

Borrow against my retirement savings

Life throws everyone curve balls and more often than not they involve money. Very few people have extra cash to meet every unexpected emergency and they look to borrow against their assets. If you own a home, you may be able to borrow against its equity. If you have some retirement savings, you may be able to leverage them but be prudent. Without careful planning, you could end up paying heavy penalties.

Individual retirement accounts

While you can't borrow against the money you have saved in an individual retirement account (IRA), sometimes you can withdraw some of it early. Early generally means before age 59 ½.

You can withdraw savings from an IRA early and penalty-free if you use the money to pay for:

Higher education expenses;
Medical insurance (for unemployed individuals); and

A first home (up to \$10,000).

If your expense isn't one of these special expenses, you can still take money out of your IRA and avoid harsh tax consequences if you put the money back in 60 days. If you miss the 60-day deadline, you get hit with a 10 percent penalty. The amount you withdrew is also included in your taxable income.

401(k)s and other plans

Some 401(k) plans and other retirement plans allow you to borrow against the money you have saved. Others limit borrowing to "hardship" situations or emergencies. Before you intend to borrow against your retirement savings, check the rules.

Many times, the interest rate is usually very favorable. Most plans require you to pay back the loan within five years. However, many have shorter repayment periods. Serious problems develop when you can't repay the loan.

If you can't repay the loan within five years, the amount you borrowed is included in your taxable income. You are also hit with a 10 percent penalty.

If you leave your job, voluntarily or involuntarily, before you pay the loan, you may be in for a surprise. Some employers require departing employees to immediately repay their 401(k) loans.

Mortgaging the future

If you can leverage other assets for cash, it is usually wise to leave retirement savings untouched. The minute you withdraw money from an IRA or borrow against a 401(k), your savings stop working for you. You lose valuable interest and investment gains. The longer you take to replace the money, the further you fall behind.

Before you touch your retirement savings, talk to your tax advisor.