



CLIENT ALERT - THE NEW 529-TO-ROTH IRA CONVERSION RULE

July 10, 2023

Beginning in 2024, the federal legislation known as the SECURE Act 2.0 will allow beneficiaries of 529 plans to transfer up to \$35,000 of 529 plan funds over the course of their lifetime to their own Roth IRA without paying taxes or penalties.

A 529 plan is a tax-advantaged investment account designed to help families save money for a child's education. After-tax contributions that are made to a 529 plan are invested and grow on a tax-deferred basis. If the funds are used to pay for qualified education expenses, the withdrawals, including all tax-deferred growth, are tax-free. If a 529 beneficiary does not pursue higher education or, if the beneficiary completes his or her education without exhausting the account, then the options for what to do with the remaining funds are limited. Generally speaking, those options are (1) the account owner may change the account beneficiary to another family member of the beneficiary (i.e., a child, grandchild or eligible relative) to fund an education or, (2) the account owner or the beneficiary may withdraw the remaining funds for a nonqualified use, resulting in any tax-deferred growth being included in the account owner's or beneficiary's gross income and a 10% penalty being applied to the growth.

Because of the limitations and perceived inflexibility of 529 plans, many families have hesitated to overfund 529 plans and opt for less tax-favorable investment tools instead. In introducing a raft of reforms to the laws governing retirement in the United States, the SECURE Act 2.0 sought to increase comfort with 529 plans by allowing for qualified rollover contributions (Roth conversions) of limited amounts from long-term 529 plans to Roth IRAs. These 529 Roth conversions will take on the characteristics of a conversion from a traditional IRA to a Roth IRA, meaning that any tax-deferred growth within the 529 plan that is rolled over to a Roth IRA will be tax-free once the Roth IRA owner is eligible for a qualified distribution from the Roth IRA. This will only work, however, if the conversion meets the requirements of the SECURE Act 2.0. The requirements are as follows:

1. The 529 plan must have been open for no less than 15 years.
2. Contributions made to the 529 plan, including the associated earnings, are not eligible for a tax-free transfer until after five (5) years.
3. The beneficiary of the 529 plan must be the owner of the Roth IRA.
4. The Roth IRA owner must have includable compensation in the year of the rollover at least equal to the amount of the rollover.
5. Transfers from a 529 plan to a Roth IRA are subject to Roth IRA annual contribution limits (\$6,500 in 2023).
6. The 529 beneficiary may not roll over more than \$35,000 from a 529 plan to a Roth IRA during his or her lifetime.

If you have any questions, please contact your Cummings & Lockwood attorney.