

SECURE 2.0 ALLOWS ROLLOVERS OF 529 FUNDS TO ROTH IRAS

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We're getting a lot of questions about the SECURE 2.0 provision allowing tax-free rollovers from 529 plans to Roth IRAs. Although this new rollover opportunity sounds exciting, there are a number of restrictions that may limit its appeal.

Section 529 plans offer a great opportunity to pay for college, K-12 tuition and student loan repayments. Nearly every state offers at least one plan. The most popular type of 529 plans are college savings plans, in which you make after-tax contributions that are invested in mutual funds or ETFs offered under the plan. Earnings grow tax-free, and you can withdraw the account tax-free if you use it for qualified educational expenses. You also may be able to take a state tax deduction for at least part of your contribution.

However, sometimes parents wind up not using the entire 529 account because, for example, their child gets a scholarship or doesn't go to college. If you withdraw funds and don't use them for educational expenses, the earnings in your account will be subject to income tax and a 10% penalty. The risk of unused funds has caused many parents to fund 529 plans conservatively or not to fund them at all.

In SECURE 2.0, signed into law on December 29, 2022, Congress attempted to address this problem. Starting in 2024, beneficiaries of 529 college savings accounts (e.g., children or grandchildren) will be allowed to do a tax-free rollover of up to \$35,000 to a Roth IRA.

As usual, however, the "devil is in the details." Here are those details:

- The \$35,000 limit is a lifetime maximum.

- The Roth IRA must be in the name of the 529 beneficiary – not the 529 owner (if different).
- The 529 plan must have been open for more than 15 years. It’s not clear whether a new 15-year waiting period is required when someone changes 529 beneficiaries or if the waiting period that applied to the prior beneficiary can be tacked on. We’ll need further clarification from Congress or the IRS.
- Rollover amounts can’t include any 529 contributions (and earnings on those contributions) made in the preceding five-year period.
- Rollovers are subject to the annual Roth IRA contribution limit. So, for example, if the Roth IRA contribution limit in 2024 remains \$6,500, then no more than \$6,500 can be rolled over from a 529 to a Roth IRA in 2024. Further, any actual Roth IRA (or traditional IRA) contributions made by the 529 beneficiary would count against the \$6,500 limit. The effect of this rule is that a full \$35,000 529-to-Roth IRA rollover would need to be done over several years. It also means that the 529 beneficiary doing the rollover must have compensation in that year at least equal to the amount being rolled over.
- By contrast, the income limitations on Roth IRA contributions don’t apply to these rollovers. A 529 beneficiary would be able to do a 529-to-Roth IRA rollover even if she earns too much to make a Roth IRA contribution for that year.

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