

529 Plan Rollovers to Roth IRAs

SECURE 2.0 Act adds another option for unused education funds

The recently enacted SECURE 2.0 Act provides a new way to utilize unused funds which had been saved for education.

Background

Saving for children's education and saving for retirement are two of the top priorities for many Americans. Over the years, Congress has added a number of incentives to the Internal Revenue Code to encourage saving for college. The most popular of these incentives is the 529 Qualified Tuition Program (529 plan). Unused 529 plan funds can be subject to tax and a possible penalty upon distribution.

Rollover to Roth IRA

Unused funds in a 529 plan may be rolled tax- and penalty-free to the 529 plan beneficiary's Roth IRA starting in 2024. However, certain conditions must be met. These limitations are designed to prevent individuals from using a backdoor to fund a Roth IRA for which they are otherwise ineligible. The limitations for a 529-to-Roth-IRA rollover are as follows:

1. The 529 plan beneficiary and Roth IRA owner must be the same individual.
2. The 529 plan must have been open for at least 15 years.
3. Recent 529 contributions (within five years of the rollover) and earnings on those contributions cannot be rolled over to the Roth IRA.
4. The rollover is subject to the annual Roth IRA contribution limits (\$6,500 in 2023), reduced by any other IRA contributions made by that individual during that tax year. The Roth IRA owner must have earned income in the year of the rollover at least equal to the amount rolled into the Roth that year.
5. The Roth IRA contribution limitation based on the taxpayer's adjusted gross income is waived for the rollover.
6. The maximum lifetime rollover is capped at \$35,000.

These new rollover rules create a fairly narrow "sweet spot," which will typically be where the 529 plan beneficiary is just out of college or did not attend college. Rolling these unused 529 plan funds into that plan beneficiary's Roth IRA provides a great way to start that individual out on the path to successfully saving for retirement.

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