

# Borrowing From Yourself -- Not Always the Best Plan

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The IRS says that a retirement plan can distribute benefits only when certain events occur. A company's summary plan description (SPD) should clearly state when a distribution can be made. The plan document and SPD must also state whether the plan allows hardship distributions, early withdrawals or loans from the plan account. Before taking a loan or hardship withdrawal from your 401(k) or 403(b) plan account, review the rules and potential risks.

Where can you turn if you need cash in an emergency? Some people turn to their 401(k) or 403(b) plans. After all, you're borrowing your own money and paying it back to yourself with interest.

But taking a loan from your 401(k) or 403(b) plan may put you at risk of not reaching your retirement goals. Before you take any money from your retirement account, take time to review its impact and the rules associated with 401(k) or 403(b) plan loans.

## **On the Plus Side**

If your plan permits loans (and not all plans do), you'll generally be able to borrow up to half of your vested plan balance, capped at \$50,000. Taking a loan from your plan may be easier and faster than getting a loan from a traditional financial institution. And you'll usually repay the principal and interest to your plan account through automatic payroll deduction.

## **On the Minus Side**

The money you borrow will no longer be in your account benefiting from tax-deferred growth. Plus, you'll be repaying the loan with after-tax dollars. That means the money used for repayment will be taxed twice, since you'll pay tax on it again when you withdraw it at retirement. If you have trouble contributing to your plan account while you're making loan payments, you might end up with less saved for retirement than you need. And the really bad news? If you leave your employer for any reason, you'll usually have to repay the entire loan balance within 90 days or it will be considered a taxable distribution, requiring you to pay income tax on the amount of the loan. Furthermore, you may potentially owe a 10% early withdrawal penalty on the amount in addition to taxes.

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### Hardship Withdrawals: A Last Resort

If you're faced with a financial emergency you may be able to take a hardship withdrawal from your 401(k) or 403(b) plan account. You must have an immediate and heavy financial need, such as medical expenses that aren't covered by insurance or payments necessary to prevent eviction from the principal residence or foreclosure on the mortgage. The amount withdrawn is limited to the amount necessary to satisfy the financial need.

You usually can withdraw the money you've contributed and employer contributions but not earnings. You'll owe income tax and, possibly, an early withdrawal penalty. And, unlike a plan loan, withdrawals cannot be repaid to the plan.

Please contact your plan administrator if you have any questions about your distribution of benefits.

