

# FUNDING A ROTH IRA WITH A QUALIFIED TUITION PROGRAM BALANCE

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## ABSTRACT

The SECURE 2.0 Act of 2022, part of the Consolidated Appropriations Act of 2023 (P.L. 117-328), made many changes to the tax law to promote employer retirement plans and encourage retirement savings. This act included a provision allowing transfers from a qualified tuition program (QTP) account to a Roth IRA. This paper describes and discusses this new opportunity, including some of the ambiguities with the new law that will need legislative clarification or IRS interpretation of legislative intent.

**Keywords:** Roth IRA, Qualified Tuition Program, SECURE 2.0

## INTRODUCTION

The SECURE 2.0 Act of 2022, part of the Consolidated Appropriations Act of 2023 (P.L. 117-328), made many changes to the tax law to promote employer retirement plans and encourage retirement savings. When tax laws with many facets are enacted, those changes that affect the most people and which may be easiest to understand are often the focus in the popular press. For example, with respect to retirement savings and the SECURE 2.0 ACT, one of the changes that has received much attention was the change in the age for required minimum distributions (RMDs). Tax law allows multiple types of employer-sponsored retirement accounts that allow taxes to be deferred until withdrawals are taken during retirement. However, the government does not want to permanently defer these taxes, as the government needs revenues to operate. So, at a certain age, an individual is required to start withdrawing money from these tax-deferred accounts and pay the associated taxes. These withdrawals are called RMDs.

Most retired people and those reaching retirement age may already have heard about RMDs, but even a young person who has not paid much attention can easily understand an RMD age once it is briefly explained. Since the RMD age potentially affects all people who have tax-deferred retirement savings accounts, a change in the age for RMDs from 70½ to 72 (P.L. 116-94) and again from 72 to 73 and later to 75 (P.L. 117-328) gets a lot of press.

However, other changes made by the SECURE 2.0 Act that affect fewer individuals or which are more difficult to explain and understand may get only brief mention in lists detailing the changes from a new law. In these lists these changes are often described in very general terms without many details that would allow someone to determine if the law is applicable to them and how to apply it if it is. One of the changes from the SECURE 2.0 Act that fits in this category is the part that allows a transfer from a qualified tuition program (QTP) account to a Roth IRA. Although this new option may not apply to very many taxpayers, it will certainly apply to some, and those who have excess funds in a QTP may want to understand the rules and restrictions of such transfers. QTPs will first be explained in more detail. Qualifications and limits for Roth IRAs will also be reviewed prior to detailing the new option to transfer amounts from a QTP to a Roth IRA. This new option is available starting in 2024, so understanding it now will help QTP administrators get ready for such transfer requests and will help individuals determine if they qualify for such transfers. Some ambiguities of the new law will need legislative clarification or IRS interpretation of legislative intent.

## QUALIFIED TUITION PROGRAMS

QTPs, also referred to as qualified tuition plans or section 529 plans, were first legislated by the Small Business Job Protection Act of 1996 (P.L. 104-188). QTPs can be one of two types—(1) a plan to buy “tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education costs” (IRC, section 529) or (2) a program offered by a state to allow an educational savings account to be set up for a beneficiary to pay for qualified education expenses. The first type can be set up by a state or one or more educational institutions to buy tuition credits which are guaranteed to cover a certain portion of the tuition regardless of the inflation in education costs at a particular institution by the time the beneficiary enrolls. The second type can be set up by a state, its agency, or its instrumentality as an investment account to save for future education costs; this type is not tied to a specific institution or university system.

Since 1996 the provisions of qualified tuition programs have been amended to reduce original restrictions and/or to provide more flexibility. Some of these changes, including the amendments made by SECURE 2.0, are more directly related to the second type of QTP. Thus, the second type of QTP will be the focus of this paper.

Several general rules apply to QTPs. Contributions can only be made in cash. The program must have a separate accounting for each beneficiary. The contributor or beneficiary has limited investment direction; investment changes cannot be made more than two times in a calendar year. No part of the account can be used as security for a loan (IRC, section 529).

