Earning a postsecondary credential in the post-Great-Recession economy is more critical, but also more expensive, than ever. Ninety-nine percent of the 11.6 million jobs created since the economic recovery began in 2010 have been filled by people with at least some college experience. To ensure that postsecondary access remains affordable, states have taken steps not only to reduce the price students and families pay, but also to encourage families to save for future college expenses. Research indicates that even small amounts of savings are associated with increased college enrollment and completion.

To encourage saving for college, 49 states sponsor one or two types of tax-advantage plans—college savings plans and prepaid tuition plans. Together these options are known as “529 plans,” after that section of the federal tax code. Investment earnings are not subject to federal income taxes if distributions from 529 plans are used for qualified education expenses, and many states provide additional tax benefits.

Since tuition prices are continually rising, prepaid tuition plans can be a good option to lock in today’s tuition rates for a future student. However, prepaid plans typically must be used at in-state institutions, and if tuition rates rise faster than investment returns, such plans may become insolvent. During the recession, a handful of states suspended enrollment or closed plans entirely. College savings plans, on the other hand, operate similarly to 401(k) retirement plans. They tend to offer flexibility as students can use the funds to enroll at out-of-state institutions. Even with tax benefits, 529 plans are underutilized, especially among lower- and middle-income households. As a result, states and the federal governments have enacted several policies to increase use of 529 plans.

State Action

In addition to creating and sponsoring 529 plans, several states have taken action to increase savings through the following measures:

Matching Grant Funds. Thirteen states are addressing concerns that only wealthy families benefit from 529 plans by encouraging middle- and lower-income families to participate through matching grant funds. Most states offer a dollar-for-dollar match, but Arkansas, for example, offers two dollars for every dollar invested, depending on income. Total matching amounts vary, with some states offering up to $500 dollars for up to five years or $500 to $600 per year. Some states have established a maximum lifetime award amount. Nevada limits lifetime awards to $1,500, while West Virginia limits awards to $2,500.
**Tax Benefits for Individuals.**

Thirty-two states and the District of Columbia currently offer tax benefits for 529 plans. Many states limit the deduction to a set amount, such as $5,000 for those filing individual returns and $10,000 for those filing jointly. Other states do not limit the deduction per household. Most states permit out-of-state families to purchase 529 savings plans within their state, but the family will be likely to lose their home state’s income tax benefit. Only Arizona, Kansas, Missouri, Montana and Pennsylvania allow their residents to claim a state income tax deduction for contributions to other states’ 529 plans.

**Tax Benefits for Employers.** Illinois, Nevada and Utah provide tax breaks to employers that match employee contributions to 529 plans. Illinois and Nevada allow for a 25 percent credit to employers that match employee contributions up to $500 per worker. Utah corporations are eligible for a tax benefit of up to $1,900 in contributions per qualified beneficiary.

**Automatic Tax Refund Deposits.** Several states are trying to make saving easier and automatic, such as Arkansas and Utah, which provide an option for taxpayers to deposit some or all of their tax refunds into a 529 plan. Taxpayers can typically deposit the refund to more than one account if they have multiple children.

**Federal Action**

In 2015, the Obama administration proposed taxing the investment returns on withdrawals from 529 accounts. Advocates of 529 plans argued that removing the tax-free benefit would negatively affect middle-class families’ college savings while those supporting the proposal maintained that the tax benefits helped only wealthier families. The proposal was retracted due to heightened political concerns over tuition prices. Congress, however, passed legislation to enhance 529 plan benefits by making computers and related equipment an eligible education expense. The measure also allows for a redeposit of college refunds without negative tax consequences.

Additional legislation is currently under consideration. The Boost Saving for College Act, introduced in April 2016, would create tax credits for low- and middle-income families that contribute to 529 plans and exempt employer matches, up to a certain amount, from income taxes. The bill would also allow unused funds to be rolled into Roth IRA accounts.

**NCSL Contact and Resources**

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Saving for College: 529 Plans

**Additional Resources**

SallieMae, *How America Pays for College 2016*  
College Savings Plans Network

The information contained in this LegisBrief does not necessarily reflect NCSL policy.