Withdrawing from IRAs

What is it?

If you own a traditional IRA or Roth IRA, you may be able to withdraw funds from these accounts to pay your child's college expenses. But the effect of taxes and penalties should be considered.

College expenses exempt from early withdrawal penalty

A traditional IRA is a personal savings plan that offers tax benefits to encourage retirement savings. A Roth IRA is another type of personal savings plan that offers tax benefits to encourage retirement savings. Parents who save with either a traditional IRA or Roth IRA can always withdraw their savings, but the general rule is that any withdrawals made before age 59½ are subject to taxes and a minimum 10 percent early withdrawal penalty.

However, there are some instances when the early withdrawal penalty doesn't apply, even though the withdrawal is made before age 59½. One instance is when parents tap their traditional IRA or Roth IRA before age 59½ to pay their child's qualified higher education expenses.

Tip: Qualified higher education expenses include tuition, room and board (if your child is enrolled at least half-time), fees, books, supplies, and equipment required for enrollment at a post-secondary school, including graduate school.

Caution: The exemption of college expenses from the 10 percent early withdrawal penalty does not apply to elementary and secondary school expenses; parents who withdraw funds for this purpose before age 59½ will owe a 10 percent early withdrawal penalty.

Drawbacks of using traditional IRA or Roth IRA for college expenses

You won't pay a 10 percent early withdrawal penalty on withdrawals made from your traditional IRA or Roth IRA before age 59½ that are used to pay qualified college expenses. But you will be required to add any withdrawal (distribution) amount that was not previously taxed back into your taxable income for the year. This could have the undesirable effect of pushing you into a higher marginal income tax bracket.

This means that if you have made deductible contributions to a traditional IRA and taken full deductions every year, the entire withdrawal (contributions plus earnings) is included in your income for tax purposes. For traditional IRAs funded with nondeductible contributions, however, only that portion of the withdrawal that represents earnings and deductible contributions is included in income for tax purposes.

With a Roth IRA, if you are under age 59½ when you make a withdrawal to pay college expenses, your earnings will be subject to income tax (your contributions are never subject to income tax because all contributions to a Roth IRA are made with after-tax dollars). And if you are over age 59½ at the time you withdraw the funds, you generally won't owe any income tax at all.

A second tradeoff of withdrawing from your traditional IRA or Roth IRA to pay education expenses is that you reduce your overall retirement nest egg. You may also miss out on potential growth that could have occurred had you not withdrawn the money.

Is this strategy right for you?

It depends on the funding sources you have available. Most financial professionals recommend not tapping your retirement accounts to pay college expenses if other funds are available.

Need help making important IRA decisions?

If you have any questions about IRAs, we want to help. As a member of Arsenal Credit Union you have access to David Weis, our knowledgeable financial advisor available through our broker-dealer CUSO Financial Services, L.P. (CFS)*. Click here to learn more about David and the services he offers.

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