

Don't Cash Out

If you're strapped for cash, you may be considering tapping your retirement account. But hold off. Cashing out of a retirement account can be very expensive, as there may be serious tax consequences. This is money you don't want to touch except in an emergency.

The cost of early withdrawals

Your workplace retirement plan may allow hardship withdrawals if you can show that you have no other resource to pay for a need that the Internal Revenue Service deems essential. One example of such a need is to prevent foreclosure on your house. But there's a price to pay: You'll owe income taxes on the money you take out—plus a 10% early-withdrawal penalty if you're under 59 ½ years old.

So if you're 40 years old and your combined federal and state income tax bracket is 25%, it will cost you \$3,500 to take a \$10,000 withdrawal. That's \$2,500 in taxes plus \$1,000 in an early-withdrawal penalty.

What if you're laid off?

Leave your money in your former employer's retirement plan (if your balance is \$5,000 or more¹) or ask to have it rolled over into an individual retirement account (IRA). Either way, your assets remain tax-deferred, and you'll be able to transfer them into a new employer's plan.

¹If your balance is between \$1,000 and \$5,000, your former employer may either maintain your account or transfer it to an IRA. If it's below \$1,000, your account may automatically be cashed out. Taxes and early-withdrawal penalties may apply.