Policy Report

**College Savings Plans and
Individual Development Accounts:**

Potential for Partnership

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Washington University in St. Louis
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College savings plans or 529 plans, named after the Internal Revenue Code section, are designed so individuals can make after-tax deposits for future higher education expenses (tuition, fees, books, supplies, and equipment) at colleges, universities, vocational schools, or other post-secondary educational institutions. Administered by state Treasury Departments, all 50 states and the District of Columbia have college savings plans in operation.

The majority of college savings plans allow accounts to be opened with a $25 check, money order, electronic funds transfer, or with as little as $15 through an automatic deposit. Earnings on college savings plans are free from federal income taxes; however, the penalty for a non-qualified withdrawal is a federal tax of 10 percent of the untaxed *earnings*, and state penalties vary among plans. [1]

College savings plans may provide good partnerships with Individual Development Accounts (IDAs). Several states encourage participation in college savings plans by low-to-moderate income families through matched savings. Other states already have links to IDAs. These precedents for outreach and inclusion may offer lessons for future policy and program development.

Matching Incentives within College Savings Plans

Currently, five states offer a savings match within their college savings plans. Match rates, match caps, and other plan features vary by state. For example, some states offer matches only in the first year of participation, and others impose an age requirement for match eligibility. Savings matches based on income may represent a growing trend, as Rhode Island and Maine have recently added this feature to their plans. Following is a brief summary of the five states offering matches.

Rhode Island. Beginning in 2003, Rhode Island's college savings plan, *CollegeBoundfund*, matches contributions up to $500 per year based on family size and income. A 2:1 match ($1,000 maximum per account) is offered to state-resident families with an adjusted gross income (AGI) at or below 200% of the poverty level, and families with an AGI between 201% and 300% of the poverty line are eligible for a 1:1 match ($500 maximum per account) annually for five years. To be eligible for a match, the college savings plan account must be opened when the child is 10 years of age or younger.[2]

Maine. In order to qualify for a match in the *NextGen College Investing Plan*, the AGI of state-resident families must be $50,000 or less. Any new account with an initial contribution of at least $50 may apply to receive a *NextGen Initial Matching Grant* of $200. In addition, any existing account receiving contributions of at least $200 may apply to receive a *NextGen Annual*

[1] For further information related to tax benefits, withdrawal restrictions, etc., see Clancy, Margaret (2001). *College Savings Plans: Implications for Policy and for a Children and Youth Savings Account Policy Demonstration*, http://gwbweb.wustl.edu/csd/Publications/index.htm.
[2] Rhode Island CollegeBoundfund http://riheaa.org/saving/fiveten/

Matching Grant of 25% of all amounts contributed, up to an annual maximum grant of $100 for any one beneficiary.[3]

Michigan. The *Michigan Education Savings Plan* provides a matching grant of $1.00 for each $3.00 contributed by state residents to their college savings plan. The lifetime maximum state match is $200, available during the first year of enrollment only, if the beneficiary is six years old or younger. To be eligible for the match, the beneficiary must reside in a household with a family income of $80,000 or less.[4]

Minnesota. The *Minnesota College Savings Plan* provides an annual matching grant to eligible state-resident families contributing at least $200 to the college savings plan during a calendar year. Maximum matching grants are $300 per year and the match rate is linked to AGI: families with a federal AGI of $50,000 or less may receive a matching grant of up to 15% of their contributions during the year, and families earning between $50,000 and $80,000 may receive up to 5% of their contributions. Account owners must apply for the grant no later than December 31 of each year.[5]

Louisiana. *Louisiana Student Tuition Assistance & Revenue Trust (START)* college savings plan matches a portion of deposits made by all state residents, with the match rate dependent on the AGI of the account owner. The savings match rate ranges from a high of 14% of contributions for those families with an AGI up to $29,999 to a low of 2% for incomes of $100,000 and above.[6]

Links to College Savings Plans through IDAs

While the above-mentioned states are offering savings matches to all state residents as a feature of their college savings plan, other states are providing links to college savings plans through IDAs. For example, using the college savings plan account as the IDA savings vehicle, Vermont offers a savings match to low-income college savings plan participants. In contrast, at the end of the IDA program, Oregon and Pennsylvania allow IDA participants to roll over participant savings and match funds into the college savings plan, offering more investment choices and long-term accounting after the IDA program ceases. Pursuant to state legislation,[7] an education saver may transfer the entire IDA balance into the *Oregon 529 College Savings Network* and Pennsylvania's *Tuition Account Program (TAP).* In Pennsylvania, the matching funds are earmarked within *TAP* to prohibit unauthorized withdrawals of the savings match.

