Sean Williams and Joel Michael Updated: September 2017

Saving for College: 529 Plans

What are 529 plans?

529 college savings plans allow parents and others (e.g., grandparents or the student him or herself) to save for college costs in accounts that qualify for special tax treatment. The plans are operated by states. (Higher education institutions may operate pre-paid tuition plans, which are not discussed in this short subject.) Each account has an "owner" (usually the person contributing) and a "beneficiary" (the individual whose education costs will be paid). The owner retains ownership and control of the account and can change the beneficiary. Under federal law, investment of the accounts must be done by the state or the investment company it contracts with to operate its plan, but account owners can choose from among state plans offering an array of investment options and have limited authority to transfer funds once per year among plans. Thus, they indirectly have some investment control.

Do income or contribution limits apply to the plans?

Unlike most other tax incentives and aid programs for higher education, no income limits apply to 529 plans. Even the highest income families qualify to use them. Contributions must be made in cash. Each state plan sets its contribution limit, but federal law limits this to the amount necessary to provide for the qualifying higher education expenses of the beneficiary. Most states set this limit higher than $300,000. Minnesota limits account balances to $425,000.

What tax benefits are available for 529 plans?

Investment income on 529 accounts is exempt from both federal and Minnesota income taxes, if the income is used for qualifying higher education expenses. Qualifying expenses include tuition, fees, room and board, books, and some other education expenses. Investment income on the accounts that is used for nonqualifying purposes is taxed as ordinary income, plus a 10 percent penalty. 529 plans also provide special estate and gift tax benefits. Beginning in tax year 2017, Minnesota will allow both a nonrefundable income tax credit and an income tax subtraction for contributions to any state's 529 plan.

Does Minnesota have a 529 plan?

Yes, 1997 legislation authorized the Minnesota College Savings Plan, and the plan began operating in 2001. TIAA-CREF, a large national financial institution, provides administration and investment management services for the plan. As of December 31, 2016, the Minnesota plan had about $1.24 billion in assets and 63,839 accounts. Nationally, at the end of December 2016, total 529 plan assets were about $275 billion for about 12.9 million accounts.

Can a Minnesotan participate in other state plans?

Yes, most state plans allow nonresidents to participate, although special preferences may be provided for residents. The federal and Minnesota tax benefits apply equally to investments in other state plans. Although precise evidence is not available, it appears that Minnesota residents have invested more money in other states' 529 plans than in the Minnesota College Savings Plan.

Who participates in 529 plans?

Available evidence suggests that most 529 plan assets are held by families in the top income groups. The table below shows the distribution of 529 plan and Education Savings Account (ESA) assets by income group, based on data from the Federal Reserve's 2013 Survey of Consumer Finance. About 77.7 percent of these assets are held by the top population decile (the 10 percent of the population with the highest incomes) and about 87 percent by the top quintile.

529 Plan and ESA Assets by Income of Account Owners
(amounts in 2013 dollars)

Income group	Median income*	529 plan and ESA assets (millions of $)	% of total assets	% of households with assets
1st quintile (0 – 20%)	$13,189	$383	0.2%	0.2%
2nd quintile (20% – 40%)	27,392	1,810	1.0%	0.5%
3rd quintile (40% – 60%)	45,654	5,248	2.9%	0.9%
4th quintile (60% – 80%)	76,090	16,449	8.9%	2.8%
9th decile (80% – 90%)	121,947	17,028	9.3%	7.4%
Top decile (90% – 100%)	230,502	142,972	77.7%	14.0%
Total	**$46,668**	**$183,890**	**100%**	**3.0%**

* Median income of all households in income group, not just those with assets.

Source: House Research calculations using Federal Reserve Board, *Survey of Consumer Finance* (2013). Estimates are less precise for subgroups, particularly those with fewer assets.

Do other states provide additional state tax benefits for 529 plans?

Many states with income taxes provide deductions or credits for contributions to 529 plans. In tax year 2016, 29 states and the District of Columbia allowed tax deductions and three states (Indiana, Vermont, and Utah), credits for 529 plan contributions. Minnesota will offer a tax credit and deduction for 529 contributions beginning in tax year 2017.

Nevada and Illinois allow a credit for employers who make matching contributions for their employees. Eight states with income taxes do not provide 529 plan deductions or credits. Most states limit deductions to contributions to the state's own plan, but six states provide deductions for contributions to any state plan. Starting in tax year 2017, Minnesota's deduction and credit will be available for contributions to any state plan. Most of the deductions and all three credits are subject to dollar caps; four states allow deduction of the full amount contributed.

Do states provide other incentives for participation?

Nine states provide ongoing matching grants of some type; most are subject to income limits. Five states offer a onetime grant upon the opening of an account or the birth of the child. Three states provide college scholarships to 529 beneficiaries. Minnesota, Michigan, and Missouri previously operated but discontinued matching grant programs. Matching grants are not subject to federal tax, while state tax deductions or credits reduce the federal itemized deduction for state income taxes, diluting their benefits to many recipients by 10 percent to 39.6 percent.

For more information: See the House Research short subject, *Minnesota's Tax Credit and Deduction for 529 Contributions*, September 2017.