Leftover 529 Funds

A Retirement Savings Option

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AS THE Y EAR 2022 WAS DRAWING TO A CLOSE, the U.S. Congress passed the SECURE 2.0 Act, an update to the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019. The update contains 92 provisions designed to promote retirement savings, including alterations to retirement plans across the board with a focus on 401(k) and 403(b) plans. Some of the relevant updates and changes:

- Increases the required minimum distributions (RMDs) age for traditional IRA-type account holders from 72 to 73 as of 2023, and to 75 beginning in 2033.
- Reduces the penalty for failure to take an RMD from 50 to 25 percent.
- Permits emergency withdrawals of $1,000 per year without penalty from 401(k) and 403(b) accounts.
- Provides a Roth contribution option for SIMPLE and SEP IRAs.
- Allows employers to make matching contributions to student loan payments in 401(k), 403(b), 457(b), and SIMPLE IRA accounts.

529 LEFTOVERS

A key provision of SECURE Act 2.0 involves changes, as of 2024, to 529 college savings plans, in particular to unused or leftover funds. While the costs of higher education continue to rise, there also continues to be instances where funds are leftover in a 529, such as:

- The student receives a scholarship that had not been anticipated.
- The student selects a lower-cost program or institution than had been planned for.
- The student receives an inheritance.
- The student chooses to follow a different career path, and the 529 funds are no longer needed.

The SECURE Act 2.0 includes an option for using 529 plan leftovers that avoids penalties for nonqualified withdrawals — funds withdrawn for non-educational expenses ordinarily incur a 10 percent penalty. Specifically the Act allows the student, or beneficiary, to rollover the remaining balance into a Roth IRA. Prior to the updated Act, options for unused 529 funds were limited to saving for a future educational cost, such as graduate school; transferring the money to another beneficiary in the family; or paying up to $10,000 on student loans. The updated Act allows the 529 beneficiary to use up to $35,000 of leftover funds to open a Roth IRA.

CONSIDERATIONS

In allowing the beneficiary to convert 529 funds to retirement savings, the Act supports its intent by getting that individual started on their retirement savings program, letting them put money aside they will be able to draw on tax-free after age 59 1/2. However, there are a few things to keep in mind when considering the leftover rollover:

- The 529 plan must have been in existence for at least 15 years prior to any rollover to a Roth. As such, there will be a waiting period after graduation prior to converting newer 529s, ones set up closer to the student's anticipated college enrollment.
- The rollover to a Roth can only happen in increments of annual Roth contribution limits. For example, the current Roth contribution limit is $7,000; if a the 529 beneficiary were to begin moving their 529 leftovers to a Roth in 2024, the most they could roll over prior to year-end is $7,000. It is likely that the annual Roth contribution limit will increase over time, but as currently scheduled, a full $35,000 rollover will take five years to complete.

Still, for individuals with unused 529 funds, SECURE 2.0 has provided an option that can benefit them well beyond the days of their schooling, one than can set them up for a successful retirement. Consider that $35,000 in a Roth account at age 25 growing at a rate of just 5 percent compounded annually over 40 years will result in more than $250,000 in retirement savings at age 65.

For more information on 529-to-Roth rollovers, gifting ideas for younger family members, and how 529s can fit into your overall financial planning picture, contact us at HBKS Wealth Advisors by phone at 724-934-8200, or email me at bdusch@hbkswealth.com. We're always happy to discuss options for you and your loved ones, and strategies that will help you achieve financial success.

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