Who Controls the Funds in a Section 529 Plan?

Article Highlights:

- Qualified Tuition Accounts
- Custodial Accounts
- Who Can Contribute?
- Who Controls the Account?
- Changing the Account Beneficiary

This question frequently arises: Who controls the funds held in a Section 529 qualified tuition account? These accounts can become quite large, as they are limited only by the projected cost of a college education, and those costs will vary between state plans. Some states base their maximums on the cost of an in-state, four-year education, but others use the cost of the most expensive schools in the U.S.—including graduate studies. Most have limits in excess of $200,000, and some can reach $475,000 or more. Thus, it is only natural that those who fund an account would be concerned about who controls the account’s distributions. This is especially true when grandparents or others are making contributions to an account that is limited only by gift-tax considerations.

Some parents will simply save money for their minor children’s college costs in a custodial account; these accounts become the children's property once they reach the age of majority, depending upon state law, which is usually 18 or 21. At that point, the parents lose control. Unlike these child custodial accounts, Section 529 plans are not irrevocable gifts: The parent or other account owner retains control.

Generally, the same person who contributed the money controls the Section 529 account. This doesn't have to be the case, however. Someone else, such as a grandparent, could make a donation but name the child’s parent as the account owner, or a parent could establish the account and allow others to contribute to it.

Money cannot be removed from the account without the permission of the account owner. If the child (the designated beneficiary of the plan) decides not to go to school, the account owner can simply change the beneficiary to another “family member,” a term that, for the purposes of beneficiary changes, can refer to the beneficiary’s sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, and any spouse of any of those individuals—but not the spouse of the original beneficiary.

This rule for beneficiary changes gives parents and other donors the flexibility to use the funds for the family member who needs them the most. For example, if a designated beneficiary decides not to attend college or receives a full scholarship, another child can be named (as long as the new child is a member of the family). Alternately, if funds remain in the plan after a child has finished school, a younger family member can be named as the beneficiary for the balance.

There are no tax issues if the transfer is within the same generation or an older generation of the family, such as changing the beneficiary to a sibling of the original beneficiary. However, if the transfer is to a beneficiary in a younger generation, the transfer is considered a taxable gift from the old beneficiary to the new beneficiary, and a gift tax return will need to be filed.

If you have questions related to Section 529 plans and how they might be used to save for a child’s future education, please call.