

IRC Section 529 Qualified Tuition Plan

Qualified tuition programs¹ (QTPs) allow a person² to either prepay a student's tuition or contribute to a savings account established to pay the student's qualified higher education expenses. Both prepaid tuition plans and savings account plans may be established by the various states. Beginning in 2002, eligible private institutions were also authorized to establish prepaid tuition plans.

- **Prepaid tuition plans:** Cash contributions are made to a qualified trust that invests the funds so as to offset increasing future costs of tuition. The contract allows one to purchase a number of course units or academic periods that are redeemed when the beneficiary is old enough to attend college.
- **Higher education savings account plans:** Cash contributions are made to an account established for a named beneficiary. An investment management firm typically directs the investments. The amount available for higher education expenses depends on growth in the account between contribution and withdrawal.

Contributions to these programs are not tax deductible.³ However, the earnings in the accounts grow tax deferred.

Contributions

Contributions to a QTP must be in cash and may not exceed the amount necessary to provide the beneficiary's qualified higher education expenses. See IRC Secs. 529(b)(2) and 529(b)(6). Program sponsors will specify maximum total contribution amounts based on factors such as the beneficiary's current age, current education costs, projected inflation and anticipated investment returns. In some programs, up to as much as \$240,000 may be contributed for a beneficiary. Other considerations include the following.

- For federal gift tax purposes, contributions are considered completed gifts of a present interest. See IRC Sec. 529(c)(2)(A)(i). Contributions in any one calendar year that exceed certain limits may be subject to a federal gift tax. Generally, no federal gift tax will be payable if a contribution is limited to the annual exclusion amount discussed in IRC Sec. 2503(b). For 2003, this is \$11,000.⁴ A married couple can elect to "split" gifts for a total annual contribution of \$22,000.
- If a contribution for a single beneficiary in one calendar year exceeds the annual exclusion amount, the donor may elect to treat the contribution as having been made ratably over a five-year period.⁵ See IRC Sec. 529(c)(2)(B). Thus, for 2003, an individual could contribute up to \$55,000 for a single beneficiary in one calendar year. If a married couple elects gift splitting, \$110,000 could be contributed.
- Beginning in 2002, contributions could be made to both a QTP and a Coverdell Education Savings Account⁶ (C-ESA) for the same beneficiary in the same year.

¹ These were known as Qualified State Tuition Programs before 2002 and are authorized by IRC Section 529.

² An eligible account owner may include an individual, a trust or estate, a partnership or LLC, an association, a corporation, or a 501(c)(3) charitable organization.

³ The rules discussed here concern federal law. State and local law may vary. Depending on the state, contributions may be tax deductible or distributions may be tax exempt.

⁴ The annual gift tax exclusion (\$11,000 in 2003) is indexed for inflation in increments of \$1,000.

⁵ If the donor dies before the end of the five years, a pro-rata portion of the contribution is included in his or her estate

⁶ Certain income limits apply to contributors to Coverdell ESAs.