Another rule requires the program to have safeguards to prevent contributions for a specific beneficiary that exceed what would be needed for the qualified education expenses of that individual (IRC, Sec. 529). For example, the Utah Educational Savings Plan (UESP), doing business as “my529,” publishes a Program Description booklet that outlines how the plan works for contributions, withdrawals, transfers, fees, and so forth. The latest version (February 2023) states that “The maximum aggregate account balance of all my529 accounts for the same beneficiary is \$540,000. This amount estimates the current costs for an undergraduate and graduate degree at the highest-cost public or private educational institution in the United States” (my529, February 15, 2023, 23). While the account(s) may grow beyond this amount through earnings, no additional contributions would be allowed beyond this limit. The federal law requires safeguards, but it does not set the dollar limit, and the dollar limit set by a state entity can be changed over time as educational costs continue to increase.

A contribution to a QTP is deemed to be a completed gift to the beneficiary. Therefore, amounts contributed to a beneficiary’s QTP in excess of annual limits may be subject to gift taxes. For 2023, an individual (couple) can give up to \$17,000 (\$34,000) to an individual without being subject to gift taxes. However, a contributor can give up to five times that limit (\$85,000 (\$170,000 for a couple)) to a QTP and treat it as a gift made over five years by reporting that election on Form 709 (IRS, Form 709). This would preclude any additional gifts to that individual, to a QTP or otherwise, over the following four years without making them subject to the gift tax, with the exception of any additional amounts given to the extent the gift tax exclusion for any of those future years increases by indexing. For example, if a grandparent makes an \$85,000 contribution to a grandchild’s QTP in 2023, electing to treat it as made ratably over five years, and the gift tax exclusion increases to \$18,000 in 2024, the grandparent could give another \$1,000 to that grandchild in 2024 without incurring a gift tax liability (my529, February 15, 2023).

In general, distributions from a QTP for qualified education expenses are excluded from federal income taxes. While contributions to a QTP are made with after-tax money, the earnings in the account over time will never be taxed if used for qualified expenses.

When originally legislated, tax-free withdrawals from a QTP had to be qualified higher education expenses, which meant “tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible education institution” (P.L. 104-188). Tax-free withdrawals from a QTP can now include much more. Without mentioning all specific restrictions, additional costs that can qualify for tax-free QTP withdrawals include the following:

- Expenses for special needs services for a special needs beneficiary in connection with enrollment or attendance,
- Expenses for purchase of a computer, peripheral equipment, software, Internet access and related services, if they are to be used primarily by the beneficiary while enrolled at an eligible education institution,
- Reasonable costs for room and board for an academic period for students who are at least half-time students,
- Expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an appropriately registered apprenticeship program,
- Payments of principal and interest on a qualified education loan, limited to \$10,000 per individual over all years, and
- Tuition for enrollment at an elementary or secondary public, private, or religious school, limited to \$10,000 per year (IRC, section 529).

Because the tax code is careful to avoid a double tax benefit, qualified withdrawals from QTPs need to be coordinated with any expenses claimed for the American Opportunity credit or the Lifetime Learning credit. Coordinating with distributions from Coverdell education savings accounts or any other tax benefits related to education costs would also be necessary.

If distributions are made from a QTP for anything other than qualified education expenses, the earnings portion of such distributions becomes taxable income. In addition, a 10 percent penalty is levied on these amounts, as the account was supposed to have been created and used for qualified education expenses. However, the penalty is not applicable for certain exceptions: the beneficiary has died or is disabled, has received a scholarship (exemption limited to amount of the scholarship), is attending a U.S. service academy, or is claiming certain federal education credits (IRC, section 530; my529, February 15, 2023).

Within limits, certain transfers of QTPs are allowed without being taxable if made within 60 days of a QTP distribution. A rollover from one QTP to another QTP for the same beneficiary is permitted. A transfer from a QTP for one beneficiary to a QTP for someone “who is a member of the family of the designated beneficiary” is also allowed, with a broad definition of a family member, which is beyond the scope of this paper. A transfer to an ABLÉ account for the designated beneficiary or a member of the family of the designated beneficiary may also be allowed if made before January 1, 2026 (IRC, section 529). An ABLÉ account is an account set up under the Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 to provide support for someone who is disabled (P.L. 113-295).

