BUILDING BLOCKS FOR RETIREMENT

Retirement Planning Essentials

Do Not Remove

Tapping Your Retirement Account for Other Financial Needs Can Have Costly Consequences

According to a December 13, 2022, article in The New York Times[1], hardship withdrawals from workplace retirement accounts are rising — "another sign, along with rising credit card debt, that many Americans have been feeling financial pain from inflation."

At some point, most people find themselves in a situation where they need access to cash quickly. If that happens to you, you may think about taking money out of your retirement plan account through either a loan or distribution. While those are both possible options, you need to understand the impact of this action on your long-term goals.

Hardship Withdrawals

Hardship withdrawals can be taken for "immediate and heavy" financial need, according to the Internal Revenue Service. But while a hardship withdrawal may solve a short-term issue, it may have a costly impact. Consider the following chart to see the financial implications before you remove funds from your account. If you're under age 59½, you may get hit with both ordinary income taxes and an additional 10% federal income tax penalty.[2]

Example	
Amount of withdrawal:	$40,000
Ordinary income taxes:	($9,600)
Early withdrawal penalty tax:	($4,000)
Leaves you with just:	**$26,400**
Assumes the account holder is under age 59½ (and no exception to the 10% additional tax applies) and has a 24% effective federal income tax rate. Additional state and local income taxes may be levied (if applicable).	

Plan Loans

When you take out a plan loan, there are no income tax or early-withdrawal penalty consequences. However, you generally have up to five years to repay any loan from your retirement plan account. Leaving your job (or losing it) before the loans are repaid may mean you have to pay the money back in full right away. If you don't, the amount that still needs to be repaid may be considered a distribution and subject to federal and state income taxes (if applicable), as well as the additional 10% federal income tax penalty if you are under age 59½ (unless an exception applies).

Missing Out on Potential Growth Opportunities

As much as you may need the money now, taking a distribution or borrowing from your retirement account undermines the potential for the funds to grow through tax-deferred compounding — on both the money you have invested as well as any growth of that money's earnings. This could make it more difficult for you to reach your retirement goals.

If you're thinking about taking a distribution or loan from your retirement plan account, consider consulting with a financial advisor (your plan's advisor may be able to help).

1 https://www.nytimes.com/2022/12/16/your-money/hardship-early-401k-withdrawal-loans.html
2 There are a few exceptions to the 10% penalty, including a birth or adoption, terminal illness, and a qualified disaster. Check with a tax professional to confirm which expenses are exempt from the 10% early-withdrawal penalty.

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