

401(k) Withdrawals

What?

The economy is forcing people to find alternative money to cover living expenses. More taxpayers are turning to their 401(k) plans than ever before.



Who can withdraw money?

401(k)s were intended for retirement. To take money from your 401(k), you must be able to show hardship. 401(k) plan administrators can grant hardship withdrawals for specific reasons only:

- tuition
- purchase of your principal residence
- medical bills
- prevention of foreclosure

The consequences:

- Income tax is due on the distribution.
- Just because you can claim hardship, you will most likely not be able to escape the 10% early-withdrawal penalty if you are under 59 1/2. Paying tax plus penalty will cost you 25% of your distribution if you are in the 15% bracket or 35% of the distribution if you are in the 25% bracket. You will also owe tax to your state. This is costly, and the money can not be replaced.
- Taking a hardship withdrawal prohibits you from contributing to your 401(k) plan for six months.
- Remember that this is your retirement fund, and that two thirds of Americans have less than \$50,000 saved for retirement. You do not want to be one of them.
- You are depleting an asset that is protected from creditors. Your 401(k) is safe even if you file bankruptcy.

The loan option:

- You can borrow up to 50% of your vested account balance up to \$50,000.
- The loan must be paid back within 5 years unless it's for your principal residence.
- Payments are deducted from your paycheck, and must be made at least quarterly.
- Most loans charge 1 or 2 percentage points above prime—a very low rate.
- The loans are easy to set up. You do not even need a reason for borrowing the money.
- You can still contribute to your 401(k) while repaying the loan.

Loan drawbacks:

- To afford payback, most borrowers reduce contributions leaving a dent in their retirement income.
- If you are laid off or quit your job, the balance of your loan becomes due. A loan that can not be repaid becomes a distribution, with tax, and most likely penalty, as described above.