Besides the federal tax benefits for a QTP, states may also offer tax benefits. Some states offer a deduction or a credit for QTP contributions. For example, Utah offers a state tax credit for contributions to a QTP up to a certain limit for most taxable entities, but corporations can instead take a tax deduction. The Utah credit for 2023 is 4.65% (the 2023 state tax rate) of up to \$2,290 contributed per beneficiary (or up to

\$4,580 per beneficiary for joint filers). For corporations, the deduction in Utah is limited to contributions up to \$2,290 per beneficiary (my529, May 17, 2023). These state tax benefits may only be available to residents of the particular state sponsoring the QTP, so those who want to contribute should be aware of whether state tax benefits are available to them. In Utah, only the account owner who is a Utah taxpayer can get the Utah tax credit for QTP contributions to my529; this is true even if some contributions come from others who are not the account owner. However, the Utah credit or deduction is only applicable if the account beneficiary is younger than age 19 when designated as the beneficiary on the account (my529, February 15, 2023). As expected, if nonqualified withdrawals are made from a QTP, state tax benefits previously claimed may need to be recaptured. This would depend on specific state tax laws.

As mentioned previously, a QTP is designed to save only amounts that would be needed for the qualified education expenses of the beneficiary. However, for many different reasons, a well-funded QTP may still have a balance when the beneficiary is done using amounts from the account. Without necessarily being exhaustive, the following list indicates some of these reasons:

- the beneficiary received scholarships, athletic or academic, which covered some or all of the educational costs,
- the beneficiary qualified for tax credits or other educational tax benefits, reducing the need for the QTP,
- the beneficiary attended a less expensive institution than saved for—this could include years at a community college or not being admitted to the most expensive private school originally targeted,
- the beneficiary took another path than formal post-secondary schooling or training (entrepreneurship, on-the-job training, decided further formal education was not desirable, had trust fund or inheritance to provide income and did not want more education, experienced trauma or mental or physical health concerns making more education difficult, got married and started raising a family, etc.),
- the QTP investment returns were unusually and unexpectedly high,
- the beneficiary graduated early by accelerating credits earned--this could include advanced placement credits from high school, concurrent enrollment credits from high school, testing out of specific courses and receiving credit, or consistently enrolling for an overload to graduate sooner,
- the beneficiary may have lived at home and attended a nearby institution, thus saving on room and board, and
- the beneficiary may have had a parent who was on the staff or faculty at the educational institution, thus providing some tuition waiver, requiring less to be withdrawn from the QTP.

What are the options for using the balance in a QTP once the educational goals of the beneficiary have been met? Some options have already been mentioned. The balance can be transferred over to another QTP for a member of the current beneficiary's family. Since the definition of a member of the family in this case is quite broad, this may be a good option in many cases. A QTP balance can also be rolled over to an ABLE account for the beneficiary or a member of the beneficiary's family. However, this option currently expires after December 31, 2025, and there is an annual limit for this type of transfer without resulting in some taxation and possible excise taxes. Rules for any of these transfers should be understood prior to making any transfers.

Another option is to withdraw the funds from the QTP. However, the earnings portion of the withdrawal will be treated as a nonqualified expense, making it subject to income taxes and to the 10% tax penalty unless one of the exceptions mentioned earlier applies.

Starting in 2024, another option will become available for a QTP balance not expected to be used for qualified educational expenses—a transfer to a Roth IRA. This new option was legislated in the SECURE 2.0 Act (P.L. 117-328). Smith (2023) mentioned some basic rules relating to Roth IRAs. These Roth IRA rules will be reviewed prior to a discussion of the specific rules relating to a transfer from a QTP to a Roth IRA.

