

SECURE 2.0 Act Provides Another Solution for Excess 529 Plan Savings

Due to the many benefits they offer, 529 plans are among the most popular and tax-smart ways for individuals and families to set aside money for education expenses. The plans allow individuals to contribute funds that can grow tax-free and be withdrawn without incurring state or federal taxes when used for a broad range of qualified educational expenses, including K-12 and college tuition, fees, books, and certain room and board costs, among others. And since contributions are considered gifts for tax purposes, they qualify under the annual gift tax exclusion, which is \$17,000 for individuals (\$34,000 for a married couple filing jointly) in 2023. In 2024, these limits increase to \$18,000 for individuals (\$36,000 for a married couple filing jointly).¹

Even better, 529 account owners can accelerate their gifting schedule by front-loading the plan, which can be an effective strategy for high-net-worth families seeking to reduce their estates through gifting, to lower their estate tax liability. Through front-loading, parents or grandparents can contribute up to five years of gift-tax-exempt funds into the 529 account in a single tax year. For example, the five-year election in 2023 would allow contributions up to \$85,000 per individual, or \$170,000 for a married couple filing jointly. In 2024, the limit for front-loading contributions will increase to \$90,000 per individual, or \$180,000 for a married couple filing jointly. For each of the five years, you must report the five-year election on IRS Form 709.²

What if you've set aside too much in a 529 plan?

While 529 plans offer many advantages it's important to note that, with limited exceptions, funds used for nonqualified purposes are subject to a 10% penalty in addition to state and federal income taxes.³ That can be a problem if you're sitting on a plan with excess savings.

There are many reasons why money saved through a 529 plan may go unused, such as when a beneficiary receives a scholarship or does not attend college, resulting in a considerable sum of money earmarked for education with no beneficiary to use the funds. Fortunately, several options exist to remedy the situation. For example, parents can switch the designated beneficiary to another child or family member and continue using the 529 account for qualifying educational expenses. If your child earns a tax-free scholarship, you can take an equivalent amount out of the 529 plan without the 10% penalty (though the earnings portion of the distributions will be taxable). In addition, a lifetime limit of up to \$10,000 per beneficiary may be used to pay off qualifying student loans.⁴

In cases where these are not viable options, a provision under the SECURE 2.0 Act of 2022, that takes effect next year may provide a solution.

Beneficiaries can soon roll over unused funds

Beginning January 2024, beneficiaries of 529 college savings accounts will be permitted to roll over up to \$35,000 over the course of their lifetime from any 529 account in their name to a Roth IRA. For many account owners and their beneficiaries, this solves the problem of what to do with unused savings left in the plan. However, there are several important considerations:⁵

- The 529 account must be open for at least 15 years before funds can be rolled over into a Roth IRA
- 529 contributions made within the preceding five years cannot be rolled over
- Rollover amounts are subject to annual IRA contribution limits
- If the 529 beneficiary is different from the 529 account owner, the Roth IRA must be in the beneficiary's name
- The lifetime maximum that can be rolled over is \$35,000

Understanding the annual rollover limit

Annual limits for 529 rollovers are the same as annual IRA contribution limits, less any IRA contributions the account owner makes for the same tax year. In other words, if the beneficiary makes any IRA contributions, the amount they are eligible to roll over from the 529 account is reduced by those contributions. For example, the contribution limit for IRAs in 2024 is \$7,000 for those under age 50. Therefore, if a 38-year-old beneficiary contributes \$3,000 to any IRA, the maximum amount they could roll over from their 529 account is \$4,000 (for a total of \$7,000 for the year).

Is a 529-to-Roth IRA rollover right for you?

Keep in mind, the ability to roll unused assets into a Roth IRA at a later date is not a reason to overfund a 529 plan. Drawbacks to the 529-to-Roth IRA rollover include the long waiting period until assets are eligible for a rollover, as well as strict limitations on amounts that can be rolled over annually. In addition, the rules governing these rollovers may be subject to change as new legislation is introduced or amended in the years ahead. However, if you're an account owner or beneficiary with unused assets in a 529 account that was established at least 15 years ago, a rollover to a Roth IRA may be an appropriate strategy to consider.

If you have questions about this or other strategies available to help you move closer to your goals, call the office to schedule a meeting.

¹"Frequently Asked Questions on Gift Taxes." IRS.gov, 22 NOV 2023, <https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes>

²Ibid.

³"529 Plan Penalty: Approved Expenses and How to Avoid Fees." Cfnc.org, 23 OCT 2023, <https://www.cfnc.org/news/529-plan-penalty-approved-expenses-and-how-to-avoid-fees/>

⁴"Publication 970: Tax Benefits for Education." IRS.gov, 2022, <https://www.irs.gov/pub/irs-pdf/p970.pdf>

⁵Bendig, Erin, "529 Plans Get a Boost With Tax-Free Rollovers to Roth IRAs." Kiplinger.com, 24 FEB 2023, <https://www.kiplinger.com/retirement/retirement-plans/529-plans-get-a-boost-with-tax-free-rollovers-to-roth-iras>

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Some IRAs have contribution limitations and tax consequences for early withdrawals. For complete details, consult your tax advisor or attorney.

Investors should consider the investment objectives, risks, charges and expenses associated with municipal fund securities before investing. This information is found in the issuer's official statement and should be read carefully before investing.

Investors should also consider whether the investor's or beneficiary's home state offers any state tax or other benefits available only from that state's 529 Plan. Any state-based benefit should be one of many appropriately weighted factors in making an investment decision. The investor should consult their financial or tax advisor before investment in any state's 529 Plan.