

New 529 Account Rollovers to Roth IRA's

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Congress recently passed a \$1.7 trillion omnibus spending package that made substantial changes to retirement and tax rules. These have been referred to as *Secure Act 2.0* because they extend the retirement provisions of the original *Secure Act of 2019*. One of the changes allows rollovers from 529 college savings accounts to Roth IRA accounts starting on January 1, 2024. Unsurprisingly, the new rules are complicated. But they provide another way to avoid taxes and penalties upon termination of a 529 account if the beneficiary decides not to go to college.

A 529 account is one of the most popular ways to save money for college. The account-holder is exempt from taxes on earnings from the assets in the account provided that they're spent on qualified educational expenses. In addition, 30 states allow an income tax deduction on contributions to a 529. The tax benefits, in tandem with the ever-rising cost of college, are encouraging more families to save in 529 accounts. Assets in 529's rose to \$388 billion in the second quarter of 2022, up from \$348 billion in second quarter of 2020.

I. Rules on Rolling Over a 529 Account into a Roth 401(k)

Below is an overview of what families need to know about the rollovers.

1. Limit to the Amount Rolled Over:

The new rules allow beneficiaries to roll over up to \$35,000 in their lifetime from any 529 account in their name to a Roth IRA in their name.

2. Effective Date of Rollovers:

The new rules become effective on January 1, 2024. At that time, beneficiaries can start moving money from their 529 account(s) to their IRA account. Until December 31, 2023, the current rules apply.

3. Rules Applying to 529 Rollovers:

Any amount of money that is rolled over from a 529 account into a Roth IRA account will be subject to the Roth IRA annual contribution limits. The contribution limit for 2024 will be \$6,500, with an extra \$1,000 allowed for those individuals over the age of 50 with the limited catch-up allowance.

The beneficiary cannot roll over any money from their 529 account into a Roth IRA without incurring penalties and taxes unless the 529 account has existed for at least 15 years. Account-holders and beneficiaries cannot roll over contributions or earnings that were made in the previous five years.

This new feature of 529 accounts will give families another reason to use a 529 to save for college without concerned over their child's ultimate decision to attend college. However, there are serious constraints to rollovers. For example, as noted above, the rules don't apply unless the 529 account has been open for at least 15 years. However, rollovers may encourage more families to start saving for college well in advance of enrollment.

II. Alternative Uses of 529's That Don't Incur Taxes

If the beneficiary doesn't take a traditional college path, savings in a 529 may still result in tax and educational benefits because they may be used for certain other educational purposes. Beneficiaries can use 529 funds to cover costs at any post-secondary institution of higher education that receives Federal financial aid. This includes community colleges; technical, art, or music schools; vocational and certificate programs; trade schools; and continuing education programs. The funds can also be applied to the cost of study-abroad programs at about 400 colleges located in other countries.

The only requirement for 529 accounts is that beneficiaries must spend the proceeds on qualified expenses, including tuition, fees, books, supplies, and computers, as well as on-campus room and board for students enrolled at least half-time. 529's cannot be used to cover such costs as application fees, personal living expenses, or transportation.

Other education-related applications uses of 529 funds that may avoid taxes include:

1. Family Members May Use the Money

Most 529s accounts allow account-holders to change the beneficiary once every year. If the original beneficiary won't be using the money for college, the assets may be transferred tax- and penalty-free to an eligible family member. This can be a sibling, aunt, uncle, niece or nephew, step-sibling, parent, step-parent, spouses of all those individuals, or a first cousin. If the original beneficiary changes their mind about college, the account-holder can convert the 529 account back to them.

2. Parents May Pay Special-Needs Costs

If the beneficiary has a documented physical or emotional disability, the parents can use a 529 account to pay for certain types of support. This includes services that enable him or her to attend a post-secondary school. If the disability prevents the student from attending school, the parents may withdraw the 529 funds without penalty, though they will need to pay income taxes on the earnings.

3. K-12 Private School Costs May Be Eligible

Federal tax rules allow another option for parents with children attending nonpublic elementary or secondary schools. They may withdraw up to \$10,000 to cover tuition at private and religious elementary and secondary schools without incurring any Federal tax liability.

III. Terminating a 529 May Not Incur a Large Tax Bill

Account-holders can terminate a 529 by simply withdrawing the funds, which may result in only a modest increase in taxes. The withdrawn amount will be taxed at the beneficiary's rate, which is likely to be low if it's a student. The account-holder will need to pay a 10% penalty only on earnings growth rather than the entire value of the account.

There are a few situations where 529 account-holders may not incur any penalty. If the beneficiary dies or becomes disabled, or if he or she enrolls in a U.S. military academy, there is no penalty. If the beneficiary is awarded a scholarship, account-holders can withdraw up to the amount of the award and do whatever they want with it without penalty. But taxes will need to be paid on any gains in the account.