

Betterment

Thinking of taking money from your 401(k)?

Before you consider tapping into your hard-earned savings, let's break down the details of 401(k) loans and hardship withdrawals—what they mean, when they make sense, and the impact they could have on your financial future.

401(k) loans

Your retirement plan permits loans, but you'll have to pay back the amount with interest. While it's not taxable, borrowing from your 401(k) could put a dent in your long-term savings. Below are a few things to consider beforehand:

Pros

- You're borrowing money from your own account, which means your credit won't be checked.
- You'll pay interest on the loan back into your 401(k) account, not to an issuer of the loan.

Cons

- The money you borrow stops earning investment returns, which could slow the growth of your retirement savings.
- When you repay the loan, the interest is paid with after-tax dollars, meaning you'll be taxed again when you withdraw that money in retirement.
- If you leave your job, whether voluntarily or not, the loan balance will need to be repaid quickly. If you can't repay it, it could be treated as an early withdrawal, subject to taxes and penalties.

Possible circumstances

- Down payment on a home
- Education expenses

Other considerations

- Do you have alternative options besides tapping into your retirement savings? Generally speaking, using a 401(k) loan for purchases like vacations, home improvements, or non-essential expenses can negatively impact your financial future.
- You can borrow up to $50k or 50% vested balance (whichever is less) in a 12 month period.
- Must be *repaid* within 5 years.

Hardship Distribution

In times of immediate and financial need, you might be eligible for a hardship distribution. You'll need to see if you meet the qualifications for one of the hardship circumstances defined by the IRS, and the amount you withdraw can't exceed the amount necessary to cover the financial need. Learn more here: IRS explanation of hardship rules.

Pros

- You don't need to pay back the distribution amount.
- You get access to your savings for certain immediate needs.

Cons

- Your withdrawal is subject to federal and state taxes, typically costing around 20%. Additionally, you'll incur a 10% penalty if you're under the age of 59 ½.
- You're removing funds from your retirement account permanently and the funds you withdraw cannot be rolled over into any other retirement plan.
- By removing that money, your principal balance will be smaller, potentially limiting future returns.

Possible circumstances

- Medical expenses
- Preventing foreclosure or eviction

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