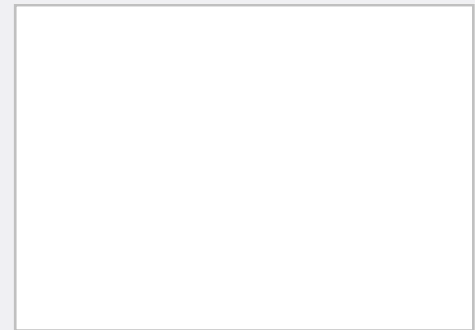


College Payment Strategies:

Where Should the Money Come From?



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Everyone knows college is expensive. Average tuition and fees at a private nonprofit four-year college now run in the mid-\$40,000s per year.¹ Those numbers have climbed faster than general inflation for most of the past two decades, and there is little reason to expect that to reverse.

The good news is that many families never pay the full sticker price. Grants, scholarships and financial aid packages can bring the cost down substantially. But once those are factored in, most families still face a meaningful balance. The question becomes: where should the rest of the money come from?

The answer depends less on any single rule than on understanding how each funding source behaves — how it is taxed, whether it affects aid eligibility, and what it costs you to use it.

Consider All Your Options

First, take stock of the funding sources available to you. These typically include 529 college savings plans, taxable brokerage accounts, traditional savings accounts, cash from current income, gifts from family members, and loans. Each comes with its own rules and tax treatment — and which sources you tap, and in what order, matters more than most families expect.

529 Plan

- Contributions grow tax-deferred, and withdrawals are tax-free when used for qualified education expenses. Anything else will likely trigger income tax plus a penalty on the earnings portion of the withdrawal.
- Qualified expenses cover more than tuition — room and board, textbooks, computers, and certain postsecondary credentialing and licensing costs generally count as well, and the definition has been broadened more than once in recent years.
- One important note: 529 plans owned by parents are treated as parental assets and may reduce financial aid awards.

Brokerage Account

- When you sell assets to fund a withdrawal, any profit is subject to capital gains tax. Long-term gains are taxed at preferential rates, but brokerage funds are still generally less tax-efficient than 529 assets for education costs.
- Your balance also factors into financial aid eligibility.

Savings Account

- Interest is taxed as ordinary income, but withdrawals themselves do not create taxable events.
- Like brokerage accounts, savings can reduce aid eligibility — considerably more so when the account is held in the student's name rather than a parent's.

Current Income

- Paying from income offers no direct tax advantage, but it lets you avoid tapping accounts you would rather leave invested.
- Bear in mind that income is a major factor in financial aid determinations.

Gift From a Family Member

- Family members can give a set amount per recipient each year — indexed periodically for inflation, and doubled for married couples electing to split gifts — without gift tax consequences.
- Gifts can affect financial aid if deposited into an account owned by the student or a parent.
- Relatives can also pay tuition directly to the institution, which sidesteps the annual exclusion limit entirely and avoids the aid impact for both students and parents.

Student Loans

- Parents have access to student loans in the form of Federal Direct Parent Plus Loans and private student loans, both of which can help bridge the gap when savings, income and other resources aren't enough.
- Federal loans may offer lower interest rates than private loans. Parents may also be able to deduct a limited amount of student loan interest each year.

Conventional Wisdom Around Payment Strategies

As a rule of thumb, take full advantage of any “free” money — scholarships and grants — before deciding which of your own resources to draw from.

From there, the conventional sequence is to spend from taxable accounts before tax-deferred ones, so that tax-advantaged assets keep compounding as long as possible. When those sources are exhausted, families typically turn to federal or private student loans, which charge interest and are therefore usually the most expensive way to pay.

Of course, rules of thumb are broad by design. The sequence that works for one family may be wrong for yours, and a few common situations flip the order entirely:

- **Short-term gains in the taxable account:** If selling brokerage assets would realize short-term capital gains — taxed at ordinary income rates rather than preferential long-term rates — it may cost less to take 529 withdrawals first and let the taxable positions season.
- **Education tax credits:** Federal education credits can be worth a meaningful amount per student, but expenses paid from a 529 plan do not count toward them. Paying at least some tuition from non-529 sources can preserve your ability to claim the credit. Because these credits phase out above certain income levels, whether this applies to you depends on your earnings in the year you pay — so check the current thresholds rather than assuming.
- **Aid-sensitive years:** Because aid formulas look at both income and assets, the timing of a large withdrawal or gift can matter as much as its source. A withdrawal in one year may affect an aid award in a later one.

Avoid Touching Your Retirement Savings

Securing your retirement is fundamentally more important than funding college. The reason is simple: college can be financed with loans if it has to be. Retirement cannot. No lender will extend you credit against a shortfall in your seventies.

Your best bet is to steer clear of your 401(k) and IRA assets. While a provision does allow penalty-free IRA withdrawals for education expenses, using it is generally not worth the trade-off. Withdrawing early sacrifices years of tax-advantaged compounding, and because these accounts carry annual contribution limits, what you take out cannot always be replaced quickly — or at all, if you are close to retirement.

The same logic applies to any assets earmarked for retirement income, including annuities purchased to provide guaranteed income later in life. Repurposing those dollars for tuition can unwind years of planning that is difficult to rebuild on a compressed timeline.



Principles That Outlast the Numbers

Tax figures, contribution limits, loan caps and credit thresholds all move — some annually, some whenever legislation changes them. The underlying logic of a college payment strategy moves far more slowly. If you remember nothing else, remember these:

- Free money first. Scholarships and grants before anything you have to repay or liquidate.
- Understand the tax treatment of each source before you touch it, not after.
- Know which accounts count against financial aid, and who owns them.
- Protect retirement assets. They are the one goal you cannot borrow to fund.
- Sequence matters, and so does timing — the same withdrawal can cost more or less depending on the year you make it.
- Verify current limits and thresholds before acting. They change, often quietly.

¹CollegeBoard, Trends in College Pricing: Highlights, 2025, <https://research.collegeboard.org/trends/college-pricing/highlights>

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