Understanding | *Loans*

BORROWING FROM YOUR RETIREMENT PLAN

If you have a large, unexpected expense, you may find you need to take out a loan. Should you borrow from your retirement plan or an outside lender? Before you decide, make sure you consider the advantages and disadvantages of taking a loan from your retirement plan account.

ADVANTAGES

Easy Money

Borrowing from your retirement plan is quick and easy. You can apply for a retirement plan loan for any reason, and you probably won't need a credit check. While your plan probably will have limits on the amount you can borrow, any fees charged in connection with the loan are likely to be modest.

Simple Repayment

Another advantage of borrowing from your retirement plan is that you won't have to pay interest to an outside lender. You'll pay the loan interest and principal amount back to your plan account. Repayment is simple since the money is taken directly out of your paycheck through automatic payroll deduction. Plus, your plan's interest rate may be relatively low compared to other lenders' rates.

Credit Rating Reprieve

Taking out a loan from your retirement plan will have no impact on your credit rating. Unlike a bank or outside lender, a retirement plan doesn't report loan activity to credit rating agencies.

DISADVANTAGES

Tax Toll

Unlike regular retirement plan salary deferrals, loan repayments aren't pretax. You'll have to pay income taxes on the earnings you use to repay the loan and then pay taxes again in the year you receive taxable distributions of the repaid amounts from your plan.

Giving Up Growth

When you take a loan from your plan, the money you borrow will no longer be invested and potentially benefiting from tax-deferred growth. Over time, through compounding, the growth you give up could be significant.

Difficult To Repay Loan and Still Save

You might not be able to repay your plan loan and still save for retirement. Your plan generally will require you to pay back the loan within five years. Not making any contributions during that time could reduce the amount you're able to accumulate for retirement.

Loan Due If You Switch Employers

If you leave your job while you still have a plan loan outstanding, you could have a tax problem. The outstanding loan balance will likely be due and payable immediately or in a relatively short period of time after you terminate employment. If you can't repay the loan, you'll have to pay income taxes on whatever amount you still owe and, possibly, a 10% early withdrawal penalty as well.

There are some advantages to borrowing from your retirement plan. However, you should also consider the disadvantages of this option because you don't want to shortchange your retirement.

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