Should I Rollover 529 Funds To A Roth IRA?

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One of the most talked about provisions of the SECURE 2.0 Act is the ability to rollover funds from a 529 plan to a Roth IRA. Funds distributed from a 529 plan are generally subject to income tax and a 10% penalty unless they are used to pay for qualified education expenses but beginning in 2024, 529 plan distributions to a Roth IRA may be excluded from income for federal tax purposes subject to certain conditions and limitations. Unfortunately, there is a lack of clarity around the requirements relating to how long a 529 account must be open and how long funds must be in the account to be eligible. Additional guidance is needed, but it is unclear if or when the IRS will provide this guidance.

In general, the SECURE 2.0 Act provides that the following conditions must be met to distribute funds from a 529 plan to a Roth IRA tax-free:

1. **Direct Transfer:** Distributions must be direct trustee-to-trustee transfers from the 529 plan to the Roth IRA. You should contact the Roth IRA trustee to determine if there are any specific requirements before requesting a rollover to ensure it will be accepted. Each 529 plan has its own specific form in connection with a Roth IRA rollover. Following are links to the rollover forms for the Georgia Path2College and Utah my529 which are the most common plans for our firm's clients:
   - Path2College Direct Rollover Out to Roth IRA Form
   - my529 Roth IRA Rollover Request Form
2. **Roth IRA owner is the same as the 529 beneficiary:** The owner of the Roth IRA (or beneficiary in the case of a custodial account) must be the designated beneficiary of the 529 plan.
3. **Plan maintained 15+ years:** The 529 plan must have been maintained for at least 15 years. The IRS has not provided guidance on whether closing and reopening an account, a rollover from another plan, a change of account owner, a change of beneficiary, or any other change to a plan would reset the 15-year clock.

4. **Funds in plan 5+ years:** Distributions from the 529 plan cannot exceed the aggregate amount contributed to the 529 plan (including attributable earnings) at least 5 years prior to the distribution. The IRS has not provided guidance on how to determine which funds meet the 5-year requirement or how to account for prior distributions, internal transfers, rollovers from other plans, or other types of plan contributions or withdrawals.
5. **Annual distribution limit:** Distributions from the 529 plan during any tax year cannot exceed the annual Roth IRA contribution limit reduced by the aggregate contributions made during that taxable year to all IRAs maintained for the designated beneficiary of the 529 plan. The Roth IRA contribution limit is the lesser of the Roth IRA owner's taxable earnings or $7,000 ($8,000 if age 50+) for 2024. Note that while you must generally fall below a certain income level to contribute to a Roth IRA, the income limitation does not apply to qualifying 529 plan distributions to a Roth IRA.
6. **Lifetime distribution limit:** Distributions to a Roth IRA from all 529 plans for a designated beneficiary cannot exceed $35,000 in aggregate (i.e., each individual has a $35,000 lifetime limit).

Funds distributed from a 529 plan that do not satisfy the conditions of a tax-free Roth IRA rollover will be subject to income tax and a 10% penalty. The tax and penalty might be avoided if the funds can be used to pay qualified education expenses. However, those considering a 529 plan to Roth IRA rollover are probably doing so because the designated beneficiary does not have qualified education expenses. The tax and penalty might also be avoided if the distribution could be recharacterized as an indirect rollover. However, Utah's my529 SECURE Act 2.0 FAQs page indicates that "rollover requests that are rejected by the Roth IRA trustee and returned to my529 will be treated as new contributions by my529." The result would be that no funds are effectively removed from the 529 plan, but the attempted rollover amount would presumably be subject to tax and the 10% penalty. Assuming this is the case, you would be better off simply making a nonqualified distribution and paying the tax and penalty because at least the funds would no longer be in the 529 plan.

In addition, although a qualified 529 plan distribution to a Roth IRA may be excluded from income for federal tax purposes, not all states use the federal definition of qualified expenses for 529 plans. In states that do not have the same definition of qualified expenses, a 529 plan distribution to Roth IRA could be subject to state level taxes and penalties. The website savingforcollege.com offers information on rollovers from a 529 plan to a Roth IRA, including a 529 comparison tool that lists the states that do not treat distributions from a 529 plan to a Roth IRA as a qualified expense for state tax purposes. Below is information regarding the state tax treatment of a 529 plan to Roth IRA rollover for Georgia and Utah, but you should confirm the state tax treatment before requesting a rollover. If you have questions about your potential state tax liability, you will need to consult with your tax advisor.

- For Georgia taxpayers, a rollover from a 529 plan account to a Roth IRA will be treated as a qualified withdrawal. If you are not a Georgia taxpayer, these withdrawals may include recapture of tax deduction and state income tax. See path2college FAQs re: withdrawals.
- For Utah taxpayers, the amount of the Roth IRA rollover must be included as income on your Utah tax return in the year of the rollover, to the extent it was deducted or used in calculating the tax credit on a current or previously filed Utah tax return. See my529 SECURE Act 2.0 FAQs page.

The SECURE 2.0 Act opens new opportunities for using 529 plan funds. By rolling over leftover funds to a Roth IRA, you can tap into the tax-free growth potential for retirement. This is a powerful new tool for your long-term financial plan. Yet, there are complexities to consider, and it is up to the individual requesting a 529 plan to Roth IRA rollover to determine the plan's eligibility. You must verify that the 529 account has been open and funded for the requisite time periods (15 years and 5 years respectively) and ensure the distributions do not exceed the annual and lifetime limits (regular annual IRA contribution limit and $35,000 respectively). You must also satisfy any requirements the Roth IRA trustee may have and comply with the 529 plan's Roth IRA rollover procedures. If there is a question as to whether the conditions of a tax-free Roth IRA rollover have been met, consider holding off on the rollover until the IRS provides additional guidance or you are certain that all requirements have been satisfied. If you have additional questions about the requirements or tax implications of a 529 plan to Roth IRA rollover, you should consult with your tax advisor or 529 plan administrator.

If you have any questions or would like to discuss further, please reach out to your client service team, or call 404.264.1400. You can also visit us on the web at **HomrichBerg.com.**

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