

Life & Legacy

Redefining retirement, one step at a time

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RETIREMENT PLANNING

Thinking of prematurely tapping your retirement account?

Only a few very specific financial circumstances call for prematurely accessing your retirement funds. But when and if the time comes, here are some possibilities you'll need to consider.

Unexpected life events can throw even the best-laid financial plan into chaos, sending you into crisis mode. For example, when a large medical co-pay or other debt arises, or even if you're just tired of being underwater with credit cards, you may be tempted to withdraw from your retirement accounts.

Rationales aside, tapping these funds is largely taboo among financial planning specialists. "Early withdrawals from retirement funds should be used only as a last resort," says Scott Deaton, a Wealth Planning Advisor with Mosaic Consulting, affiliated with Lincoln Financial Advisors Corp., in Canonsburg, Pennsylvania. "Not only do you take an immediate hit in the payment of ordinary income taxes and a potential tax penalty, but tapping that money early is also going to completely change your retirement projections."

Though there's no disputing these consequences, dire circumstances may still cause you to consider using retirement savings. If that happens, here's what you should know about withdrawing from the following types of retirement accounts:

Borrow from your IRA. Though you can borrow from an IRA once within a 12-month period, for up to 60 days without tax or penalty, there's a huge caveat: "If your liquidity is poor, there could be a huge cost to your retirement account," Deaton explains. If you don't redeposit the money within 60 days, you'll pay ordinary

income taxes. A 10% tax penalty also applies if you're younger than 59½. (Penalties may be waived in certain situations, such as a first-time home purchase—up to \$10,000—and high, unreimbursed medical bills.)

"Borrowing from an IRA is a last-gasp solution for short-term liquidity problems," says Deaton.

Roth IRA. Given that you've already paid taxes on Roth contributions, this is the best place to go. You can withdraw your contributions anytime without penalty. Withdraw any appreciation of your assets inside the Roth, however, and things get more complicated. If it's considered a nonqualified distribution, you may be exposed to a 10% tax penalty in addition to being taxed on the amount at ordinary income rates. You may be able to use some of the funds for a first home or unreimbursed medical expenses, but restrictions apply, so it's best to check with your tax advisor and financial planner. Of course, losing the potential tax-free growth of those assets is likely the biggest cost and may significantly reduce your eventual retirement account.

Borrow money from your 401(k) or 403(b). Most 401(k) and 403(b) plans allow participants to take out loans against their accounts. You can typically borrow up to the smaller of \$50,000 or 50% of the balance, and then must pay back the loan with interest over a set period of time, usually five years. "One benefit is that the interest on the loan is paid back to you instead

Who We Are:

Custom Wealth Management comprises a group of trained specialists who help business owners, professionals, executives and retirees understand complex estate, business succession, retirement and investment problems. Its associates are registered representatives of Lincoln Financial Advisors Corp.

of your lender,” says Deaton. “But you’ve taken your money out of the marketplace, so you may lose out on any potential appreciation.” Another downside: If you lose your job, you’ll need to repay the loan immediately; otherwise, taxes and penalties may apply.

Make a hardship withdrawal. The IRS allows you to withdraw cash from your workplace retirement account for specific reasons. (Check with your benefits administrator, since not all

companies offer this option.) These include “immediate and heavy financial needs,” such as large medical expenses, a down payment on a primary home, or tuition and related educational expenses. As is the case with a traditional IRA, the withdrawal will be taxed as ordinary income and be subject to a 10% tax penalty. In certain circumstances, such as permanent disability or unreimbursed medical expenses totaling more than 7.5% of your adjusted gross income, the IRS may waive the penalty.

Note that you can’t pay back a hardship withdrawal the way you would a 401(k) loan—you’ll still be constrained by the account’s contribution limits—so this move permanently sets back your retirement savings.

Avoiding a retirement account withdrawal is the best strategy. “I strongly advise my clients not to tap into their retirement accounts,” says Deaton. “Withdrawing money from your retirement accounts now could force you to work longer or save more now, and potentially have less to spend during retirement.”

TALK TO YOUR FINANCIAL PLANNER ABOUT:

- Creating a liquidity plan that may help you avoid a cash crunch
- Putting money into a Roth IRA
- Planning to meet major obligations such as college costs

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