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BORROWING FROM A COMPANY RETIREMENT PLAN

BRENTWOOD, Tenn. – The troubled economy has taken its toll, resulting in job losses, home foreclosures and tighter credit. Faced with a financial emergency, many people scramble to find available cash. At such times, the money in your qualified company retirement plan may seem like a great resource. Tapping into your retirement plan can be an acceptable step in the absence of other borrowing options, according to the Tennessee Society of CPAs. Here's a look at how to make the most of this borrowing option and common mistakes to avoid.

INTEREST ADVANTAGES

A retirement plan loan has a number of advantages over other borrowing options. First, instead of paying interest to a lender, you are actually paying interest to yourself, a much more rewarding prospect. In addition, the interest rate on such loans is typically lower than what you would pay on credit card balances or other commercial debt.

NO CREDIT CHECK

It has been difficult for many people to get credit during recent months, as lenders have frozen loans or raised their lending standards. That's not a problem with your retirement plan loan, because you are essentially the lender. There are no credit checks or negotiations necessary. The paperwork is relatively uncomplicated, and you can arrange to have your payments deducted from your regular paycheck, making it easy to pay off the loan and incorporate the payments into your monthly budget.

DRAWBACKS TO CONSIDER

While there are relative benefits to a retirement plan loan, there are also important disadvantages. One major drawback is that you lose the investment potential of any money you borrow. Let's say you have \$5,000 in a retirement plan, and during the coming year that investment will earn 5 percent, or \$250. If you borrow that \$5,000 from your retirement plan, you miss out on the chance to earn the \$250. Thus, potential lost earnings are a "hidden" cost of your loan.

THE SLIPPERY SLOPE

If you borrow from a retirement plan, it's also important to avoid getting into the habit of treating the account as a source of ready cash. CPAs advise that setting up a retirement account should be a top priority. The earlier you begin saving, the more time that your money has to grow. If you interfere with that growth potential by taking regular loans from a retirement plan, you will cheat yourself out of what could amount to thousands of dollars in retirement nest egg funds over time.

BORROW BUT DON'T WITHDRAW

After weighing the advantages and disadvantages, you may still decide that you do want to tap into your retirement plan funds. Remember, though, that with any tax-advantaged retirement account, it's significantly better to take a loan rather than withdraw the funds outright. When you take a withdrawal before you reach the age of 59½, you will be subject to a 10% penalty on the amount you take, and you will also have to pay income tax on that money. If you withdraw \$5,000, in other words, you will owe the Internal Revenue Service a \$500 penalty as well as tax on that withdrawal.

About Money Management

Money Management is a weekly column on personal finance prepared and distributed by the Tennessee Society of Certified Public Accountants (TSCPA) as a part of its financial literacy initiative.

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