Planning For Your Future

Should You Borrow From Your Retirement Plan?

(NAPSA)—Let's say you need money for a big expense. Maybe you need a new car, a house, or some home remodeling. Should you borrow from your retirement plan? Or should you avoid that option—so as not to risk your retirement?

Borrowing from your retirement account may appear to have several benefits, especially if you are still many years away from retirement. The money is yours anyway, the interest rates are competitive and you make the payback to yourself. There can, however, be a serious downside to tapping your retirement account for money.

Financial experts advise you to think twice before you borrow money from your retirement plan.

A Compound Issue

Borrowing from your retirement savings plan can short-change your retirement. According to retirement experts at Diversified Investment Advisors, first you lose the tax-deferred compounding power of the money you borrow. That's because, when you take money out of your account as a loan, there's that much less money on which to earn tax-deferred returns. As a result, you benefit less from compounding, which means earning money on your reinvested earnings as well as your original investment. Over time, compounding can have a substantial impact on the growth of your investment.

Taxes and Paybacks

You also get stuck paying taxes twice if you take out a loan. First, you pay back the loan with after-tax dollars. Then, you pay taxes again when you take the money out at retirement.

You could face even more taxes and penalties if you have to pay your loan back early. If you leave your job while your loan is outstanding, your loan probably will become due immediately. If you cannot pay it back right away, it will be treated as a taxable distribution, subject to income taxes. It may also be considered an early withdrawal, with a ten percent penalty from the IRS.

Finally, many people who borrow from their retirement savings plan contribute less to the plan because they are also making repayments—with interest. As a result, you may end up with less than you expected when you're ready to retire. If you decide to borrow from your plan, try to continue to contribute at the same rate, and make the repayments in addition to your contribution.

Looking Elsewhere

You may want to look elsewhere if you need money, rather than borrowing against your retirement savings plan. For example, if you're car shopping, see if you're eligible for a low-cost loan offered by the automaker. If you own a home, you may be able to get a home equity loan to cover unexpected expenses. These or other options may be better than jeopardizing your long-term retirement security.