Choose Your Future TODAY

Retirement Thieves:
Loans and Distributions

How would you feel if you discovered that someone was dipping into your paycheck…stealing a few bucks from your pay each month? Now think about your retirement "paycheck" – what if someone is stealing some of the money you intend to live on when you're no longer working? The thief could be you! Decisions you make today will have an impact on your income after you retire. Here are some things to keep in mind when it comes to "borrowing" from your future:

Cash distributions have big tax repercussions. With few exceptions, anytime you take a cash distribution from your employer-sponsored retirement plan, 20% of your distribution amount is automatically withheld to pay required Federal Income Tax withholding before you ever see the money. Depending on where you live, state taxes can be deducted, too. Finally, when you file your income tax return for that year, you'll have to hand over another 10% of your original distribution amount to pay an "early withdrawal" penalty (unless you're over age 59 ½ or permanently disabled). Losing around 40% of your starting distribution balance can really sting.

Rollovers help you avoid a big tax hit and better manage your money. Having multiple accounts in former employers' 401(k)/403(b) plans can become a problem if you neglect those older accounts. If you move and forget to notify your former plan administrator or you forget to monitor the investments in the old accounts, you're putting your money at risk. Direct rollover distributions from one employer plan into another are tax-free. Make sure your money is working optimally for you and not languishing in an old account – roll over any old balances into your current employer's plan or an Individual Retirement Account (IRA).

Loans can have a major negative impact on your future income. Not all plans allow for loans, but in those that do, many people assume that borrowing from their 401(k)/403(b) is a safe way to come up with money in an emergency because you're "paying yourself back." But removing a chunk of your "earning power" can do serious damage to your balance in the long run – while you're trying to pay your loan back, you've hampered your account's ability to gain strength through compound earnings. If you change jobs while you're still paying off the loan, any amount you haven't paid back becomes taxable income to you. And one more thing: since you're paying back your loan with post-tax money and you'll pay taxes on your money when you take it out at retirement (in most cases), a loan can be considered money that gets taxed twice!

If you're tempted to borrow or take a distribution of 401(k)/403(b) money, ask yourself: is the "present you" stealing from the "future you?"

Example: Chris, 28

Chris had to pay for some emergency car repairs and wasn't going to be able to pay his other bills at the end of the month. He knew he still had a 401(k) balance from his last job, so he requested a cash distribution.

Distribution Amount: $5,500

Federal Taxes Deducted: $1,110

State Taxes Deducted: $110

Tax Penalty: $550

Amount Chris keeps: $3,740

Amount of Chris' distribution at retirement if he had rolled over his money instead of taking a distribution: **$77,000**

Estimated amount assumes one-time lump sum deposit of $5,500. Rate of return 7%. Balance after 39 years.

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