

Navigating SECURE 2.0's New 529-to-Roth Rollover Opportunity

Presented by John Esposito

SECURE 2.0 was signed into law as part of the Consolidated Appropriations Act, 2023, at the end of last year. Section 126 of the legislation included a provision to permit tax-free rollovers from 529 plans to Roth IRA accounts starting in 2024. This provision seeks to resolve a long-standing issue with 529 college savings accounts related to beneficiaries not attending or completing college, resulting in unspent funds left in 529 plans. The Senate Finance Committee's [summary](#) of SECURE 2.0 set forth the factors driving the imposition of the new rule:

"Families and students have concerns about leftover funds being trapped in 529 accounts unless they take a nonqualified withdrawal and assume a penalty. This has led to hesitating, delaying, or declining to fund 529s to levels needed to pay for the rising costs of education. Section 126 eliminates this concern by providing families and students with the option to avoid the penalty, resulting in families putting more into their 529 account. Families who sacrifice and save in 529 accounts should not be punished with tax and penalty years later if the beneficiary has found an alternative way to pay for their education. They should be able to retain their savings and begin their retirement account on a positive note."

Before passage of SECURE 2.0, options for leftover 529 account balances were limited. Essentially, the owner could:

1. Change the beneficiary to another family member
2. Take a nonqualified distribution of the account balance (thereby incurring taxes and penalties)
3. "Kick the can down the road" and hope that a future opportunity will exist to address the educational needs of the beneficiary or family member

The ability to roll 529 funds to a Roth IRA could be a useful option to handle unused 529 funds; in fact, it may be the most impactful planning opportunity from SECURE 2.0. Rather than finding an education-related use for the funds or taking a tax hit, the owner will be able to provide the 529 beneficiary with continued tax-deferred growth of the funds and, in most instances, tax-free withdrawal of the balance.

529-to-Roth Rules and Limitations

The following limits and timeframes were placed on the ability to take such action:

- The recipient Roth IRA must be in the name of the 529 beneficiary.
- The 529 plan must have been open for more than 15 years.
- Rollover amounts cannot include any contributions to the Roth IRA (or any earnings on those contributions) within five years of the rollover.
- Rollovers are subject to a \$35,000 lifetime maximum.

It's important to note that Roth IRA contribution limits and rules still apply (with one major exception). Accordingly, a onetime rollover of the entire \$35,000 lifetime maximum limit will not be an option because the annual Roth IRA contribution limit (currently \$6,500 if younger than 50 years old) still applies. Therefore, to use the entire lifetime limit of \$35,000, the owner will need to effectuate the rollovers over a period of years within the Roth contribution limits. In addition, taxpayers would need to be cognizant if the beneficiary contributed to a traditional or Roth IRA outside of the 529 during the same tax year because the annual contribution limit is the aggregate of all contributions (i.e., the 529-to-Roth rollover does not carry with it an independent limit).

The beneficiary must also have earned income to support the Roth contribution; therefore, rollovers to Roths for minor beneficiaries may not be available unless such minor child has earned income themselves (e.g., child model, lawn mowing, or babysitting).

There is, however, an important Roth contribution rule that is *inapplicable* to the new 529-to-Roth rollover opportunity. In 2023, an individual's modified adjusted gross income must be less than \$153,000 (\$218,000 for married filing jointly) to contribute to a Roth IRA. That limitation **does not** apply to 529-to-Roth rollovers. Therefore, even high earners who are normally restricted from using a Roth IRA may have the opportunity to get funds into a Roth (much like a "backdoor" Roth IRA conversion).

Although the new opportunities presented by this legislation are exciting, confusion persists in certain areas.

The 15-Year Clock

What is the effect of changing a 529 plan beneficiary with regard to the new 529-to-Roth rollover rule? This is an area that the text of SECURE 2.0 did not specifically address.

The major concern is whether the change in beneficiary or rollover of funds from one plan to another "restarts" the 15-year clock or whether the ability to roll over is tied to the original account opening date, irrespective of any beneficiary changes in the interim.

Clarity on this unknown item is essential for a few reasons:

1. Given the 15-year wait time, some individuals could choose to open and "seed" a 529, even prior to having children, to start the 15-year clock and later change the beneficiary to a future child.
2. If a change of beneficiary does not affect the 15-year rule, then, theoretically, an account owner could complete Roth rollovers exceeding \$35,000 from an account by changing the beneficiary.
3. Changing beneficiaries of 529 plans is common for families where money needs to be allocated to a different child for educational costs based on disparity of expenses or the educational needs of the child.

Ideally, clarity on this issue will come in the form of an issuance of guidance from Congress or the IRS on the specific effect of a change of beneficiary on the ability to do a 529-to-Roth rollover. Given the significant delays in the issuance of regulations related to the original SECURE Act and the persistent uncertainty as to the application of its provisions, however, it is possible that clarity may not come before the rule takes effect in 2024.

As we wait for 529-to-Roth-IRA rollovers to become a reality, it is important to understand the new rule's applications and limitations.

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John Esposito, AIF®

Dimatteo Group Financial Services Inc.

1000 Bridgeport Avenue | Suite 506 | Shelton, CT 06484

203.924.5420 | 203.402.8305 fax | www.dimatteofinancial.com | jesposito@dimatteofinancial.com

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