

529 Plan Leftovers



A New Option

By Michael RINGLER
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THE U.S. GOVERNMENT has developed a qualified savings plan model that allows parents to stash away money and let it grow tax-free for their children’s educations. So-called 529 Plans are state-sponsored, meaning that each state has its own plan structure and guidelines. You can pick the plan you like, whether you live in that state or not. While most 529 plans are opened to cover costs of a college education, you can use the funds for qualifying expenses at any level, from kindergarten through graduate school.

And because you invest after-tax dollars in a 529 plan, qualified withdrawals are not taxed; nor are the earnings that compile over the years as you make contributions and grow the plan value. In fact, there are few things not to like about 529 plans, and they have become a very popular way to invest and pay for a child’s education.

While 529 plans are fairly straightforward, there are some nuances, including one that is typically top of mind of a parent opening a plan: What happens to the leftovers? That is, if the child doesn’t use all the money in the plan for qualified educational expenses, what can I do with the unused funds? On one hand, you can simply move the funds to another beneficiary, that is, another of your children, or perhaps a grandchild. But if the original beneficiary is likely the only person to use those funds, you’ve been faced with a penalty of 10 percent of the earnings portion of the remaining funds at withdrawal. As well, those earnings were taxable.

However, as of 2024, there’s another option. The beneficiary, the student, can roll over the unused funds, up to \$35,000, to a Roth IRA, penalty-free and tax-free. The benefit is a provision of SECURE Act 2.0.

There are restrictions on how the rollover can be done, most importantly:

- **Holding periods:** The plan must have been in place at least 15 years before you can execute a rollover. Any earnings during the last five years before the rollover aren’t eligible for a tax-free rollover.

Students with 529s can roll over the unused funds, up to \$35,000, to a Roth IRA, penalty-free and tax-free.



- **Annual limits:** You can't roll over the entire \$35,000 in the same year. You're restricted to the annual contribution limit, which in 2024 is \$7,000.
- **Ownership:** The beneficiary of the 529 plan must also be the owner of the Roth IRA, and they must have earned income at least equal to that year's rollover amount.

Another tax-related consideration: 529 plan distributions, or withdrawals, are allocated between earnings and contributions. The contribution portion will never be taxed or penalized since it was made with after-tax dollars.

The Roth IRA rollover option answers one of the biggest concerns of people considering opening a 529 plan for their child. And in so doing, it also affords the beneficiary an opportunity to start their retirement savings program early in their work life.

We can help you choose a plan and determine the best way to fund it. Call us for more information at **716-672-7800**; or email me at mringler@hbkswealth.com.

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