401(k) Early Withdrawals and Loans

Although it is not generally recommended as a sound personal financial choice, early withdrawal or borrowing money from your 401(k) is sometimes the only choice you have. If you find yourself short on cash and faced with an emergency, you may have a number of options with your 401(k). Here are two.

Loans

If your 401(k) plan has a loan option, you can borrow money against your account and repay yourself with interest. You can use your loan for anything. But, most companies will only allow you to borrow up to 50 percent of your vested account value. You repay the loan through deductions from your paycheck.

There are pros and cons to taking a loan against your 401(k). It is a cost-effective method to borrow since you are borrowing your own money and paying it back at low interest. And, because it is your money, you won't get declined because of bad credit. One of the drawbacks to taking the loan is that you lose the compounded interest you would have received on the money your borrowed. And, you could lose even more money if your company is one that does not allow you to invest in the 401(k) while you have an outstanding loan.

Finally, keep in mind that if you leave the company, the loan is immediately due regardless of whether you were fired or laid off.

Hardship Withdrawals

A hardship withdrawal is one of the valid types of withdrawals that you can make from your 401(k) plan. Check the prospectus of your plan to determine what qualifies as a hardship. You may find that you can withdrawal money for some of the following reasons:

- Onset of a sudden disability
- Money for the purchase of a first-time home
- Money for payment of higher education expenses
- Money needed to avoid eviction or foreclosure
- Money for certain medical expenses that aren't reimbursed by your insurer

Regardless of why you withdraw the money from your plan, you will probably have to pay ordinary income taxes and a 10 percent early withdrawal penalty if you're younger than 59½.