Leftover Rollover

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Suppose you've been contributing to a 529 college savings plan, but your son or daughter doesn't use all the money for tuition, books, etc. Do you just ask for the remainder of your money back?

Any contribution to a 529 plan is deemed to be a completed gift to the beneficiary—typically a child or grandchild of the donor. If you don't want to incur a gift tax, then you can contribute up to $18,000 a year, but you can make five years of contributions at once—$90,000—if you treat the contribution as if it was spread over a five-year period. (You would do this on IRS Form 709 for all five years). If you only want to contribute, say, $50,000, then you can apply $10,000 per year. After the contribution, the money grows tax-free and can be used to pay college expenses without being taxed.

But back to the first question; you have the money in the account, but now it looks like the son or daughter isn't going to use all of it. What do you do? You can indeed revoke the funds in the account, but that means they will be added back to your taxable estate, earnings will be taxable, and the IRS will assess a 10% tax penalty.

You can roll the money from one 529 plan to another one, tax-free so that it covers another daughter or granddaughter. That allows you to jump-start another child's or grandchild's college savings.

Finally, starting this year, you can transfer the stranded funds to a Roth IRA. There are restrictions. One of the most severe is that the 529 plan must have been maintained for at least 15 years, and the amount transferred must come from contributions and earnings made at least five years before the transfer. The Roth IRA must have the same beneficiary as the 529 plan, meaning that the money can't go back to an account held by the parents, grandparents, or other children. However, the owner of a 529 plan can change the beneficiary to another individual before the transfer.

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In 2024, the aggregate amount transferred from the 529 plan to a Roth IRA for any individual cannot exceed $35,000. That means the transfer might not be a good option for parents whose child suddenly decides to forego college. But for leftover funds, the money that would have gone to pay for college can be used to pay for future retirement expenses instead—and preserve its tax-free growth in the process.

Sources:

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https://www.bankrate.com/retirement/roll-over-529-roth-ira/

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number (215) 325-1595 or you can click here to schedule a meeting.

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