 savings plan for each of the five grandchildren (beneficiaries) with $200,000 apiece. That totals $1 million, and the remaining $2 million, is used to open four "placeholder" 529 accounts for the temporary benefit of the grandchildren's parents—although the trust still "owns" the monies in these placeholder accounts. Each of the four placeholder 529 accounts is seeded with $500,000, recognizing the current per account maximum contribution limitations in many states. (See "Jones Family Education Trust: 2020," p. 26.)

Year 2030: Bill's and Betty's five grandchildren are all entering college. Due to 7.2% annual tax-free

Jones Family Education Trust: 2020

Internal Revenue Code Section 529 accounts opened



— *Jeffrey J. Pritchard*

appreciation, each grandchild's 529 account has grown to $400,000, which is fortunate because four years of elite private school now costs $370,000. The four 529 placeholder accounts have also doubled in value to a cumulative $4 million. In the subsequent four years, the five individual grandchildren's 529 plans within the trust are entirely spent down for college expenses—but all five grandchildren graduate!

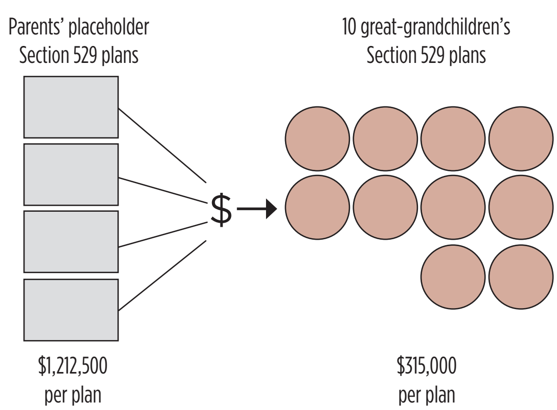
Year 2040: Ten years later, all five grandchildren are married, and each has two children. And, in keeping with our simplification efforts, we'll assume that all 10 great-grandchildren are born in 2040—perhaps each of the Jones' offspring simultaneously had a set of twins. The $4 million in the Jones family education/529 trust placeholder accounts have now grown to $8 million. On the birth of those 10 great-grandchildren, the trustees establish 10 separate 529 savings plans, one for each great-grandchild and each funded with $315,000 transferred from the placeholder accounts. At the end of 2040, the Jones family trust contains 10 separate 529 savings plans, one for each great-grandchild, seeded with $315,000 and $4.85 million remaining in the four placeholder accounts within the trust. As the generations age, the trusteeship is now passed to the next generation. (See "Jones Family Education Trust: 2040," this page.)

Year 2058: After nearly two more decades of tax-free growth, each of the 10 great-grandchildren's 529 savings plan has grown to $1.1 million, which is fortunate because four years of elite private school now costs approximately $1.09 million based on the ongoing 4% annual tuition inflation. The 529 placeholder accounts within the trust have cumulatively grown to just under $17 million. In the subsequent four years, the 10 individual 529 plans within the trust are entirely spent down for college expenses—but all 10 great-grandchildren graduate!

Year 2070: This year, the 10 great-grandchildren have 20 children (so there's a total of 20 great-great-grandchildren). The four placeholder accounts within the Jones family trust have grown to $39 million. During the year, the current trustees open 20 separate 529 savings plans, one for each great-great-grandchild and each with $1 million transferred from the four original placeholder accounts. At year end, the trust has 20 529 plans for the benefit of individual great-great-grandchildren, with each containing $1 million. After funding the 20 separate accounts, the four placeholder accounts now hold a combined $19 million. As the generations age, the trusteeship is passed to the next generation. (See "Jones Family Education Trust: 2070," p. 27.)

Jones Family Education Trust: 2040

There's $4.85 million remaining in the four placeholder accounts



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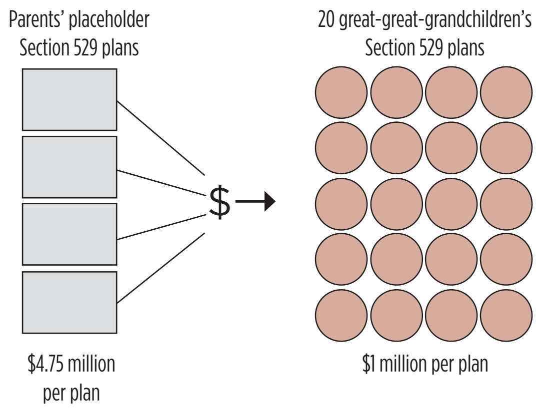
Year 2088: After another 18 years of 7.2% tax-free growth, the trust's four placeholder accounts cumulatively contain $66.4 million. Each of the 20 great-great-grandchild's separate 529 savings accounts has grown to $3.5 million, which is fortunate because four years of elite private school now costs $3.55 million after all those decades of 4% tuition inflation. In the subsequent four years, the 20 individual 529 plans within the trust are entirely spent down for college expenses—but all 20 great-great-grandchildren graduate!

We'll stop our hypothetical illustration here, 68 years after Bill and Betty Jones first created the Jones family education/529 trust. During the ensuing generations, Bill and Betty financed the college aspirations of five grandchildren, 10 great-grandchildren and 20 great-great-grandchildren. Due to long-term compounding, their original $4 million trust contribution had grown by over $100 million in nominal dollars, and because the gains all occurred within 529 plans, no taxes were paid by the Jones Family trust along the way. Pretty remarkable!

Jones Family Education Trust: 2070

Each great-great-grandchild's Internal Revenue Code Section 529 plan contains $1 million



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SPOT LIGHT

Two Faced

Untitled by Tracey Emin sold for GBP 10,625 at Christie's Modern British Art Day Sale on June 18, 2019 in London. Emin is known for her work in a variety of mediums, including installations and neon lights. Her work is sometimes described as raw and provocative and is considered to be autobiographical. For example, she once exhibited an installation titled *My Bed* at the Tate Gallery—which featured her own unmade, messy bed.

An Educational Legacy

An ancillary benefit in creating a long-term family educational fund may in fact be its most compelling aspect for some grandparents. Many families find that establishing a charitable giving vehicle, such as a donor-advised fund or private foundation, is a means of creating family-wide participation and engagement, a unifying entity or multigenerational touchstone.

In that same manner, a family educational fund can provide commonality, mutual purposefulness, a generational transfer of responsibilities and a formal purpose for widely dispersed generations gathering together. It can become one more tradition that enables your client's family to maintain some of its unique identity for future generations. A family educational fund can do more than assist with postsecondary education.

The advantages and features of 529 college savings plans, within a family trust, provide an excellent framework with which to start building a family educational legacy.

Endnote

1. Internal Revenue Code Section 7701(a)(14).