**Take-Away:** A Michigan owner of a 529 account who transfers ‘excess’ 529 funds to a Roth IRA may be subject to a state income tax recapture if their initial contribution to the 529 account created a state tax deduction or credit.

**Background:** We’ve covered this new feature to convert ‘excess’ 529 funds to a Roth IRA in the past, noting all the conditions and limitations associated with such a rollover. One last consideration in making the rollover decision is the effect of the rollover on state income tax exposure. While the rollover of the ‘excess’ 529 funds to a Roth IRA are tax-free for federal income tax reporting purposes, that may not be the case for state income taxes.

**State Income Tax Treatment:** States take different positions on their tax treatment of 529-to-Roth IRA rollovers.

> **No State Income Tax:** 9 states that have no state income tax to worry about: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.
>
> **Follow Federal Law:** 21 states have announced that they will follow federal law: Alabama, Arizona, Delaware, Georgia, Hawaii, Idaho, Kansas, Kentucky, Maine, Maryland, Nebraska, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Virginia, West Virginia, and Wisconsin.
>
> **‘Recapture’ States:** Some states allow residents to take a state tax deduction or credit for 529 contributions made to that state’s plan or program. 10 states have indicated that 529 contributors may be

subject to state income tax 'recapture' if 529 funds are transferred to Roth IRAs. Thus, the residents of these states who claimed a state tax deduction or credit will have to pay it back if they make a 529-to-Roth IRA rollover. These 'recapture' states include **Michigan**, Illinois, Indiana, Iowa, Massachusetts, Minnesota, Montana, Utah, and Vermont. **[Source- MESP Plan Disclosure Supplement 1, dated January 1, 2024.]**

**California:** California has announced that its residents who make a 529-to-Roth IRA rollover **will be subject to state income tax and an additional 2.5% California tax on earnings,** even though California does not allow a state income tax deduction for 529 contributions.

**Still Unclear:** The remaining states [Arkansas, Colorado, Connecticut, Louisiana, Mississippi, Missouri, New Jersey, Oklahoma, and Rhode Island, along with the District of Columbia,] have not yet clearly stated the state tax implications of a 529-to-Roth IRA rollover.

**Conclusion:** There are a lot of 'hoops to jump through' before excess funds are rolled over to a Roth IRA. Added to those conditions to satisfy is the fact that it may result in a recapture of state income taxes by the owner or the 529 account if he/she claimed a prior deduction on their state income tax return for the 529 contribution.