

## Dangers of Taking a 401(k) Loan

**Q. I took a loan against my 401(k) last year. What happens if I leave my job before it is paid back in full?  
-- Borrower**

**A.** Loans from your 401(k) may have seemed like a smart idea, but if you leave your job before it's paid in full, you could face some unpleasant consequences.

Many employers offer the opportunity to borrow money against an employee's 401(k) with the understanding that the loan will be paid back over a five year period of time, said **Claudia Mott**, a certified financial planner with **Epona Financial Solutions** in Basking Ridge.

"The IRS usually limits the amount that can be borrowed to \$50,000 or one half of the employee's vested balance -- whichever is smaller," she said. "It is at the employer's discretion to determine the interest rate that will be charged on the loan which may be 1 to 2 percent above the current prime rate."

Mott said dipping into your retirement savings should be a last resort option after exhausting all other borrowing alternatives.

She said using these funds for short-term cash needs costs more than the interest that will be charged for the loan. Also, there is also the loss of the tax-free growth that accrues from dividends, interest and capital appreciation on the investments held in the account.

Additionally, the plan may prevent contributions from being made while the loan is outstanding which means potentially foregoing the "free money" match an employer is providing, Mott said.

"Although the rules may vary from one employer to the next, in general an employee who either leaves a company or is terminated has 60 days to repay the outstanding 401(k) loan balance," she said. "If this doesn't occur, the loan will be considered a distribution."

The amount of the outstanding balance will be considered taxable income to you. If that's not bad enough, there will be a 10 percent early withdrawal penalty levied if the recipient is under age 59 1/2.

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