401(k) Loan Repayment

A longer repayment time can be an advantage.

Provided by Ivana Lotoshynski, CFP®

The conventional wisdom about taking a loan from your 401(k) plan is often boiled down to: not unless absolutely necessary. That said, it isn't always avoidable for everyone or in every situation. In a true emergency, if you had no alternative, the rules do allow for a loan, but they also require a fast repayment if your employment were to end. Recent changes have changed that deadline, offering some flexibility to those taking the loan. (Distributions from 401(k) plans and most other employer-sponsored retirement plans are taxed as ordinary income, and if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, once you reach age 70½, you must begin taking required minimum distributions.)

The new rules. Time was, the requirement for repaying a loan taken from your 401(k)-retirement account after leaving a job was 60 days or else pay the piper when you file your income taxes. The 2017 Tax Cuts and Jobs Act changed that rule – now, the penalty only applies when you file taxes in the year that you leave your job. This also factors in extensions.[1]

So, as an example: if you were to end your employment today, the due date to repay the loan would be the tax filing deadline, which is April 15 most years or October 15 if you file an extension.[1]

What hasn't changed? Most of what transpires after a 401(k) loan still applies. Your repayment plan involves a deduction from your paycheck over a period of five years. The exception would be if you are using the loan to make a down payment on your primary residence, in which case you may have much longer to repay, provided that you are still with the same employer.[1]

You aren't just repaying the amount you borrow, but also the interest on the loan. Depending on the plan, you're likely to see a prime interest rate, plus 1%.[1]

If you do take the loan, a good practice may be to continue making contributions to your 401(k) account, even as you repay the loan. Why? First, to continue building your savings. Second, to continue to take advantage of any employer matching that your workplace might offer. While taking the loan may hamper your ability to build potential gains toward your retirement, you can still take advantage of the account, and that employee match is a great opportunity.

Ivana Lotoshynski, CFP® may be reached at 973-227-3390 or contact@peoplewealthmatters.com – http://peoplewealthmatters.com/

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1 - kiplinger.com/article/taxes/T001-C001-S003-ex-workers-get-more-time-to-repay-401-k-loans.html [2/13/19]