



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

300A Outlet Pointe Blvd., Columbia, South Carolina 29210
P.O. Box 125, Columbia, South Carolina 29214-0575

SC INFORMATION LETTER #24-4

SUBJECT: Future Scholar, South Carolina’s 529 College Savings Plan – 529 Plan
Rollover to a Roth IRA
(Income Tax)

DATE: April 11, 2024

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2014)
S.C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #09-3

SCOPE: An Information Letter is a written statement issued to the public to announce general information useful in complying with the laws administered by the Department. An Information Letter has no precedential value.

INTRODUCTION

Internal Revenue Code Section 529, “Qualified Tuition Programs,” allows state sponsored education savings programs. The South Carolina College Investment Program (“SCCIP”) is South Carolina’s 529 education savings plan. South Carolina’s plan is administered by the State Treasurer’s Office as provided for in Title 59, Chapter 2, and is commonly known as “Future Scholar, South Carolina’s 529 College Savings Plan.”

In general, when an individual opens an account (“529 account”) as part of a “qualified tuition program” the funds in the 529 account grow tax deferred and are not taxable when withdrawn, provided the funds are used to pay qualified education expenses. Section 59-2-80 of the South Carolina Code of Laws provides for South Carolina’s income tax treatment of earnings and withdrawals from the SCCIP, which is a qualified program under the Internal Revenue Code.

If the funds in a 529 account are not used for qualified educational expenses, any nonqualified withdrawals may incur a 10% federal penalty and any investment gains may be subject to income tax. According to the Internal Revenue Code, if the beneficiary of the 529 plan has not exhausted all funds in the 529 account, withdrawal of the remaining funds is a nonqualified withdrawal and penalties and taxes will typically apply. However, as part of the SECURE 2.0 Act passed in 2022, Congress provided that after January 1, 2024, any funds remaining in a 529 account can be rolled into a Roth IRA without tax or penalty, subject to certain qualifications.

INTERNAL REVENUE CODE AMENDMENTS

Prior to the amendments to the Internal Revenue Code enacted via the SECURE 2.0 Act, a withdrawal from a 529 plan was a qualified withdrawal only if used to pay for qualified higher education expenses. Internal Revenue Code Section 529(e)(3) defines a “qualified higher education expense” as “tuition, fees, books, supplies and equipment required for enrollment or attendance at an eligible education institution.” In recent years, on multiple occasions, Congress has expanded the definition of “qualified higher education expense.”

This Information Letter only concerns the expansion enacted with the passage of the SECURE 2.0 Act, which added a new paragraph (E) to 26 U.S.C. § 529(c)(3). The new subsection provides in part, “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) shall not apply to so much 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.”

ROTH IRA ROLLOVER OPTION

Starting on January 1, 2024, a 529 account holder can roll unused 529 assets into a Roth IRA owned by the 529 account beneficiary without incurring the usual 10% penalty for nonqualified withdrawals and without generating any taxable income subject to the following requirements and limitations:

- The 529 account must be maintained for the benefit of the designated beneficiary for at least 15 years ending on the date of the distribution. Any contributions made to the 529 in the 5-year period immediately before the distributions start (including the associated gain on those contributions) are ineligible for a tax-free rollover.
- The beneficiary of the 529 plan must own the Roth IRA into which the funds are rolled over and the beneficiary/owner must have earned income in an amount equal to or greater than the amount of the rollover.
- The rollover must be performed as a direct, trustee-to-trustee transfer between the 529 account and the Roth IRA custodian.
- There is a lifetime limit of \$35,000 that can be rolled from a 529 account into a Roth IRA. Also, the annual limit on contributions to a Roth IRA applies and any amount rolled over from the 529 account must be aggregated with other direct contributions made to the Roth IRA in the same year. In 2024, the contribution limit to a Roth IRA is \$7,000 for anyone under age 50.

SOUTH CAROLINA INCOME TAX IMPLICATIONS

Roth IRAs are governed by Section 408A of the Internal Revenue Code. Although contributions to a Roth IRA are not deductible, the “qualified distributions” of both principal and income are excluded from “gross income” in the year the distributions are taken. 26 U.S.C. § 408A(d)(1). Likewise, according to the Internal Revenue Code, contributions to a 529 account are not deductible,¹ but the qualified distributions, including growth, are not included as part of the income of the beneficiary. 26 U.S.C. § 529(B). Because South Carolina has conformed to sections 408(A) and 529 and because calculating South Carolina taxable income begins with federal taxable income, qualified distributions from either a Roth IRA or a 529 account are not included in South Carolina taxable income. See S.C. Code Ann. § 12-6-560.

Furthermore, S.C. Code Ann. § 59-2-80(B) provides for the exclusion from gross income of the earnings on investments and reads, in part:

Any interest, dividends, gains, or income accruing on the payments made pursuant to an investment trust agreement under the terms of this chapter or on any account in the SCCIP Trust Fund shall be excluded from the gross income of any such account owner, contributor, or beneficiary for purposes of South Carolina income taxes, to the extent such amounts remain on deposit in the SCCIP Trust Fund or are withdrawn pursuant to a Qualified Withdrawal.

Based upon Internal Revenue Code Section 529, South Carolina Code Title 59, Chapter 2, and confirmation from the Office of State Treasurer, which administers the SCCIP, qualified withdrawals from the SCCIP include qualifying rollovers into a Roth IRA. These qualified withdrawals are not taxable income for South Carolina income tax purposes beginning in tax year 2024.

Of course, other nonqualified withdrawals remain taxable in South Carolina. Section 59-2-80(C) provides for the taxation of withdrawals that are not qualified withdrawals and the recapture of those contributions that were deducted from South Carolina income.

The earnings portion of any withdrawals from an account that are not qualified withdrawals shall be included in the gross income of the resident recipient of the withdrawal for purposes of South Carolina income taxes in the year of the withdrawal. Withdrawals of the principal amount of contributions that are not qualified withdrawals must be recaptured into South Carolina income subject to tax to the extent the contributions were previously deducted from South Carolina taxable income.

¹ Although contributions to 529 accounts are not deductible from income according to federal law, South Carolina allows for an income tax deduction based on eligible contributions. Section 59-2-80 provides the South Carolina income tax implications of contributing to the SCCIP. According to S.C. Code Ann. §§ 12-6-1140(11) and 59-2-80(D), eligible contributions to the SCCIP including funds transferred from another qualified 529 plan to the SCCIP are deductible from South Carolina income up to the maximum allowable contribution.

Accordingly, taxpayers should be aware that withdrawals that are not qualified withdrawals, such as withdrawals not used for qualified educational expenses or Roth IRA rollovers in excess of the contribution limits, are taxable in the year of the withdrawal to the extent they are: (1) from the principal amount of contributions that were previously deducted from South Carolina taxable income or (2) attributable to any tax free earnings of the 529 account.

QUESTIONS ABOUT SOUTH CAROLINA'S 529 COLLEGE SAVINGS PLAN

For more information about Future Scholar, South Carolina's 529 College Savings Plan, call 1-888-244-5674 or visit futurescholar.com.