

Chicago Daily Law Bulletin

Changes to 529 accounts allow tax-free rollover to ROTH IRAs Family Law

By [Jason Sposeep and Ricardo Santiago](#)

Jason Sposeep is a Senior Partner with Schiller, DuCanto & Fleck LLP, and Ricardo Santiago is an Associate with the firm.

POSTED May 31, 2023 11:08 AM

Late last year, President Joe Biden signed into law a \$1.7 trillion federal spending bill that included a provision to allow families to roll over funds from their Section 529 college savings plans to Roth individual retirement accounts — free of tax — starting in 2024.

Although the amendment comes with limitations, divorcing couples who own Section 529 accounts for their children's education should make sure to address the post-divorce treatment of these accounts when finalizing any settlement addressing college education, since this new law will potentially make these accounts more valuable in divorce.

What are 529 accounts and where did they come from?

Named for Section 529 of the Internal Revenue Code, 529 accounts are tax-advantaged savings plans that allow individuals to contribute after-tax dollars to an investment fund that they can later use to pay for a designated beneficiary's education. The state invests the money placed in the fund until the account owners are ready to use the money to pay for qualified educational expenses without incurring tax on their investment gains.

Since the Section 529 was enacted, there have been several amendments to the law, including the Economic Growth and Tax Relief Reconciliation Act of 2011 (making earnings in 529 plans completely tax free when used for college) and the Tax Cuts and Jobs Act of 2017 (expanding qualified expenses to include payments made for elementary or secondary tuition at public, private or religious institutions).

Almost anyone can open a 529 plan but only one person can own the 529 account. However, the account owner can name a successor custodian of the account, change the account owner, and/or replace the current beneficiary. In many cases, one parent will own the account and the other parent will be the successor. The beneficiary of the account is the person whose educational expenses will be paid from the 529 account. The beneficiary, in many cases, is the child resulting from a marriage, but can also be a grandchild, niece or nephew, friend, or even the account owner herself. The ability to change the beneficiary may come in handy when the original beneficiary has completed their education and the 529 account still has unused funds that would otherwise be taxed or penalized as a result of a withdrawal that is not used for education purposes.

What changes are coming in 2024?

By allowing the tax-free rollover of money in a 529 account to a Roth IRA, the federal spending bill signed by Biden provides some relief to 529 account owners and beneficiaries with leftover money

Chicago Daily Law Bulletin

in their accounts. Despite the benefits a rollover of this nature may provide, the amendment has the following limitations:

- The account must have been maintained for at least 15 years before you can roll over any money.
- Contributions to the 529 account made within the last five years of the date of distribution do not qualify to roll over to a Roth IRA.
- The 529 account rollover amount must not exceed the maximum contribution amount allowed by the receiving Roth IRA in any given taxable year, such amount is further decreased by the amount of any prior contributions already made to the Roth IRA during the same taxable year as the intended rollover.
- The receiving Roth IRA account must be owned by the 529 account beneficiary, not by the 529 account owner.
- There is a lifetime cap of \$35,000 on money that can roll over from the 529 account into the Roth IRA.

How do the changes to 529 accounts affect divorcing couples?

There are many factors that can affect how a divorcing couple could find value or dispose of the funds in a 529 account, such as the age of the account owner, spouse and beneficiary; the amount of money in the account; the existence of potential new beneficiaries; and whether the divorce is contested or amicable.

Traditionally, beneficiaries could take advantage of 529 accounts with leftover funds to further their education, for instance, pursue graduate school. Under the Tax Cuts and Jobs Act, account owners can use leftover funds by naming a younger beneficiary, after the original beneficiary graduated from college, and paying for high school tuition — or even funding a 529 account further to pay for the college expenses of grandchildren, or paying for their elementary and high school tuition if the funds are abundant.

Under the new law, account owners have greater flexibility to put unused funds to work, such as by funding multiple 529 accounts to their maximum contribution limits and rolling the \$35,000 maximum into IRAs, where the money can continue to grow for decades.

For divorcing couples, the ability to roll unused funds from 529 accounts into IRAs could translate into additional retirement money that needs to be negotiated in the same manner as a traditional retirement account.

For example, an older couple going through an amicable divorce, having money leftover in a 529 account that designates their daughter as the beneficiary, whose daughter does not intend to pursue further education, might be more likely to agree in their marital settlement agreement to roll over leftover money in their 529 account to the daughter's Roth IRA for her retirement; a

Chicago Daily Law Bulletin.

rollover amount of \$35,000 could compound to more than \$1 million dollars by the time the daughter retires.

In contrast, a young couple with a toddler, going through a highly contested divorce, might want to consider adding very clear and specific terms in their marital settlement agreement to prevent the account owner from changing the beneficiary from their toddler to themselves and rolling over the money into their own Roth IRA down the line.

Without clear terms in a marital settlement agreement to prevent a unilateral rollover of 529 account funds into an IRA, a divorcing owner of multiple 529 accounts could easily name a child from a new relationship as the new 529 beneficiary on those accounts to the detriment of the child born from the marriage. In these cases, a knowledgeable family law attorney could help the parties negotiate obligations to continue to fund existing 529 accounts or even trade traditional retirement accounts for 529 accounts, taking into consideration the effects of the new law, giving the parties additional flexibility in their divorce finances.