

Tapping retirement savings can be costly venture

by [Kathy Bergstrom](#)

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When you're struggling to pay the mortgage in these tough economic times, the money in your 401(k) account can



Scott Paulus

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look pretty attractive as a source of cash.

Local financial advisers say in general taking money out of a 401(k) account for any reason besides retirement is a bad idea. But there are strategies to soften the tax blow and the impact on your retirement savings.

Before dipping into your 401(k), consider other resources, planners say. That could include using a home equity line of credit, borrowing against the

cash value of a whole life insurance policy or cashing out a non-qualified annuity, advisers say. A reverse mortgage is an option for homeowners who are 62 and older.

Of course, try to cut your expenses, and consider getting a part-time job.

"Getting money out of a 401(k) is a really bad idea," said Kelli Send, senior vice president for **Francis Investment Counsel** in Pewaukee.

But during this recession, people across the country don't have emergency funds and have limited options, she said.

In addition to depleting your retirement savings, early withdrawals from 401(k) plans are subject to income tax and a 10 percent penalty if withdrawn before age 59-1/2.

If you have an individual retirement account (IRA) in addition to your 401(k), Send suggests withdrawing from that account first because you can direct from which investments the money comes.

Early withdrawals from traditional IRAs have the same penalties as 401(k) funds, but when you take money out of a 401(k), the money comes out of funds at the same ratio as your current balance, Send said. That means if 90 percent of your balance is in stock funds, 90 percent of the distribution will come out of stock funds, and you'll be selling low, she said.

With an IRA, you can keep money in the stock accounts and withdraw from the more conservative funds to take advantage of an eventual stock market rebound, she said.

If you are still employed, about 70 percent of employer 401(k) plans allow participant loans, which is better than a withdrawal, Send said.

The loan proceeds won't be taxed or subject to the 10 percent early withdrawal penalty. The interest you pay on the loan goes into your own account, but loan repayments are made post tax, and the participant will be taxed again when they are withdrawn at retirement, Send said.

"You are paying yourself, but you're also losing the ability to invest those funds in whatever other investments you might have had," said Tim Steffen, senior vice president and financial and estate planning manager for **Robert W. Baird & Co. Inc.** in Milwaukee.

If you leave the employer, you must pay the loan back within 60 days or it will be treated as a distribution, subject to taxes and penalties, he said.

You have to be eligible for a hardship to withdraw money from your 401(k) plan. The hardships are buying a home, preventing eviction or foreclosure, paying for college, paying medical bills, funeral or burial expenses and catastrophic losses to your primary residence, Send said. Not all employers allow hardship distributions, she said.

If you are unemployed and need to access your 401(k), Send recommends rolling the money over into an IRA, investing it conservatively and pulling money out only as needed.

Then you won't pay taxes and penalties on the entire amount if you don't spend it all, she said.

IRAs offer an option to withdraw money without paying the 10 percent penalty, but the withdrawal must be for medical expenses or for first-time home buyers, Steffen said.

Another option that allows the account holder to avoid the penalty is to take out a fixed dollar amount every year for the longer of five years or until reaching the withdrawal age.

Tax treatment is better on Roth IRA withdrawals, Steffen said. An account holder would not be taxed on distributions equal to their contributions because the contributions were made post tax. Those distributions also would not be subject to the early withdrawal penalty.

The account holder would pay taxes and the 10 percent penalty for withdrawing any earnings from a Roth IRA.

CASH OPTIONS

- Take out a 401(k) loan – This can be an option if you're still employed and your employer allows loans. You won't have to pay taxes or an early withdrawal penalty.
- Take money out of an IRA first – You can direct which types of funds the withdrawal comes from to avoid depleting your investments in stocks.