5.11.21 Tutorial Tuesdays: Tuition or Retirement

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Don’t Pick Paying Your Kids’ College Tuition Over Saving for Retirement

It’s true that college costs are climbing, and no one could blame parents for wanting to remove all or some of that financial burden from their kids’ shoulders. For the 2019–2020 school year, the College Board reported the average cost of tuition and fees was $36,880 for private colleges, $10,440 for state residents at public colleges, and $26,820 for out-of-state residents at public colleges.

On the other hand, people are living longer in retirement, guaranteed pensions are disappearing, and Social Security’s contributions are less than they used to be.

Reasons not to spend your retirement savings.
While it’s very much a personal decision if and how much to shell out for your children’s education costs, for most Americans—who are already behind in retirement savings—it’s a better investment for you and your family to keep saving for retirement and find other ways to pay for college.

1. Using money from a tax-advantaged employer retirement account, like a 401(k), to pay for college isn’t an equal transaction—meaning you’ll lose money in the short- and long-term.

- Right off the bat, you’ll pay a 10 percent tax penalty on early withdrawals if you’re below age 59½.
- You’ll pay a potentially bigger tax bill the year of the withdrawal as the money withdrawn is counted as income.
- You’ll lose tax-free growth on your savings. Unlike taxable investment accounts, where you may have to pay the IRS annually for capital gains, employer-sponsored retirement accounts can grow tax-free.
- Early withdrawals will erode your portfolio’s growth potential because you’ll shrink the benefit of compounding interest.

2. Because the money you withdraw will be counted as taxable “ordinary income,” you could hurt your child’s ability to qualify for more—or any—student aid. However, if you leave your retirement savings in their protected accounts, they won’t be included in your total income.

3. Paying for all or large amounts of your child's college bill can harm their financial maturity and encourage them to make less-than-optimal choices when it comes to their academic performance, choosing a profitable major, and managing their day-to-day expenses.

4. There are more options to save and pay for college then there are for retirement. Students can work while in school, qualify for scholarships and grants, take out loans that they'll have a longer time and increasing earnings to pay off, and stretch out their education by studying part time and working part time to avoid student debt all together.

5. Depleting your retirement or long-term care savings can come back to haunt your children if they then need to become financially responsible for you in your old age. The average household spends around $46,000 per year in retirement while receiving less than $17,000 from Social Security. That's a $30,000 shortfall every year for those who haven't saved enough for retirement.

What are your options?
Financial experts say one of the best ways to avoid having to decide between college costs and retirement savings is to set up a 529 savings account for each of your children as early as possible. In general, they have a higher earning potential than other savings accounts. (Remember that as a Nymeo member, you have access to two Financial Advisors who can guide you when making these types of decisions.)

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