

Douglas M. Hatcher, CPA, CFP®



Thomas C. Ottmar, CPA

## Hatcher Financial

T 602-955-8500 F 602-956-0572 4647 N. 32nd St., Ste. 280, Phoenix, AZ 85018-3327

May 2018

# Using a Roth IRA as a College Savings Tool

*A tax-advantaged option too many families overlook.*

**At first glance, a Roth IRA might seem an unusual college savings vehicle.** Upon further examination, it may look like a particularly smart choice.

**A Roth IRA allows you to save for college without the constraints of a college fund.** This is an important distinction, because you cannot predict everything about your child's educational future. What if you contribute to a 529 plan or a Coverdell ESA and then your child decides not to go to college? Or, what if you save for years through one of these plans with the goal of paying tuition at an elite school and then a great university steps forward to offer your child a major scholarship or a full ride?

If you take funds out of a Coverdell ESA or 529 college savings plan and use them for anything but qualified education expenses, an income tax bill will result, plus a 10% Internal Revenue Service penalty on account earnings. (The 10% penalty is waived for 529 plan beneficiaries who get scholarships.)<sup>1,2</sup>

**You gain flexibility when you save for college using a Roth IRA.** If your child gets a scholarship, elects not to attend college, or goes to a cheaper college than you anticipated, you still have an invested, tax-advantaged account left to use for your retirement, with the potential to withdraw 100% of it, tax free.<sup>3</sup>

You can withdraw Roth IRA contributions at any time, for any reason, without incurring taxes or penalties. When you are an original owner of a Roth IRA and you are age 59½ or older, you can withdraw your Roth IRA's earnings, tax free, so long as the IRA has existed for five years. From a college savings standpoint, all this is great: parents 60 and older who have owned a Roth for at least five years may draw it down without any of that money being taxed, and younger parents may withdraw at least part of the money in a Roth IRA, tax free.<sup>4</sup>

You probably know that the I.R.S. discourages withdrawals of Roth IRA earnings before age 59½ with a 10% early withdrawal penalty. This penalty is not assessed, however, if the early withdrawal is used for qualified higher education expenses. Occasionally, parents roll over money from workplace retirement plans into Roth IRAs to take advantage of this exemption.<sup>5</sup>

**With a Roth IRA, your investment options are broad.** In contrast, many 529 college savings plans give you only limited investment choices.<sup>1</sup>

*Building Your Nest Egg for a Secure Tomorrow*

Securities offered through 1st Global Capital Corp. Member FINRA, SIPC  
Investment advisory services offered through 1st Global Advisors, Inc.

Members: American Institute of Certified Public Accountants • Arizona Society of Certified Public Accountants



Hatcher Financial

## *Using a Roth IRA as a College Savings Tool*

**You can even save for college with a Roth IRA before your child is born.** No doing that with a 529 plan – you can only start one after your child has a Social Security Number.<sup>6</sup>

**Admittedly, a Roth IRA is not a perfect college savings vehicle.** It has some drawbacks, and the big one is the annual contribution limit. You can currently contribute up to \$5,500 to a Roth IRA per year, \$6,500 per year if you are 50 or older. That pales next to the limits for 529 college savings plans (though it certainly exceeds the yearly limit for Coverdell ESAs).<sup>2,7</sup>

Some families earn too much money to open a Roth IRA. Joint filers, for example, cannot contribute to a Roth if they make in excess of \$198,999 in 2018. There is a potential move around this obstacle: the so-called “backdoor Roth IRA.” You create a “backdoor Roth IRA” by rolling over assets from a traditional IRA into a Roth. That action has tax consequences, and once the rollover is made, you are prohibited from putting the assets back into the traditional IRA.<sup>4,7</sup>

Lastly, there is a bit of an impact on financial aid prospects. When funds are distributed from a Roth IRA and used to pay for college costs, those distributions are defined as untaxed income on the Free Application for Federal Student Aid (FAFSA). Fortunately, the total asset value of the Roth IRA is not reported on the FAFSA.<sup>7</sup>

**Roth IRAs may help families who want to save for retirement and college.** If you already have a good start on retirement savings and want to open one with the intention of using it as a college fund, it may be a superb idea. If you like the potential of having tax-free retirement income and may need a little more college funding for your kids, it may be a good idea as well. Talk to a financial professional to see how well it might fit in your overall financial or retirement strategy.

### **Citations.**

- 1 - fool.com/retirement/2018/03/25/3-reasons-not-to-rely-on-529-plans.aspx [3/25/18]
- 2 - quicken.com/rules-withdrawing-education-savings-accounts [4/17/18]
- 3 - tinyurl.com/yd4mjdbh [3/28/18]
- 4 - investor.vanguard.com/ira/roth-ira [4/17/18]
- 5 - budgeting.thenest.com/can-use-rollover-ira-finance-sons-college-education-23928.html [4/17/18]
- 6 - bankrate.com/banking/savings/529-college-plan-downsides/ [2/27/18]
- 7 - thebalance.com/is-it-okay-to-use-a-roth-ira-to-pay-for-college-expenses-4009940 [1/31/18]

This material was prepared by MarketingPro, Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. This information has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is no guarantee of future results. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All indices are unmanaged and are not illustrative of any particular investment.

*Building Your Nest Egg for a Secure Tomorrow*

Securities offered through 1st Global Capital Corp. Member FINRA, SIPC  
Investment advisory services offered through 1st Global Advisors, Inc.

Members: American Institute of Certified Public Accountants • Arizona Society of Certified Public Accountants