## **ROTH IRAs**

Roth IRAs were first allowed by the Taxpayer Relief Act of 1997 (P.L. 105-34). These accounts are similar to traditional IRAs except the direct contributions to a Roth IRA are made with after-tax money. Then, if rules are followed, all distributions made from the account later are tax free. These accounts have become more popular in recent years, as some taxpayers are now learning they will be in a higher tax bracket during retirement than they were previously. Since the earnings in these accounts can be distributed tax free during retirement, these accounts may be more beneficial to some taxpayers than traditional IRAs or other tax-deferred retirement accounts. Also, having both tax free and tax deferred retirement accounts will give individuals more flexibility in managing their tax liability during retirement.

### **Direct Contributions**

Direct contributions to Roth IRAs are limited by the amount of earned income; this limit applies to all IRA contributions during a year to both Roth and traditional IRAs. Total IRA contributions for a year are also limited by an indexed annual maximum; this was \$2,000 in 1998 but has risen to \$6,500 in 2023. However, taxpayers who are 50 or older can make an additional catch-up contribution of \$1,000 per year (financialsamurai.com). If a married individual has a spouse with minimal income, that individual can also fund the annual limit to the spouse's Roth IRA if the individual's earned income is large enough to fund both accounts.

The ability to contribute to a Roth IRA also phases out over a range of modified adjusted gross income (MAGI). Up until 2006, the phase-out range for those married filing jointly (or qualifying widowers) was \$150,000 - \$160,000, but after 2006, this range has been indexed (P.L. 109-280). For 2023, the range is \$218,000 - \$228,000. For those married filing separately (who lived with their spouse), the phase-out range is \$0 - \$10,000 and is not indexed. For other filing statuses, including married filing separately (not living with the spouse during the year), the phase-out range up through 2006 was \$95,000 - \$110,000 but has now increased through indexing to \$138,000 - \$153,000 in 2023 (ptmoney.com).

Because there is an annual limit for direct IRA contributions, a deadline exists for Roth IRA contributions for a specific year. The deadline is the tax return due date for filing that year's tax return (not including extensions). For example, a direct Roth IRA contribution could have been made up to April 18, 2023, for the 2022 tax year.

Because direct contributions to a Roth IRA have already been taxed, they can be withdrawn at any time without taxes or penalties. If two conditions are met—the account owner is over 59½ and the account (or account owner's first Roth IRA account) has been open at least five years—withdrawals from the Roth IRA are qualified distributions and there are no taxes or penalties on earnings included in the withdrawal. "The five-year period starts on the first day of the tax year for which you made a contribution to any Roth IRA, not necessarily the one you're withdrawing from. So, if you contribute to a Roth IRA for the first time in early 2023, but the contribution is for the 2022 tax year, then the five years will end on Jan. 1, 2027" (fool.com). If those two conditions are not met, withdrawals are not qualified (termed early

distributions) and can be subject to taxes and perhaps to penalties, depending on the circumstances and possible exceptions, both beyond the scope of this paper.

Because the federal government is not expecting tax revenues from distributions from Roth IRAs, there are no required minimum distributions (RMDs) for a Roth IRA as there are for a traditional IRA, at least not during the life of the account holder. When the account holder dies, there are now specific rules for distributions, depending on who the beneficiary is. Again, this topic is beyond the scope of this paper.

## **Rollovers**

Besides direct contributions to Roth IRAs following the rules above, a Roth IRA account can also receive rollover money from other Roth IRAs or other designated Roth retirement accounts. “A designated Roth account is a separate account created under a qualified Roth contribution program to which participants may elect to have part or all of their elective deferrals to a 401(k), 403(b), or 457(b) plan designated as Roth contributions” (IRS, Publication 575, 4-5). Because these amounts are already in accounts designated as Roth accounts, the original contributions to those accounts were taxed, and the earnings in these accounts were already qualified as tax-free Roth earnings. Therefore, there would be no tax consequence for these rollovers. They would also not be subject to the annual dollar limit on contributions, the earned income requirement on contributions, or the income phase-out limitation that exists for direct contributions. As there is no annual limit and no tax consequences for rollovers to a Roth IRA from another Roth account, there is no specific annual deadline for making such rollovers.

