Don't Raid Retirement Accounts to Pay for College

MARTINSVILLE, N.J., Oct. 17, 2011 /PRNewswire/ -- College costs have been rising faster than the overall inflation rate for many years. It has gotten so expensive that many parents have been withdrawing from their retirement accounts to cover the cost. A recent study by Sallie Mae indicated that 24% of parents would dip into retirement savings to help with their child's tuition costs. Andrew Novick, Esq., CFP®, VP of Client Service at Condor Capital comments on this issue.

Novick: This is an alarmingly high number. By using retirement savings, parents are risking their own future financial security. In most cases, a retirement account should not be used to cover non-retirement expenses, including college costs.

What is the main drawback of raiding an IRA to pay for college?

Novick: It will be extremely difficult to rebuild an IRA since the annual contribution limit in 2011 is $5,000 ($6,000 for those 50 years of age or older). There are several ways to approach funding college, such as a scholarship, student loan, or looking at a lower cost school, but the ways to fund retirement are much more limited.

Are there other disadvantages?

Novick: Distributions from a Traditional IRA are generally considered taxable income and will be subject to a 10% early withdrawal penalty if the account owner is under 59 1/2. The 10% penalty is waived if used for qualified higher education expenses, but it is still taxable income and is therefore not a tax-efficient approach to paying for college. These qualified expenses include tuition, room and board, fees, books, supplies, and equipment required for enrollment at a post-secondary school, including graduate school. Roth IRAs have similar issues, but only the earnings portion of the distribution is taxable. Additionally, all IRA withdrawals have a negative impact on potential financial aid for the student.

What about using a 401k?

Novick: Parents often discontinue 401k contributions in order to increase take home pay, which can be used to cover college expenses, but lose important income tax benefits – pre-tax contributions and tax-deferred growth. They can also lose company matching contributions. Alternatively, they may look to borrow from their 401k, which can also have pitfalls.

How should parents save for college?

Novick: Section 529 Savings Plans are specifically designed for college savings. Contributions grow on a tax-deferred basis and distributions are tax-free if used for qualified education expenses. Some states offer tax deductions for contributions. I urge parents to start saving for their children's college costs early and using a 529 plan is a great place to start.

Any concluding comments?

Novick: Saving for a child's college and for retirement are two distinctly different events. Parents need to make sacrifices in order to save for their children's college, but it is much better than tapping their retirement accounts and damaging their own financial future. Always consult your tax advisor before making a decision on tapping your IRA.

Condor Capital
Founded in 1988, Condor Capital is an employee-owned, SEC-registered investment advisor based in Martinsville, N.J. employing 15 professional and support staff. Since Condor is a fee-only investment management firm, its fees are based on portfolio size, not sales commissions or number of trades. For more information on Condor Capital, please visit www.condorcapital.com or call 732-356-7323.

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