Research

More 529 College Savings Plans (not less)

CHAD MILLER | FEBRUARY 10, 2015

As a response to the recent attempts to eliminate the tax-free treatment of the popular 529 College Savings Plans, the U.S. House of Representatives has taken a different approach: moving legislation to strengthen them. The House introduced a bill, aptly named H.R. 529, which will amend the Internal Revenue Code to improve 529 college savings plans.

529 College Savings Plans

Named after Section 529 of the Internal Revenue Code, a 529 college savings plan is a state or educational institution sponsored savings plan designed to encourage saving for future college costs. There are two types of 529 plans: pre-paid tuition plans and college savings plans. Prepaid plans let you lock in tuition at today's rate, and pre-pay all or part of the costs of an in-state public college education. They may also be converted for use at private and out-of-state colleges. Savings plans work much like a 401K or IRA by investing contributions in mutual funds or similar investments. In general, 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. Money withdrawn from 529 plans and not used for eligible expenses is subject to income taxes, as well as a 10 percent federal tax penalty.

Over the last fourteen years, investments in these plans have grown from $8 billion to nearly $227 billion (as reflected below). In 2013, $14 billion was withdrawn from some 1.6 million plans to pay for costs related to higher education. Estimates have shown that 70 percent of account holders earn less than $150,000, with another 10 percent having incomes below $50,000. On average, families contribute $175 a month amassing roughly $19,700 in their accounts.

Total Assets in State-Sponsored Section 529 College Savings Plans in 2013 Dollars (in Billions), 1999 to 2013

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House Proposal

The legislation (H.R. 529) would expand, modernize, and strengthen tax-free 529 college savings plans. Specifically (as explained by Rep. Lynn Jenkins the bill's sponsor) the bill:

- Expands qualified expenses for 529 account funds;
- Eliminates unnecessary paperwork regarding aggregation requirements

- Removes the penalty and taxes associated with re-deposit of refunds from colleges, provided that it occurs within 60 days of the student withdrawing from the college.

These are modest changes to a program that America's middle-class has clearly embraced as simple straight forward way to invest in their children's future education costs. Additionally, improving the savings plans further reinforces the policy objective of ensuring that students utilize a savings-based, rather than a loan-based, method of financing higher education.

Conclusion

Policymakers should consider ways to make college more affordable for all students – middle and low-income. Historically, however, a basic role in higher education for the federal government has been to ensure access and affordability for more low-income students to enroll in post-secondary education. Over the last 30 years, as the cost of higher education has spiraled upwards, the need for policies assisting the middle-class with affordability have led to a myriad of tax incentives. In recent years, participation in 529 plans have grown considerably – incentivizing middle-class families to plan and save for college costs. For most families, the tax policies 529's are common sense. 529 savings plans ensure affordability without the burdens of student loan debt, and is an example of a policy that is worth strengthening.