LM Federal Credit Union
Aaron Welch, RFC
Financial Advisor
1200 E Joppa Road, Suite G
Towson, MD 21286
667-308-2724
awelch@moneyconcepts.com

LM Federal Credit Union
Wealth Management & Financial Planning Services

Should I use my 401(k) to fund my child's college education?

Should I use my 401(k) to fund my child's college education?

You can, but it isn't your best option. Your 401(k) plan should be dedicated primarily to your retirement.

There are two primary drawbacks to using your 401(k) for college funding. First, if you withdraw funds from your 401(k) before you are 59½, you will owe a 10% premature distribution penalty on the withdrawal. This penalty is in addition to income taxes you will owe on the withdrawal. Second, frequent dips into your 401(k) reduce the amount of money you ultimately have available to reap the benefits of compounding and tax deferral. This, in turn, reduces the overall funds for your retirement.

If you really need to use your 401(k) funds to pay for college, a better option might be to borrow from your plan if your plan allows loans. Plan loans are not taxed or penalized, as long as you repay the funds within a specified time period. But make sure you compare the cost of borrowing college funds from your plan with other finance options. Although interest rates on plan loans may be favorable, the amount you can borrow is limited, and you generally must repay the loan within five years. In addition, some plans require you to repay the loan immediately if you leave your job. Your retirement earnings will also suffer as a result of removing funds from a tax-deferred investment.

If you want to save for college in a retirement vehicle, consider using a traditional IRA or Roth IRA instead. With IRAs, you will not owe a 10% premature distribution penalty on withdrawals you make before age 59½ if the money is used to pay your child's qualified college expenses.