CSF
CollegeSavings
FOUNDATION

PERMANENCE OF 529 PLAN TAX TREATMENT CRITICAL TO AMERICAN FAMILIES' COLLEGE SAVINGS

A college education today is more important and more expensive than ever. A family can expect to spend on average $12,127 for just one year at a public college or university or $29,026 for just one year at a private institution; that's over $48,000 for a 4-year public education or $116,000 for a 4-year private education (College Board, *Trends in College Pricing*, 2005). The same family in 15 years can expect to spend more than $108,000 for a 4-year public college and over $260,000 for a 4-year private college (College Savings Foundation, 2005). Faced with these steadily increasing college costs, millions of American families have turned to 529 savings plans to help save for college. These plans help families save by allowing them to make after-tax contributions that then grow tax-free and can later be withdrawn without federal taxation when used for qualified higher education expenses. Under current law, qualifying withdrawals from 529 savings plans are only tax-free through 2010.

To help ensure the continued success of these savings plans so that college remains an attainable goal for all Americans, the College Savings Foundation urges Members of Congress to co-sponsor and move quickly in 2005 to enact legislation making permanent the tax-free nature of qualifying withdrawals from 529 plans (H.R. 2386/S. 1112).

COLLEGE COSTS CONTINUE TO CLIMB, OUTPACING THE EARNINGS GROWTH OF AMERICA'S FAMILIES

- Increases in the costs of attending college continue to outpace the growth of American families' earnings and savings. Over the past decade, college tuition and fees increased by 59% at 4-year public institutions and by 42% at 4-year private institutions. During the same period, however, median family income increased by only 2%. As a result, the percentage of family income required to pay the cost of higher education has increased significantly. (College Board, *Trends in Student Aid*, 2005.)

- American families are concerned about saving for college. A recent survey indicates that while 95% of American families anticipate sending a child to college, 63% are concerned about their children going in to debt to pay for college and 62% are worried about saving enough for college (American Century Investments, *Caravan Survey*, 2004). In the past decade, the amounts students borrowed from nonfederal sources to help finance their education increased by 934% (College Board, *Trends in Student Aid*, 2005).

THE SAVINGS POWER OF 529 PLANS

- A 529 savings plan is a state-sponsored college savings plan that helps families save for future college costs. The "savings power" of a 529 plan is derived from its various tax-favored aspects. Under federal income tax rules, individuals can make after-tax contributions into 529 plans, have earnings grow tax-free, and withdraw amounts tax-free if used for a beneficiary's qualified higher education expenses. (Section 529 also governs prepaid tuition programs under which a family may "purchase" future tuition at the state's eligible colleges or universities.) All 50 states and the District of Columbia have at least one prepaid tuition program or college savings plan.

MILLIONS OF AMERICAN FAMILIES RELY ON 529 PLANS TO SAVE FOR COLLEGE

- With higher education costs continuing to climb, millions of American families have increasingly turned to 529 savings and pre-paid plans as their primary mechanism to finance a college education. In fact, American families have established over 7.6 million accounts for their children and have contributed over $72 billion to these accounts (College Board, *Trends in Student Aid*, 2005). One recent industry survey reveals that the average and median account balances are $10,742 and $11,217, respectively, with 68% of 529 plan account balances below $10,000, demonstrating a high use among middle-income families (College Savings Foundation, 2005).

THE POLICY ADVANTAGES OF ENCOURAGING 529 SAVINGS PLANS

- The "savings power" of a 529 plan encourages American families to take responsibility for financing their children's education and lessens the burden on government and university loan and grant programs.
- Moreover, these plans promote overall good savings habits. Over 68% of respondents to a recent survey stated that contributing to a 529 plan had taught them to be more disciplined and educated savers (Toys and Tuition Survey, Fidelity Investments/Russell Research, 2005).
- Policymakers should encourage the use of these plans so that American families can save in advance for higher education expenses rather than paying after the fact through years of burdensome debt. Policymakers also should encourage use of these plans so that American families do not have to forego a college education and the lifetime of higher earnings such an education represents.
- Higher education yields significant benefits for individuals and society. College graduates have significantly higher earnings (approximately 62% more per year than high school graduates). Further, college graduates experience lower levels of unemployment and are less likely to depend on social safety-net programs. In addition, college graduates are more likely to participate in civic activities, including voting and volunteer work, and have lower incarceration rates. (College Board, *Education Pays*, 2004; *Education Pays Update*, 2005.)

CONGRESSIONAL ACTION NEEDED TO MAKE COLLEGE SAVINGS INCENTIVES PERMANENT

- Under current law, withdrawals from 529 savings plans for qualified higher education expenses are only tax-free through 2010. After 2010, the savings power of these programs will be substantially diminished when such withdrawals become taxable at the tax rate of the child or other beneficiary. In addition to the loss of tax-free treatment for qualifying withdrawals, several other rules governing 529 plans will expire in 2010. These include rules allowing private educational institutions to establish prepaid tuition programs, rules providing for enhanced portability between plans and beneficiaries, and rules permitting beneficiaries to take advantage of both a 529 plan withdrawal and a Hope or Lifetime Learning Credit in the same taxable year.
- The uncertainty about the future tax treatment of 529 plan withdrawals can be difficult to understand and leaves families with young children unsure of what the tax features of 529 plans will be when their children are ready to attend college. The result can be a reluctance to set aside savings for college.
- There is broad support for making permanent the tax-free treatment of 529 plan withdrawals. A recent survey indicates that for those individuals with a position on the issue, nearly 90% support making the tax-treatment permanent (American Century Investments, *Caravan Survey*, 2004).
- Congress should move quickly to make permanent the tax-free nature of qualifying withdrawals so that American families can have the certainty they need to commit to college savings. Companion bills have been introduced to do just that – H.R. 2386, introduced by Representatives Melissa Hart (R-PA) and Earl Pomeroy (D-ND), both of the House Ways and Means Committee, and S. 1112, introduced by Senator Charles Grassley (R-IA), chairman of Senate Finance Committee, and Senator Max Baucus (D-MT), Ranking Democrat on the Senate Finance Committee. The members of the College Savings Foundation urge Members of Congress to join the 109 House Members and 45 Senators as co-sponsors of this legislation and work for its prompt enactment in 2005 so that college remains an attainable goal for all Americans.

The College Savings Foundation (CSF) is a Washington, D.C.-based not-for-profit organization with the mission of helping American families achieve their education savings goals. A primary focus of CSF is building public awareness of and providing public policy support for 529 college savings plans – an increasingly vital college savings vehicle. CSF's members include firms that offer 529 plans and/or participate in those plans as investment managers, governmental bodies, law firms, accounting and consulting firms, and non-profit agencies.