State Financial Officers FOUNDATION

LOOK TO THE STATES

MEMORANDUM

TO: State Financial Officers Foundation Members

DATE: February 23, 2018

SUBJECT: In support of recent 529 changes

Introduction

529 Plans were created in 1996 by the Small Business Job Protection Act to help families save for higher education in a tax-advantaged manner. The name comes from Section 529 of the IRS code that specifies the plan's tax advantages, and states, state agency, or educational institution must sponsor the 529 plan. All fifty states and the District of Columbia sponsor at least one type of 529 plan. In 2016, approximately $275.1 billion in assets were held under management and nearly 13 million accounts opened nationwide.[i]

529 plans encourage savings with tax advantages on both the federal and state levels. Earnings from investments are tax-free, and many states have other tax advantages such as a tax deduction or tax credit to encourage savings.

Recent Changes

With Public Law 115-97, more commonly referred to as the Tax Cuts and Jobs Act, the United States Congress expanded the 529 program to allow funds to be used for K-12 tuition at public, private, or religious schools up to $10,000 per student per year. Each state has had to elevate its own statutes to determine whether their 529 program is aligned automatically with this expansion. Some states like Missouri, Utah, Virginia and others are automatically aligned and families in these states may automatically begin using funds in 529 accounts for K-12 tuition. Other states have determined that their statutes do not automatically align with the expansion, and they will need authorizing language to allow families to take advantage of this change.

Benefits

This change aligns directly with the principles of the State Foundation Officers Foundation. In the Foundation's Statement of Principles, it reads "Our society does not guarantee equality of result, but we do promise equality of opportunity to all." The 529 expansion has the possibility to provide greater opportunity to all students. This change allows American families to use their savings in 529 plans to create an educational experience that their child needs. Studies have shown that when a child participates in a program that allows for a customized educational experience, they are more likely to go on to college and gain employment.[ii]

This change also provides direct tax relief to working and middle class families. In a 2017 survey of parents, 45 percent of private school parents have taken on a part-time or other job for additional income, changed their job, and/or taken out a new loan to support their child's K–12 education.[iii] In Missouri, a working class family making $45,000 in yearly income can save nearly $600 in taxes with this change, essentially reducing their tax burden by 22 percent. That additional income could be reinvested in furthering their child's education with tutoring or after-school programs. Including K-12 tuition for public, private and religious schools is a good start to help working and middle class families ensure that their child's future is not determined by ZIP code they were born in.

Considerations

The expansion of the 529 program to include K-12 tuition may have an impact on state revenues. However, initial analysis released by non-governmental entities included unrealistic assumptions to devise extraordinary high fiscal impacts. For example, many estimates released immediately after the passage of P.L. 115-97 included a 100% adoption rate. Therefore, initial estimates are most likely exaggerated.

For purposes of cost considerations, it is important to remember that the adoption rate will not be 100% for two reasons. First, Americans have always been slow to open 529 accounts. According to data collected by the College Savings Plan Network, only 0.53% of eligible individuals opened 529 accounts one year after its introduction. Second, many Americans who may utilize funds in their 529 accounts for K-12 tuition already have 529 accounts and are utilizing its benefits. Therefore, we can expect that some of the fiscal impact may be mitigated.

With this in mind, many states have released estimates on the impact of these 529 changes. An internal calculation in Missouri estimates the impact to be approximately $3 million. While state budgets face more and more pressure, revised estimates show that the impact will be minimal.

Another consideration is the impact on public schools. Rightfully so, many school administrators are interested in understanding whether this change will impact the public school system, as the expansion allows funds in 529 programs to be used for public, private and religious schools. Although an important conversation, funds in 529 programs have been used for private higher education institutions for decades. Additionally, it is important to note that 529 programs are unique from recent developments in the educational system such as education savings accounts and voucher programs. 529 programs are funded by individuals, family members, or outside organizations, and these funds are post-tax dollars.

A final consideration is whether this change will encourage families to use funds in 529 accounts for K-12 tuition instead of for higher education. Some opponents of the expansion mention this as a concern. First, the principles of SFOF directly align with allowing families to use their money as they see fit. Second, because of the K-12 expansion, 529 programs have shared anecdotally that field representatives have been able to engage with parents at elementary schools previously not interested, which will hopefully lead to a lifetime of savings. Last, instead of a concern, this should be an opportunity for 529 administrators to revitalize and reset their programs. A common issue for 529 programs is that many families believe the only eligible expense is a four-year degree. This expansion provides an opportunity to teach families that funds in 529 programs can be used for four-year degrees, two-year degrees, community colleges, dual enrollment college credit, and many other expenses, as well as K-12 tuition.

Final Comments

It is of the utmost importance that states work together to fully implement the 529 expansion to include K-12 tuition as an eligible expense. Currently, the inconsistent treatment of the 529 expansion has created confusion for families, who may use funds in their accounts for K-12 tuition and not realize until much later that there will be a tax penalty if they live in states that have not adopted these changes.

While more can and must be done to ensure quality education for all students in America regardless of income and ZIP code, the expansion of the 529 program creates another tool for states to help families and students.

Written by Missouri Treasurer Eric Schmitt

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[i] CSPN 529 Plan Data, December 31, 2016, http://www.collegesavings.org/wp-content/uploads/2015/09/December-2016.pdf.

[ii] Matthew Chingos and Paul Petersen, *Experimentally Estimated Impacts of School Vouchers on College Enrollment and Degree Attainment*, 2015, https://sites.hks.harvard.edu/pepg/PDF/Papers/PEPG15_01_Chingos_Peterson.pdf.

[iii] Andrew D. Catt and Evan Rhinesmith, Ph.D., *WHY INDIANA PARENTS CHOOSE: A Cross-Sector Survey of Parents' Views in a Robust School Choice Environment*, September 2017, https://www.edchoice.org/wp-content/uploads/2017/09/Why-Indiana-Parents-Choose-2.pdf.