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"401(k) withdrawals just became a better option"

Joshua Sutin quoted in "401(k) withdrawals just became a better option"

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Employees struggling with pay cuts and medical expenses related to the coronavirus may be faced with what sounds like a tantalizing, too-good-to-be-true offer: Take as much as $100,000 from their 401(k) plan without the usual early withdrawal penalty and spread out the tax payments over multiple years.

The $2 trillion federal legislation passed last month that provides forgivable loans to small businesses and stimulus checks to low- and middle-income taxpayers also made it more attractive to withdraw money from employer-sponsored 401(k) retirement plans.

But financial experts warn that tapping 401(k) plans early even with the new relaxed rules could have lasting negative financial consequences. An early 401(k) withdrawal is still an expensive way to generate cash, compounds the losses for investors selling shares in a down market and will make it harder to save enough for retirement.

I would consider it a last-ditch thing, said Jason L. McGarraugh, a certified financial planner for Neal Financial Group in Houston.

Financial planners recommend that consumers have three to nine months of expenses in an emergency savings account. But many people live paycheck to paycheck, making it difficult to pay bills if they lose their jobs. Forty percent of consumers dont even have an extra $400 to cover an unexpected expense, according to the Federal Reserve.

The financial pressure is only increasing as more workers face furloughs, terminations and pay cuts during the coronavirus crisis. Many are looking at the money in their 401(k) plans to cover mortgages, utility bills and medical expenses.

Under the new Coronavirus Aid, Relief and Economic Security Act which Congress passed and President Donald Trump signed into law last month, companies that offer employees the option of withdrawing funds have the option of raising the withdrawal limit to $100,000, up from $50,000.

The new law also removes the 10 percent penalty for early withdrawals by workers under the age of 59. It also allows employees to spread the income tax liability which can push employees into a higher tax bracket over three years instead of just one for coronovirus-related expenses.

"401(k) withdrawals just became a better option", Continued

Employers should consider expanding the amount of money employees can withdraw from their 401(k) programs, according to one employee benefit expert.

It builds loyalty and employees will feel more connected if employers try to go out and care for their employees, said Joshua Sutin, a benefit planning and tax lawyer at Chamberlain Hrdlicka.

The new stimulus act also allows companies that offer 401(k) loans to double the amount of money workers can borrow to $100,000 from $50,000. But the loan option isnt nearly as attractive as taking an outright withdrawal because the new stimulus package doesnt include the same sweeteners for loans.

Employees who take out a 401(k) loan and plan to pay it back over a five-year period with their wages can find themselves in trouble if they lose their jobs, a growing concern as the fallout from the coronavirus pandemic has pushed up unemployment to levels the nation hasnt seen since the Great Depression.

Employees who borrow from their 401(k) plans and then leave their jobs must repay the outstanding loan balance within 60 days or it becomes an early distribution and triggers the 10 percent penalty for workers younger than 59. The distribution also is treated as immediate income that can push employees into a higher tax bracket.

In normal times, investment advisers recommend a 401(k) loan compared to an outright withdrawal. But with the new stimulus package, it is probably better to consider a withdrawal, said one retirement expert.

Were in very stressed economic times, said Dave Stinnett, head of the strategic retirement consulting group for Pennsylvania-based investment management firm Vanguard. If you are taking out a loan, you have to pay it back over five years and you want to make sure its something you can do.

And if you take a withdrawal? Under the rules, you still have three years to roll the money back into your 401(k) plan.

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