

529 Plan Account Rollovers to Roth IRAs

Unused 529 plan assets can help with retirement planning.

What is a 529 plan?

A 529 college savings plan is a tax-advantaged account where after-tax funds are contributed—earnings grow tax-deferred, and withdrawals are distributed tax-free when used for qualified educational expenses. In addition, there are other options for distributing 529 funds, including up to \$10,000 per year for K-12 tuition¹, paying off up to \$10,000 of student loans, or transferring the balance to the 529 account to a different beneficiary, all qualify for federal tax-free treatment.

What's Changed?

Prior to the passing of a provision within SECURE Act 2.0, a 529 plan beneficiary who had leftover funds (i.e., the beneficiary did not use all funds for qualified education expenses) had limited withdrawal options. Withdrawals from 529 accounts for nonqualified education expenses were considered a nonqualified withdrawal, subject to income tax and a 10% federal tax penalty on earnings.

With the new regulations, 529 plan account owners or beneficiaries can roll over 529 plans into a beneficiary-owned Roth IRA tax-free and penalty-free as of January 1, 2024, subject to the limitations described below. If you qualify, this can be a great way to help kick-start retirement savings.

Key Benefits of the 529 to Roth IRA Rollover

- 1. Tax-Free Growth and Withdrawals:** Like 529 plans, Roth IRAs offer tax-free growth. In addition, qualified withdrawals² from Roth IRAs are tax-free, providing a powerful vehicle for long-term wealth accumulation.
- 2. Enhanced Flexibility:** The rollover provision mitigates the risk of overfunding a 529 plan. If the beneficiary does not need all the funds for education, a portion of the money can be redirected to the beneficiary's retirement savings.

- 3. No Penalties on Unused Funds:** Previously, leftover 529 plan funds not used for education expenses would incur a 10% penalty and income taxes on the earnings if withdrawn for non qualified expenses. This new provision allows you to avoid these penalties by rolling over the funds.
- 4. Retirement Savings for Next Generation:** By rolling over 529 plan funds to a Roth IRA, you can give your children or grandchildren a substantial head start on their retirement savings, enhancing your legacy planning strategy.
- 5. No Income Limitations:** Rollovers are not subject to the typical IRS Roth IRA income limits for contributions.

Eligibility and Limitations

While the benefits are substantial, it is essential to understand the specific requirements and limitations associated with this provision:

- 1. Lifetime Limit:** A lifetime rollover limit of \$35,000 per beneficiary.
- 2. Roth IRA Contribution Limits:** The rollover is subject to annual Roth IRA contribution limits. In 2024, this limit is \$7,000 (or \$8,000 if the beneficiary is 50 or older).
- 3. Beneficiary Income Limits:** The beneficiary of the 529 plan also must be the owner of the Roth IRA and must have earned income at least equal to the amount of the rollover.
- 4. Holding Requirement:** The 529 plan must be open for at least 15 years before funds can be rolled over.
- 5. Contribution Duration Requirements:** Contributions made within the last five years to the 529 plan are not eligible for rollover.

¹ Some states do not consider K-12 tuition payments as qualified withdrawals.

² A qualified withdrawal from a Roth IRA is one that is made at least five years after the year of the individual's first designated Roth contribution and is made: on or after attainment of age 59 1/2, on the account of the individual's disability, or after the account holder's death.

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While the new rollover rules took effect at the start of 2024, the IRS could issue further interpretive guidance and clarify details applying to specific circumstances. There are still some grey areas in the statute that are subject to different interpretations, and for which the 529 plan industry is awaiting further clarification and guidance. Some states may not treat a 529 plan rollover to a Roth IRA as a qualified expense which could create state tax penalties. We recommend consulting your tax preparer before initiating a rollover.

Next Steps

A 529 plan is a valuable financial tool that helps families prepare for the cost of college. These new rules increase 529 plan flexibility, giving families another reason to save for college.

If you have not already done so, consider taking this opportunity to open and contribute to a child's Roth IRA if the child has earned income. This will get children started on their after-tax retirement savings at a time when their personal income tax rate is likely to be low.

To ensure that your financial planning objectives are being met and to discuss how the new regulations may benefit you, please contact your William Blair wealth advisor.

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