Rolling a 529 plan to a Roth IRA

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After much anticipation, the SECURE Act 2.0 was signed into law in late 2022, providing dozens of new retirement-related provisions. These changes add to the original SECURE Act of 2019, which included new rules on how you can save and withdraw money from your retirement accounts. Under this new law, there is one provision which will allow for additional flexibility with unused funds in certain education savings accounts.

Beginning in 2024, individuals will be eligible to withdraw funds from an existing 529 plan and roll those funds into a Roth IRA for the designated beneficiary.

What is a 529 Savings Plan?

One of the more common methods of college savings is known as a 529 plan. A 529 college savings plan is a qualified, state-sponsored investment account that enables an individual to save for a beneficiary and pay for education expenses. Funds can be used to pay for college, K-12 tuition, apprenticeship programs and even student loan repayments. Although contributions are not deductible, earnings in a 529 plan grow tax-free and will not be taxed upon withdrawal for qualified education expenses.

Under the current law – which remains in effect for 2023 – any unused funds in a 529 education fund would be subject to income tax AND a 10% penalty should they be taken as a non-qualified distribution. Concerns over this drawback have led to families delaying or declining to fund a 529 plan, fearing the money they have worked hard to save would become trapped unless being subject to a penalty. Many life changes can occur between when an account is established and when it comes time to pay for education (i.e., market fluctuations, decision not to attend college, etc.), so the fear of overfunding or not being able to access most of the funds, is a definite deterrent for many families.

SECURE 2.0

Under the new law (effective January 2024), you can now roll unused funds into a Roth IRA on a tax-free basis, for the beneficiary. This should hopefully alleviate a number of concerns about overfunding a 529 plan and incurring a penalty to access the funds.

There are still some restrictions in place and certain criteria that needs to be ironed out, but here is what is known so far:

- The 529 account must have been in place for at least 15 years and move directly to a Roth IRA in the same name (the 529 beneficiary, not the person who established the plan).
- Beneficiaries can roll over a maximum of $35,000 during their lifetime.

- Annual Roth IRA contribution limits would still apply. This means the rollover would need to be done over several years, and the Roth contribution for each year would reduce the amount that can be transferred from the 529 plan. Annual limits for 2024 have not been announced, but the 2023 limit is $6,500.
- Any 529 plan contributions made in the previous five years, and any earnings from those contributions, are not eligible to be rolled into the Roth.

Another benefit to this new law is that it makes the 529 plan more attractive for employers to include as a workplace benefit, similar to the student loan matching program which will also go into effect in 2024. Employers can offer 529 plan benefits as part of a complete financial wellness program and simplify the process by establishing the plan and setting up automatic payroll deductions, which will make it easier for the employee to manage.

So whether you are just beginning the college fund planning journey, or have an existing fund with an unused balance, these new provisions offer more flexibility. Since the new law is not effective until 2024, there is still plenty of time to consider your options. It is always good to check with your financial and tax advisors if you have questions about how these rule changes could impact you and your family.