A less-formal partnership may be found in Illinois. The *Bright Start College Savings Program* manager presents information to IDA participants regarding opening a 529 account. Many other

[3] Maine NextGen College Investing Plan http://www.famemaine.com/html/education/matchinggrant.html
[4] Michigan Education Savings Plan http://www.misaves.com/overview.html#tax
[5] Minnesota College Savings Plan http://www.mheso.state.mn.us/mPg.cfm?PageID=110
[6] Louisiana Student Tuition Assistance & Revenue Trust (START) http://www.osfa.state.la.us/START.htm
[7] Examples of current legislation may be found in Appendix A.

state Treasury and Health and Human Services officials have each expressed interest in linking college savings plans and IDAs in the future.

Why is this important to the IDA field?

Available match funds. IDA program sponsors may view college savings plan matches as additional or the sole financial incentives for clients interested in education for themselves or their children. IDA matching funds are limited and restricted; thus, if a non-profit organization is located in a state offering a match for college savings, this may be an appropriate vehicle for clients to obtain savings incentives. Although matching provisions of some college savings plans may be less generous than those typically found in IDAs, the presence of financial incentives for low-income families is encouraging. Such precedents may facilitate changes to state policy in the future.

Tracking after IDA program ends. Another alternative is to use the college savings plan account, instead of a bank savings account, as the IDA savings vehicle or consider rolling over IDA funds into a state college savings plan[8] after the IDA program ends. Choosing college savings plans as the savings vehicle positions these accounts well beyond a short-term IDA demonstration or program time limits. College savings plans are established as long-term accounts, and states plan to oversee qualified withdrawals well into the future.

Broad outreach. Unlike IDAs, college savings plans are not offered through non-profit organizations, yet partnerships between state Treasury officials and non-profit organizations sponsoring IDA programs are possible. Using data currently available, a recent CSD survey sent to each state Treasurer or college savings plan director indicates that over 70% of college savings plan sponsors believe that partnerships with community-based organizations provide opportunities to reach low-to-moderate income participants. State coalitions with non-profit organizations working closely with low-income people may provide greater college savings plan participation and access to available match funds.

Centralized accounting. In college savings plans, one program manager typically holds accounts, creating a centralized accounting system. This arrangement differs fundamentally from the decentralized operations of passbook savings accounts or Roth IRAs generally used by IDA programs. In matched college savings plans, participants open an account, and the state calculates the match (generally, participants must submit an annual request to receive the matching grant) and maintains a separate account holding the restricted matching contributions. In this case, the state Treasurer's office—not the IDA sponsoring organization—is responsible for tracking financial data, calculating matches, and processing qualified withdrawals.

Potential Partnerships in the Future

With legislative change authorizing such transfers, additional partnerships with college savings plans are likely through IDA rollovers. IDA administration typically resides with state Social Service or Economic Development representatives, and the state Treasury Department oversees

[8] For general information on a specific state plan, see www.savingforcollege.com.

college savings plans. Coordination between departments may be facilitated by non-profits interested in promoting asset-based policy. States interested in protecting the IDA match beyond the IDA program time limits may elect for these funds to be tracked separately through the college savings plan.

Other possibilities for partnership include coordinated efforts for deposit of Earned Income Tax Credit (EITC) refunds into college savings plans, delivery of financial education, and outreach activities.

Our long-term vision is for tens of millions of young people to participate in college savings plans. The most promising direction is to make these plans more inclusive through publicly-funded financial incentives, such as a savings match. Although there is still much to learn, college savings plans may provide the best application of asset building for children and youth and adults saving for education.

More information from survey data and other research will be available at a later date, funded through a grant from the Ford Foundation to study college savings plans as a possible model for inclusive asset-based policy. If you have questions, or are interested in this research, please contact Margaret Clancy at the Center for Social Development. She can be reached at mclancy@gwbweb.wustl.edu.

Appendix A

Examples of Current State Legislation Connecting IDAs and College Savings Plans

Vermont
From Vermont Statutes, Title 33, Chapter 11:
http://www.leg.state.vt.us/statutes/fullsection.cfm?Title=33&Chapter=011&Section=01123

(d) Notwithstanding the provisions of subsections (a), (b) and (c) of this section to the contrary:

(1) a saver may open an account under this section as a Vermont higher education savings plan account under subchapter 7 of chapter 87 of Title 16;
(2) the duration of the saver's ownership of a Vermont higher education savings plan account shall not be subject to any limitation of time, except as provided in subchapter 7 of chapter 87 of Title 16; and
(3) the saver's ownership of a Vermont higher education savings plan account shall not be included in the saver's income or resources for purposes of the saver's eligibility for TANF or SSI funds or services.