## **Conversions**

An IRA to Roth IRA conversion is another way to get money into a Roth IRA account, at least for those who have an IRA account or who establish one or can convert other tax-deferred retirement accounts to an IRA. These conversions may be especially helpful for those who cannot make direct contributions because of income phase-out limitations or who wish to contribute more than the annual maximum allowed for direct contributions. These conversions are also not subject to the earned income limits. They are sometimes called backdoor Roth conversions, as they avoid the income phase-out limitations that exist for direct Roth IRA contributions, and they have no dollar limit. Amounts converted and going into a Roth IRA account must be taxed. To the extent the IRA from which the funds are coming has benefitted from tax deferral, the amount of any conversion to a Roth IRA would become taxable income in the year of the conversion. However, the funds in the Roth IRA could then grow tax free for the future (Smith, 2023). Although conversions do not have an annual limit, because there are tax consequences, the deadline for conversions is December 31 of the tax year for which taxes will be due.

Because conversions are not considered to be contributions, an additional five-year rule applies to each separate conversion. If converted funds are withdrawn within five years of the conversion, even though the converted amount has been taxed, the withdrawal can now become subject to the 10 percent penalty for early distributions. “This five-year rule also starts the clock on Jan. 1 of the year in which you do the conversion. As a result, those who convert late in the year only have to wait a bit longer than four years before taking withdrawals” (fool.com). Some exceptions to the penalty apply, including if the account owner is over 59½ (forbes.com). The ordering rules for Roth IRA withdrawals consider that contributions are distributed before conversions and rollover contributions from qualified retirement accounts; these ordering rules may reduce or eliminate the penalty mentioned since distributions are first deemed to be from contributions, which can always be withdrawn without taxes or penalties (IRS, Publication 590-B).

## **QTP TRANSFER TO A ROTH IRA**

In addition to the direct Roth IRA contributions, rollovers, and conversions discussed above, the SECURE 2.0 Act will allow, starting in 2024, a transfer from a QTP to a Roth IRA. Specific rules apply to such transfers.

- The QTP must have been maintained for the beneficiary for at least 15 years,
- The amount transferred must come from QTP contributions (or earnings on those contributions) made at least five years previous to the transfer (my529.org),
- The transfer must be a direct trustee-to-trustee transfer—it cannot be withdrawn by the beneficiary or account owner and separately deposited into a Roth IRA,
- The Roth IRA must have the same beneficiary as the QTP—no transfers to Roth accounts for family members of the QTP beneficiary are allowed,
- The amount transferred in any year is limited to the annual Roth IRA contribution limit, coordinated with any other IRA or Roth IRA contributions for that individual that year,
- The aggregate amount transferred from a QTP to a Roth IRA for any individual cannot exceed \$35,000, and
- The QTP trustee must provide a report to the Roth IRA trustee to which the distribution is made that includes information about the contributions, distributions, and earnings of the QTP as of the date of distribution—the Secretary of the Treasury may specify timing, manner, and other requirements of this report (P.L. 117-328).

### **DISCUSSION**

The information provided above about Roth IRAs distinguishes three methods of funding a Roth IRA: direct contributions, rollovers, and conversions. The new option to transfer amounts from a QTP to a Roth IRA is specifically designated as a “qualified rollover contribution.” In addition, “the earnings and contributions of any qualified tuition program from which a qualified rollover contribution is made under” this provision “shall be treated in the same manner as the earnings and contributions of a Roth IRA from which a qualified rollover contribution is made” to a Roth IRA from another Roth IRA (IRC, Section 408A(e)(1)(C)). Therefore, some of the earnings from the QTP that are transferred to the Roth IRA may never have been taxed but are treated as though they came from a Roth IRA for which the earnings will never be taxed, so they are not taxed at the time of the transfer.

However, this QTP transfer option also has at least one of the limits related to direct contributions, so it does not neatly fit into one of the three categories previously discussed. For example, qualified rollover contributions, in general, do not have contribution limits, but a transfer from a QTP to a Roth IRA is still subject to the annual contribution limit, coordinated with any other IRA or Roth IRA contributions for the year. However, transfers from a QTP to a Roth IRA are specifically exempted from the phase-out limits based on MAGI; MAGI above the phase-out range does not preclude a QTP transfer.

