Borrowing From Your 401(k)

You may have heard the warning to never borrow from your retirement fund. However, there may come a time when a financial crisis forces you to do just that. If you absolutely must borrow from your 401(k), consider the following.

- Review your plan document. It must specifically allow loans; if it does not, you cannot borrow from your 401(k). There are no exceptions to this rule.
- If you borrow from your 401(k) and choose to leave your company, your employer has the right to ask for immediate repayment in full.
- Many companies charge fees for 401(k) loans.
- You may have to pay income tax on some or all of the distribution. You may also have to pay a 10 percent early withdrawal penalty and federal income tax on the balance.
- Although you are technically borrowing your own money, this is still considered a loan. Should you not adhere to the loan terms, your earnings will no longer be labeled as tax-deferred and instead will become taxable income.
- Loans from your 401(k) follow many of the same procedures as ordinary loans. Never ignore the terms of the loan repayment. If you do, at retirement you will relinquish earnings on the withdrawn money and pay a huge tax penalty.
- The IRS only allows for a loan of 50 percent of total vested assets, up to a maximum of $50,000.
- The loan must be completely repaid within five years, unless the loan was used to buy your main home.
- If you choose to simply withdraw your 401(k) earnings early, you will be assessed a 10 percent penalty if you are younger than age 59½.

Before you seek a loan from your 401(k), you may wish to consider other loan sources or consult a financial advisor. For more information regarding 401(k) loans, refer to the Retirement Plans Community at irs.gov.