Rollovers From a 529 Plan to a Roth IRA

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A. 529 Plans

1. A 529 Plan is a tax-advantaged savings plan sponsored by a state, state agency, or education institution to encourage saving for future education costs.

2. 529 Plan contributions are not deductible.

3. Income earned on the funds in the account that are left in the plan after a beneficiary's education expenses are paid are subject to income tax and a 10% penalty upon distribution.

4. Unused 529 amounts can be transferred to another family member.

   a. Family members include:

      - Son, daughter, stepchild, foster child, adopted child, or a descendant of any of them
      - Brother, sister, stepbrother, or stepsister
      - Father or mother or ancestor of either
      - Stepfather or stepmother
      - Son or daughter of a brother or sister
      - Brother or sister of father or mother
      - Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
      - The spouse of any individual listed above
      - First cousin

B. Rolling 529 Plans

1. New rules are in effect for 2024 that allow beneficiaries of 529 plans to roll over unused funds to a Roth IRA without penalty.

2. These changes are intended to ease concerns about the tax implications of withdrawing money that might remain in an education savings account when it is no longer needed to finance the beneficiary's education.

3. This option was created to jumpstart a child's tax-advantaged retirement nest egg using the child's leftover tax-free education funds.

4. Limitations Apply

    a. But limitations on the rollovers and the lack of IRS guidance on the issue mean the new rules may not be as helpful as they might first appear.

C. Rollover Rules

1. The 529 plan account must have been open for more than 15 years.

2. The rollover must be a plan-to-plan or trustee-to-trustee rollover.

3. Questions

    a. What happens if the 529 beneficiary is changed?

        1) Does the 15-year holding period requirement start over?

        2) Or does it carry over from the previous beneficiary?

4. Contributions to the 529 plan and any earnings within five years of a rollover are ineligible.

5. Rollovers may only be to the Roth IRA of the beneficiary of the 529 plan account, not its owner.

    a. In cases where a parent is making contributions to a plan for a child, the parent is usually the account owner.

b. Transfer to Same Person

1) The beneficiary of both the 529 account and the Roth IRA must be the same person.

2) Joe Jr.'s educational savings money can not be transferred to Joe Sr.'s retirement.

6. Earned Income

a. Contributions to an IRA (traditional or Roth) are only allowed if the IRA owner has earned income.

b. That applies to the new SECURE 2.0 transfer opportunity.

c. The child for whom the 529 was created must have earned income in order for the money to be rolled into that person's Roth IRA.

7. Annual Rollover Limit

a. Rollovers are subject to the Roth IRA annual contribution limits of $7,000 for 2024 ($8,000 for 50 or older) less any other IRA contributions, but the limit based on the taxpayer's adjusted gross income is waived.

b. Example. If a taxpayer under age 50 contributed $5,000 to their Traditional or Roth IRA for 2024, they can only roll over an additional $2,000 from their 529 plan.

8. Lifetime Rollover Limit

a. Aggregate rollovers under the provision cannot exceed $35,000 over the beneficiary's lifetime.