An ambiguity exists with respect to whether transfers from a QTP to a Roth IRA are subject to the earned income limitation. The amended section 529(c)(3)(E)(ii)(I) says,

ANNUAL LIMITATION.—Clause (i) [referring to the general requirements of a QTP to Roth IRA transfer which excluded these transfers from gross income] shall only apply to so much of any distribution as does not exceed the amount applicable to the designated beneficiary under section 408A(c)(2) [which defines the annual contribution limit for Roth IRAs] for the taxable year (reduced by the amount of aggregate contributions made during the taxable year to all individual retirement plans maintained for the benefit of the designated beneficiary).

Section 408A(c)(2) says,

Contribution limit

The aggregate amount of contributions for any taxable year to all Roth IRAs maintained for the benefit of an individual shall not exceed the excess (if any) of-

- (A) the maximum amount allowable as a deduction under section 219 with respect to such individual for such taxable year (computed without regard to subsection (d)(1) or (g) of such section), over
- (B) the aggregate amount of contributions for such taxable year to all other individual retirement plans (other than Roth IRAs) maintained for the benefit of the individual.

Although the contribution limit for a Roth IRA is written in terms of the deductible amount under section 219, section 408A(c)(1) indicates that no deduction is allowed for a contribution to a Roth IRA, so the reference to section 219 is only defining the Roth IRA contribution limit, not an amount that is deductible for contributions to a Roth IRA. In referring to the maximum amount allowed as a deduction, Section 219(b)(1) says,

In general

The amount allowable as a deduction under subsection (a) [referring to the allowance of a deduction] to an individual for any taxable year shall not exceed the lesser of-

- (A) the deductible amount, or
- (B) an amount equal to the compensation includible in the individual's gross income for such taxable year.

From these statements, it seems that the earned income limitation would apply to QTP transfers to Roth IRAs. However, the amended section 408A(c)(3)(E) relating to the MAGI phase-out limitation states,

**SPECIAL RULE FOR CERTAIN TRANSFERS FROM QUALIFIED TUITION PROGRAMS.—**

The amount determined under subparagraph (A) [referring to the dollar limit as adjusted for the phase-out of MAGI] shall be increased by the lesser of-

- (i) the amount of contributions described in section 529(c)(3)(E) [cited and partially quoted above] for the taxable year, or
- (ii) the amount of the reduction determined under such subparagraph (determined without regard to this subparagraph).

Section 408A(c)(3)(A) is the subparagraph (A) mentioned above. It states,

The amount determined under paragraph (2) [cited and quoted above as section 408A(c)(2)] for any taxable year shall not exceed an amount equal to the amount determined under paragraph (2)(A) [included in citation and quotation above for section 408A(c)(2)] for such taxable year, reduced (but not below zero) by the amount which bears the same ratio to such amount as-

- (i) the excess of-
  - (I) the taxpayer's adjusted gross income for such taxable year, over
  - (II) the applicable dollar amount bears to
- (ii) \$15,000 (\$10,000 in the case of a joint return or a married individual filing a separate return).

These statements taken together certainly achieve the waiver of the MAGI phase-out limitation with respect to QTP transfers to Roth IRAs, because if the dollar limit is reduced by the phase out, the smaller of the QTP transfer or the reduction is added back to the dollar limit. However, these statements could also be interpreted as waiving the earned income limitation. This interpretation can be made as follows:



even if the amount of the contribution limit in section 408A(c)(2) is deemed to be zero because the individual has no earned income, the add back of the lesser of (1) the QTP transfer or (2) the amount of the reduction due to the MAGI phase-out in section 408A(c)(3)(E) to the dollar limit could be assumed to make the earned income limitation irrelevant.

