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PAYING FOR COLLEGE WHILE SAVING FOR RETIREMENT

It's that time of year. The college acceptances have been issued and the final decisions have been made. What now? All across America, families are meeting a mighty financial challenge – the challenge of paying college costs with retirement potentially on the horizon. How do they do it? They go about it consistently; they also get creative.

First, make sure the priorities are in the right order. Strange as it may sound, your retirement may need to take precedence over your child's college education. Think about it. Your son or daughter might qualify for student loans or financial aid. By the time they are 30 or 35, they will have the earnings potential to pay those loans back. Do you see any ads out there for "retirement loans" or "retirement aid"? For most, it is much harder to earn money at age 65 than at age 35. Because of this, many choose to allow the younger generation to assume the debt.

So if college costs are on your mind, consider the following short-term and long-term ideas to get you through those college years:

Consider a tax-advantaged college savings plan. Contribute to a 529 plan, which features tax-advantaged growth and tax-free withdrawals when the withdrawn funds are used to pay qualified education costs. Not all 529 plans are the same – in fact, some of them will even provide a small cash "match" or "sign-up" bonus when you start your plan. Some 529 plans are even "prepaid" – that means you may be able to secure future tuition rates at current prices, usually at in-state public colleges. Unfortunately, any money saved in the 529 plan that is not used for educational expenses will not only become fully taxable as ordinary income but will also be subjected to a 10 percent penalty. So be sure not to "overfund" a child's 529.

However, don't stop contributing to your own retirement savings accounts, and feel free to pay off consumer debts with the money from your savings and checking accounts – the assets in these accounts aren't used in most financial aid formulas.

Can retirement accounts be used to save for college?

Yes. Most financial planners discourage paying for college with funds from a retirement account; they also discourage using retirement funds for a child's college education if doing so will leave you with no funds in your retirement years. However, you can certainly tap your retirement accounts to help pay the college bills if you need to. With IRAs, both regular and ROTH, you can withdraw money penalty free for college expenses, even if you're under age 59½ (though there may be income tax consequences for the money you withdraw). But with an employer-sponsored retirement plan like a 401(k) or 403(b), you'll generally pay a 10 percent penalty on any withdrawals made before you reach age 59½ (age 55 in some cases), even if the money is used for college expenses. You may also be subject to a six month suspension if you make a hardship withdrawal. There may be income tax consequences, as well. (Check with your plan administrator to see what withdrawal options are available to you in your employer-sponsored retirement plan.) Loans are usually allowed as well but are limited in amount and generally must be paid back within 5 years.

It is important to note that withdrawals from ROTH IRA accounts are considered a return of contribution first and earnings second. So consider your withdrawal strategy if using IRA funds for current college expenses.

While paying for college has always been a challenge, by being informed, creative and consistent, most families find a way to respond. Do you need help coming up with a college funding strategy?

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