Tax-free Rollovers of 529 Plan Funds to Roth IRAs Allowed Under Secure 2.0

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Section 529 college savings accounts are used for tax-free education investments. When considering whether to create a 529 account, there generally is some apprehension that the person you are saving for won't pursue a college education or that there will be leftover assets in the account. What happens to those assets if they cannot be used for education expenses? If assets in a 529 account are used for something other than qualified education expenses, under current law, the earnings portion of the distribution is subject to ordinary state and federal income tax and a 10% penalty. This can disincentivize the use of 529 accounts because of the risk that the beneficiary may need less assets than are held in the 529 account or choose to forego college altogether.

The Setting Every Community Up for Retirement Enhancement 2.0 Act of 2022 (SECURE 2.0) was signed into law on December 23, 2022, expanding the SECURE Act of 2019, which aimed to improve laws on retirement accounts. SECURE 2.0 includes dozens of provisions, addressing everything from required minimum distributions to penalties on early withdrawals from retirement accounts. SECURE 2.0 also amends the Internal Revenue Code to permit tax-free and penalty-free rollovers from 529 accounts to Roth IRAs in certain circumstances. This is a great opportunity to extend tax-free investments for children or grandchildren. This provision takes effect in 2024 but, the rollovers are not allowed without limits.

SECURE 2.0 allows a beneficiary of a 529 account to roll over up to $35,000 from his or her 529 account to his or her Roth IRA if the following criteria is met:

- The 529 account has been maintained for at least 15 years;
- The beneficiary of the Roth IRA and of the 529 account are the same individual;
- Rollovers do not exceed a combined total of $35,000;
- The amount must be moved directly from the 529 account to the Roth IRA;
- The amount, when added to any eligible Roth IRA contribution made for the 529 account's beneficiary for the year, cannot exceed the IRA contribution limit for that year; and
- The rollover is limited to the aggregate amount contributed to the 529 account (and earnings attributed to those contributions) more than 5 years earlier.

After these amounts are converted to a Roth IRA, they become subject to the same treatment that applies to amounts converted from traditional IRAs to Roth IRAs.

What does this mean for you?

For anyone hesitating to fund a 529 account because the person you are saving for might not pursue a college education or because there might be leftover assets in the account, consider funding the 529 account now. The cost of education has been rising at an unprecedented rate, and it appears to show no signs of slowing down. If, down the road, the beneficiary of the 529 account opts not to pursue higher education or finds an alternate method for paying for their education, SECURE 2.0 provides a Roth IRA rollover option for funds not used for education expenses. Of course, another planning option is to change the designated beneficiary of the 529 account. SECURE 2.0 gives families another option to avoid the potential income taxes and penalties, retain their savings, and help the beneficiary to begin his or her retirement savings on a positive note.