From these two possible interpretations—that the earned income limit applies or is waived—it is unclear what legislative intent was. While it is very possible that the contribution limit in section 408A(c)(2) takes precedent over the dollar limit in section 408A(c)(3)(A) as adjusted by the add back in section 408A(c)(3)(E), it may still be unclear as to whether the earned income limit applies to QTP transfers to Roth IRAs. The new legislation is quite clear that the annual contribution limit applies and that the MAGI phase out does not apply, but it is not as clear as to whether the earned income limit applies. While all these limitations would apply to direct contributions, in general they would not apply to rollovers. Since a QTP transfer is a qualified rollover contribution, the legislative intent with respect to the earned income limitation would be important. Without further legislative action, the IRS may need to make a determination of legislative intent and make its interpretation clear to taxpayers and to those who administer QTPs and Roth IRAs as trustees.

Another ambiguity in the new law relates to the five-year rule in section 529(c)(3)(E)(i), which states,

IN GENERAL.—In the case of a distribution from a qualified tuition program of a designated beneficiary which has been maintained for the 15-year period ending on the date of such distribution, subparagraph (A) [referring to the general rule that QTP distributions are included in gross income unless specifically excluded] shall not apply to so much [of (sic)] the portion of such distribution which—

- (I) does not exceed the aggregate amount contributed to the program (and earnings attributable thereto) before the 5-year period ending on the date of the distribution, and
- (II) is paid in a direct trustee-to-trustee transfer to a Roth IRA maintained for the benefit of such designated beneficiary.

The interpretation of this restriction by my529 is that “Rollovers may not include contributions (or earnings) made in the last 5 years” (my529.org). Since the new QTP transfer allowed to a Roth IRA is specifically to come from long-term QTPs, the 15-year age requirement on the QTP makes sense. It may also make sense that rollovers must come from older (more than five years) QTP contributions. However, a careful reading of the technical wording of section 529(c)(3)(E)(i)(I) can lead to a different possible interpretation as illustrated by the following example.

Example: Suppose Brent’s parents opened a QTP for him when he was born. They contributed a total of \$120,000 to the QTP before Brent started studying at his local community college for two years, followed by two years at a state university. Brent graduates at the end of 2023, has a great job offer, and does not plan on further higher education. However, since they originally anticipated possible graduate studies for Brent, his parents had continued to contribute to the QTP for the last four years while he was earning his bachelor’s degree, another \$40,000. The four-year degree resulted in qualified education expenses of \$163,000 withdrawn from the QTP, which exactly depleted the \$120,000 contributed prior to Brent’s higher education plus the earnings on those QTP investments. However, the additional \$40,000 contributed to the QTP has now grown to \$43,000. Brent’s parents do not want to transfer any of this amount to QTPs for any of Brent’s family members, nor do they desire to withdraw the money for unqualified expenses, making the earnings subject to taxes and penalties. In fact, now that Brent is out of college and has a job, they want to

help him get started on his retirement savings by helping him fund a Roth IRA. They propose to make a QTP to Roth IRA transfer for Brent at the beginning of 2024 for the amount of the 2024 annual IRA contribution limit. They plan to continue to make transfers until the \$35,000 aggregate maximum transfer has been made.

While the my529 interpretation of the five-year rule given above would preclude this transfer since the remaining contributions in the QTP have not been there for five years, Brent's parents argue that the limit is on the amount of the contributions to the QTP (plus earnings) prior to the last five years, not that the actual dollars to be transferred must have been contributed prior to the last five years. They argue that since more than \$35,000 was contributed more than five years ago, even though it (plus earnings) was all distributed for qualified education expenses by the end of 2023, the requirement that the transfer not exceed the aggregate amount contributed more than five years ago has been met. Brent's parents' interpretation is reasonable given the technical wording of section 529(c)(3)(E)(i)(I). However, it may not be consistent with legislative intent. Again, either a technical correction should be legislated, or the IRS should determine legislative intent and disseminate its interpretation of this rule.

