Insight

529 College Savings Plans: Common Sense Tax Incentives

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Historically, the basic role in higher education for the federal government has been to ensure access and affordability so all students have the opportunity to enroll in a post-secondary institution. Over the last 30 years, as the cost of higher education has spiraled upward, the need for policies assisting with affordability has led to a myriad of tax incentives. One example of such incentives are 529 college savings plans. The 529 college savings plan is a state or educational institution sponsored savings plan designed to encourage saving for future college costs.

Chart 1. The Cost of Higher Education

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*Pricing over time for 4yr Public Institution
Source: College Board's – Trends in College Pricing 2014

As AAF highlighted, there are two types of 529 plans: pre-paid tuition plans and college savings plans. Prepaid plans allow students to lock in tuition at today's rate and pre-pay all or part of the costs of an in-state public institution's tuition. Savings plans work much like a 401K or IRA by investing contributions in mutual funds or similar investments. Generally, earnings from both plans are not subject to federal tax, and in most cases state tax, as long as withdrawals are for eligible college expenses, such as tuition and room and board. In recent years, participation in 529 plans have grown considerably – incentivizing families to plan and save for college costs. The College Savings Plans Network released a new report that includes 2014 data highlighting the growth of these plans. Those findings include:

• Total investment in 529 plans has reached a record level of $247.9 billion.
• Total assets in 529 plans grew by $20.8 billion dollars from 2013-2014
• ¬Total number of 529 accounts increased 4.1% over the 12 months, going from 11.6 million in December 2013 to 12.1 million as of December 2014.
• ¬Average 529 account size reached $20,474 as of December 31, 2014, a 4.5% increase over the past twelve months.

Chart 2. Total Assets & Average Account Balance for 529 Savings Plans

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Source: College Savings Plans Network

While the administration recently attempted to eliminate the tax-free treatment of 529 plans, they quickly abandoned the proposal after public opposition.

Recognizing the importance of this tax incentive and the need to modernize it, the Senate Committee on Finance is following the House of Representatives lead by considering ways to make college more affordable. This includes legislation identical to the House passed bill that would amend the tax code relating to 529 plans. Specifically, the legislation would:

• Expand qualified expenses for 529 account funds, computers would be added to the list of qualified expenses;
• Eliminate unnecessary paperwork regarding aggregation requirements;
• Remove the penalty and taxes associated with re-deposit of refunds from colleges.

While there were a number of amendments offered during the committee mark-up, the members ultimately decided to pass – unanimously – the legislation without changes in an effort to get it on the president's desk as soon as possible.

For most families, tax policies that incentivize college savings are common sense. 529 savings plans ensure affordability without the burden of student loan debt, and is a policy that is worth strengthening. The full Senate should follow the lead of their Finance Committee colleagues and work quickly to ensure the bill is enacted into law.