529 Plans: New Tax Law Provides More Options

With the rising costs of higher education, many of our clients are actively seeking ways to set aside funds to support their children and grandchildren's future education expenses. An efficient and flexible way to save for college and its associated costs is a 529 plan. A 529 plan is a tax-advantaged savings plan specifically designed to provide for the qualified education expenses of a designated beneficiary. 529 funds grow tax-deferred, and withdrawals are tax-free provided they're used for qualifying educational expenses.

We occasionally have families that have a surplus of funds in their 529 accounts once their beneficiary has graduated college. This can be due to the student receiving a scholarship, graduating early, or attending an in-state public college or military academy. When this happens, there are several options of what can be done with the leftover funds to avoid the 10% tax penalty on non-qualified distributions:

1. Transfer the funds to another beneficiary.

   If the current beneficiary has completed college and has no plans for graduate school, the 529 plan funds can be transferred to a sibling or other relative. The owner of the 529 plan may change the beneficiary at any time without tax consequences. There is also no time limit on when 529 funds need to be used by, so the funds can be left to grow tax-free for the future benefit of grandchildren or other family members. In addition, continuing to invest the funds in a 529 keeps the value out of the owner's taxable estate, but still allows for control over the assets and tax-advantaged gifting opportunities.

2. Use the money to make student loan payments.

   Included in the passage of the SECURE Act in 2019 was a provision allowing for 529 funds to be used towards qualified student loan payments. There is a lifetime limit per borrower of $10,000 and the funds used towards student loans are not eligible for the student loan interest deduction.

3. Rollover funds into a Roth IRA.

   As part of the SECURE 2.0 Act and beginning in 2024, excess 529 funds can be transferred to a Roth IRA in the same beneficiary's name, though there are a few restrictions to note. First, the 529 plan must have been opened for at least 15 years before it can be rolled over into an IRA and the rollover can only be made into the beneficiary's Roth IRA (not the owner's). Also, funds must have been in the 529 account for at least 5 years before they can be rolled over. In other words, contributions and earnings on those contributions from within the past 5 years are ineligible to be rolled over. Finally, the max amount allowed to be transferred to a Roth IRA is $35,000, and the annual contribution limits for Roth IRAs still applies ($6,500 for 2023).

As always, please don't hesitate to reach out if you have any questions or if you would like to discuss your 529 plans and strategies around maximizing benefits. We appreciate the opportunity to serve you and your family.