A third ambiguity of this QTP to Roth IRA transfer relates to the due date of the transfer. While direct IRA contributions have a tax filing due date deadline, rollovers have no specific due date, and conversions have a year end due date, it is unclear what the due date is for a qualified rollover contribution from a QTP. Even though it is called a rollover contribution, it has an annual limit. In that case, we might assume that the deadline would be the same as for a direct contribution with an annual limit—the tax filing deadline for a given year's tax return. However, this is not clearly stated in the new legislation. The IRS may again need to determine a due date and let interested parties know about it.

A fourth ambiguity can arise by looking at the five-year rule in conjunction with the due date of a QTP to Roth IRA transfer. Assuming legislative intent is that the tax filing deadline is the due date of a transfer and that the five-year rule is interpreted to mean the actual amounts to be transferred to the Roth IRA must have been contributed to the QTP at least five years ago, what are the implications? Is the five-year rule for QTP contributions similar to the five-year rules mentioned earlier for avoiding penalties on Roth IRA withdrawals? In other words, is a contribution to a QTP made any time during the year considered as if made on January 1; does the five-year clock start running on January 1 or on the actual date of the contribution to the QTP? For example, if a contribution made to the QTP late in 2020 is deemed made on January 1, 2020, could it then be transferred to a Roth IRA early in 2025, assuming it meets other requirements for this type of rollover? If so, can it be counted as a rollover contribution for the 2024 tax year, counting toward the 2024 contribution limit? And if so, can another amount that was also contributed to the QTP in 2020 be transferred to a Roth IRA early in 2025 for the 2025 tax year (using the 2025 contribution limit)? Answers to these questions may be unclear and may need legislative clarification or IRS interpretation of legislative intent.

Three major advantages of this new law are that (1) amounts can be transferred from a QTP in a distribution that would not be for qualified education expenses—this can be done without triggering tax and penalty implications, (2) the distribution can be to a Roth IRA account for the beneficiary which will provide future tax-free retirement income, (3) earnings in the QTP that are transferred never become taxable—they are treated as though they were always in a Roth account—this amount could be considerable since the account needs to have been open for at least 15 years and remaining contributions may have been invested for many years.

On the other hand, there is no guarantee that states will adopt these same rules. States could possibly tax the transferred earnings. They could also require a recapture of any state tax benefits originally received on the QTP contributions that are transferred. While many states' tax laws may start by mirroring most of the federal tax laws for inclusion and exclusions, they may also require adjustments where the states do not completely adopt federal tax laws, especially with the numerous federal tax law changes over time.

Currently there is a \$35,000 aggregate limit on these transfers for any one beneficiary. Whether this limit might increase in the future is unknown. Those with excess QTP account balances that will not be used for qualified education expenses will need to decide whether to transfer them to family members, withdraw them as nonqualified expenses and pay taxes and penalties on the earnings, or try to use this new option of transferring up to \$35,000 to a Roth IRA.

## **CONCLUSION**

SECURE 2.0 will allow, beginning in 2024, direct trustee-to-trustee transfers from QTPs to Roth IRAs for the same beneficiary. Although these transfers are called qualified rollover contributions, they have at least one of the limits of direct Roth IRA contributions. The annual limit on contributions to all IRAs applies, and an aggregate limit of \$35,000 applies to these transfers over time for an individual beneficiary. The QTP must have been open for at least 15 years.

Some ambiguities exist that need legislative adjustments or technical corrections to provide clarity. Alternatively, the IRS could provide further guidance on its interpretation of legislative intent.

QTP administrators will need to prepare to make these trustee-to-trustee transfers by the beginning of 2024. They will also need to understand the appropriate reporting requirements set out by the Secretary of the Treasury so they can meet them. They will likely also be tasked with making sure the 15-year QTP rule and the 5-year QTP contribution rule are met for any requested transfers. Roth IRA administrators will need to prepare to accept these rollover contributions but will not likely have significant adjustments to make, as they should already be able to take direct contributions, rollovers, and conversions.

This new law provides an opportunity for individuals with long-term QTPs to enhance their tax-free retirement savings if they have excess amounts in a QTP that will not be needed for qualified education expenses. It will be interesting to see how well this provision is accepted by looking at the level of such transfers starting in 2024.

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