

## **Background of Section 529 Plans**

Section 529 college savings plans – sometimes referred to as “qualified state tuition plans” – were created in 1996 as part of the Small Business Job Protection Act (SBJPA). At that time various States were developing their own versions of programs, and Congress believed it was necessary to clarify their federal tax treatment. States were allowed to establish two types of plans:

- A “prepaid tuition plan” that allowed families to prepay tuition at the State’s colleges.
- A “savings plan” that allowed families to save for “qualified higher education expenses” in a tax-free trust created by a State.

Responding to the popularity of these plans in States across the Nation, Congress enacted a number of improvements to 529 plans as part of the 2001 tax relief bill (the Economic Growth and Tax Reconciliation Act or EGTRRA). In particular, the 2001 tax law made the following important changes:

- Provided tax-free treatment for distributions for qualified higher education expenses (previously the earnings on such distributions were taxable at the student beneficiary’s tax rate).
- Allowed educational institutions to establish prepaid tuition plans.
- Increased the amount of room and board that could be paid as qualified higher education expenses.
- Allowed use of the HOPE Credit or the Lifetime Learning Credit in the same year as paying expenses from the 529 plans, as long as the same expense did not count for both.
- Allowed beneficiaries to transfer amounts between qualified tuition programs once every 12 months.
- Expanded the definition of “family” to include first cousins for purposes of transfers and changes of designated beneficiaries.

EGTRRA’s provisions will sunset for years beginning after December 31, 2010. This legislation would make the EGTRRA changes to section 529 permanent (i.e., no longer subject to the sunset). This is critically important for American families who use these plans because otherwise families do not know the tax treatment that will apply to their children’s accounts when they are actually attending college.