(Added 1999, No. 147 (Adj. Sess.), § 1.)

Oregon
From Oregon Revised Statutes (2001 edition), Chap. 458.670-458.700:
www.leg.state.or.us/ors/458.html

458.685 Approved purpose of account; emergency withdrawal; removal of account holder from program. (1) A person may establish an individual development account only for a purpose approved by a fiduciary organization. Purposes that the fiduciary organization may approve are:

(a) The acquisition of post-secondary education or job training.
(b) If the account holder has established the account for the benefit of a household member who is under the age of 18 years, the payment of extracurricular nontuition expenses designed to prepare the member for post-secondary education or job training.
(c) If the account holder has established a qualified tuition savings program account under ORS 348.841 to 348.873 on behalf of a designated beneficiary, the establishment of an additional qualified tuition savings program account on behalf of the same designated beneficiary.

458.690 Required account features. (1) Notwithstanding ORS 315.271, a fiduciary organization selected under ORS 458.695 may qualify as the recipient of account contributions that qualify the contributor for a tax credit under ORS 315.271 only if the fiduciary organization structures the accounts to have the following features:

(a) The fiduciary organization matches amounts deposited by the account holder according to a formula established by the fiduciary organization. The fiduciary organization shall deposit not less than $1 nor more than $5 into the account for each $1 deposited by the account holder.

(b) The matching deposits by the fiduciary organization to the individual development account are placed in:

(A) A savings account jointly held by the account holder and the fiduciary organization and requiring the signatures of both for withdrawals;
(B) A savings account that is controlled by the fiduciary organization and is separate from the savings account of the account holder; or
(C) In the case of an account established for the purpose described in ORS 458.685 (1)(c), a qualified tuition savings program account under ORS 348.841 to 348.873, in which the fiduciary organization is the account owner as defined in ORS 348.841.

[458.700] (5) A fiduciary organization that is the account owner of a qualified tuition savings program account:

(a) May make a qualified withdrawal only at the direction of the designated beneficiary and only after the qualified tuition savings program account of the account holder that was established for the designated beneficiary has been reduced to a balance of zero exclusively through qualified withdrawals by the designated beneficiary; and
(b) May make nonqualified withdrawals only if the qualified tuition savings program account of the account holder that was established for the designated beneficiary has a balance of less than $100 or if the account holder or designated beneficiary has granted permission to make the withdrawal. Moneys received by a fiduciary organization from a nonqualified withdrawal made under this paragraph must be used for individual development account purposes.

Pennsylvania
From Senate Bill No. 8, Act 58, Section 319:
http://www.legis.state.pa.us/WU01/LI/BI/ALL/1999/0/SB0008.HTM

Family Savings Account Program/Tuition Account Program Coordination.

(a) Program Coordination.—A saver under the Family Savings Account Program (FSA) established under Chapter 21 of the act of June 29, 1996 (P.L.434, no.67), known as the Job Enhancement Act, may transfer the saver's family savings account contributions into a Tuition Account Program (TAP) contract and become an FSA/TAP account owner if the FSA saver has successfully completed all the terms of the FSA saver's approved plan pursuant to section 2102(e) of the job enhancement act and the FSA saver's approved plan specifies education as the eligible use. The FSA saver does not have to be the beneficiary of the education.

(b) Match Payment. —The match to be provided pursuant to Chapter 21 of the Job Enhancement Act, shall be paid by the FSA saver's service provider directly to the Treasury Department for deposit in the FSA/TAP saver's selected Tuition Account Program Account.

(c) Waiver of Restrictions. —The restrictions on withdrawal of the FSA match pursuant to section 2102(f)(3) of the Job Enhancement Act shall not apply to an FSA/TAP account owner.

(d) Termination. —In the event an FSA/TAP account owner terminates the tuition account program contract pursuant to Section 313, the amount refunded to the FSA/TAP account owner shall exclude the match made pursuant to section 2102(f) of the Job Enhancement Act and any increase in value resulting from that match. The treasury department shall pay the match to the Department of Community and Economic Development.

(e) Agency Coordination. —The Treasury Department and the Department of Community and Economic Development may issue regulations to further facilitate coordination of the Tuition Account Program and the Family Savings Account Program.