Volume 20 | Number 23 Article 1

12-4-2009

Warning to Grandparents and Others: Bankruptcy Filing by A Section 529 Account Owner Can Result in Loss of a Contribution Within Last 720 Days

Neil E. Harl
Iowa State University

Agricultural Law Press
Publisher/Editor
Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.

* * * *

Issue Contents

Agricultural Law Digest

Volume 20, No. 23 December 4, 2009 ISSN 1051-2780

Warning to Grandparents and Others: Bankruptcy Filing by A Section 529 Account Owner Can Result in Loss of a Contribution Within Last 720 Days

-by Neil E. Harl*

A recent Bankruptcy Court decision[1] interpreting an amendment in the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act[2] has confirmed that the 2005 amendment poses a substantial risk where the account owner files bankruptcy within 720 days or less of contributions made to a Section 529 plan. Part or all of the contributions within that period became property of the bankruptcy estate (the debtor had a legal interest in the account as of the petition date) and the contributions are not fully excluded under 11 U.S.C. § 541(c)(2).[3] That poses a risk that many had not anticipated when contributions were made to the account.

What is a Section 529 Plan?

"Section 529 Plans" or "Section 529 Accounts" are tax advantaged plans developed to encourage saving for future college costs and were first authorized in 1996 in the Small Business Job Protection Act of 1996,[4] by providing that a qualified state tuition program is exempt from all federal income taxation except for unrelated business income tax of a charitable organization. Amendments since enactment have shaped the concept into a widely accepted vehicle for funding higher education expenses. Technically known as "qualified tuition program,"[5] the plans enable a person to purchase tuition credits or certificates on behalf of a designated beneficiary entitling the beneficiary to a waiver or payment of qualified higher education expenses (essentially pre-paid tuition plans)[6] or a college savings plan.[7]

The pre-paid tuition plans can be set up and maintained by a state or state agency or by educational institutions; the college savings plans must be set up and maintained by a state or state agency.[8] All 50 states and the District of Columbia sponsor at least one type of Section 529 plan. College savings plans typically permit an account holder to establish an account for a student or potential student (the beneficiary) for the purpose of paying the beneficiary's higher education expenses. The account holder can usually choose among several investment options for the contributions.[9] Withdrawals can generally be used at any college or university.

---

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

Agricultural Law Digest is published by the Agricultural Law Press, P.O. Box 835, Brownsville, OR 97327 (ph 541-466-5544), bimonthly except June and December. Annual subscription $120 ($90 by e-mail). http://www.agrilawpress.com Printed on recycled paper.

In re Bourguignon

In the 2009 Bankruptcy Court case, *In re Bourguignon*,[10] the debtor had set up a Section 529 plan for a daughter on March 10, 2009, and deposited $14,500 into the account. The debtor's mother later added $40,000 to the account. On March 27, 2009, just over two weeks after the Section 529 account was opened, the debtor filed a petition in Chapter 7 bankruptcy. The debtor's "Statement of Financial Affairs" disclosed a "529 college fund for children" as property owned by another person that debtor holds or controls." The debtor did not list the 529 account on Schedule B nor did the debtor claim an exemption for the account on Schedule C.[11]

The Bankruptcy Court found that the debtor had a legal interest in the account as of the petition date and that it was the property of the bankruptcy estate.[12] Moreover, the court found that the account was not excluded under 11 U.S.C. § 541(c)(2) which deals with restrictions on the transfer of a "beneficial interest under a trust." As the court pointed out, the debtor was not the "beneficiary" of the account; rather the debtor was the owner of the account.

The court then turned to the debtors' primary argument, that the account was excluded under 11 U.S.C. § 541(b)(6) which had been added in the 2005 amendments. That subsection states that property of the bankruptcy estate does not include --

> ". . . funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(a)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but --
>
> "(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which the funds were paid or contributed;
>
> "(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(7) of such Code with respect to such beneficiary. . . ; and
>
> "(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,475."

The court concluded that the above language meant— (1) contributions to a Section 529 account more than 720 days prior to bankruptcy are fully excluded from property of the estate; (2) contributions made between 365 and 720 days prior to bankruptcy are excluded from property of the estate to the extent below $5,475; (3) contributions over $5,475 in that same time frame remain fully property of the estate and (4) amounts contributed within a year of bankruptcy filing are not excluded at all from being property of the bankruptcy estate. As the court concluded, it is only funds contributed more than 720 days before bankruptcy filing that are fully excluded from the bankruptcy estate without a monetary limit. As for the $40,000 contribution by the debtor's mother, the court held that was treated the same as the debtors' contribution -- the Bankruptcy Code makes no distinction based on the source of the contributions.[13]

ENDNOTES

[1] *In re* Bourguignon, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,717 (Bankr. D. Idaho 2009).

[2] Pub. L. No. 109-8, 119 Stat. 23 (2005).

[3] *In re* Bourguignon, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,717 (Bankr. D. Idaho 2009).

[4] Pub. L. 104-188, § 1806(c)(2), 110 Stat. 1755 (1996).

[5] I.R.C. § 529(b)(1).

[6] I.R.C. § 529(b)(1)(A)(i).

[7] I.R.C. § 529(b)(1)(A)(ii).

[8] I.R.C. § 529(b)(1).

[9] See Securities and Exchange Commission, "An Introduction to 529 Plans," http://sec.gov/investor/pubs/intro529.htm.

[10] 2009-2 U.S. Tax Cas. (CCH) ¶ 50,717 (Bankr. D. Idaho 2009).

[11] 11 U.S.C. § 521(c), added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, requires debtors to "file with the court a record of any interest that a debtor has . . . under a qualified State tuition program" as defined in § 529(b)(1) of the Internal Revenue Code.

[12] *In re* Bourguignon, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,717 (Bankr. D. Idaho 2009).

[13] *In re* Bourguignon, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,717 (Bankr. D. Idaho 2009).