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County Court Strikes Down Inheritance Tax on 529 Accounts

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In a recent decision by the Allegheny County Court of Common Pleas, the court struck down Pennsylvania's statute exempting only Pennsylvania 529 plan accounts from the Commonwealth's inheritance tax. A 529 plan is a tax-advantaged savings plan designed to encourage saving for future education costs. 529 plans are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code. Under Pennsylvania law, only Pennsylvania 529 plan accounts were exempt from the tax, not 529 plan accounts set up through other states. The decision in *In re: Estate of Joseph Calihan* found the disparate treatment of in-state and out-of-state 529 plans violated the Pennsylvania state constitution.

Specifically, the court found that the state law exempting only Pennsylvania 529 plans violated the state constitution's uniformity clause by treating in-state and out-of-state 529 plans differently. The court also noted that the law violated the legislature's public policy objective of promoting savings for higher education by Pennsylvania residents by imposing a geographic restriction not found in the public policy itself. Finally, the court noted that the 529 plans in question were all very similar regardless of which state sponsored them and were all exempt from federal estate tax.

Consequently, 529 plan accounts created by Pennsylvania residents are now exempt from inheritance tax when the account creator dies regardless of what state the plan account was set up in. In the case of the Joseph Calihan Estate, that saved the estate's beneficiaries over $176,000 in Pennsylvania inheritance tax.

What are the advantages of 529 accounts? As previously mentioned, 529 accounts offer a tax advantaged way to save for educational expenses. When contributions to 529 accounts are invested, the investment earnings - along with dividend and interest income earned in the accounts - are tax-free as long as the account assets are spent on qualifying educational expenses. They also enjoy an important gift tax advantage - you can contribute up to five years of annual exclusion gifts to a 529 account in one year without using any of your lifetime estate and gift tax credit. The current gift tax annual exclusion is $18,000 per person, per year. So, this rule allows you to transfer up to $90,000 to a 529 plan in one year without having to use any of your lifetime gift tax exemption.

Finally, the person who establishes the 529 account can change the beneficiary of the account at any time with no tax consequences. For example, if you set up a 529 account for grandchild #1 but he/she does not need all the money for his/her education, you can change the beneficiary to grandchild #2 at any time with no tax consequences. While 529 accounts were always excluded from federal estate tax for the donor, this latest inheritance tax exemption just adds to the tax benefits of the 529 account, making it one of the best tools to save for college and other educational costs available in the tax code.

If you have questions about how to integrate 529 plan accounts into your estate planning, please contact Bill Blumer or any member of our Trusts & Estates Practice Group.

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