Danger: Don’t Touch

We’re used to seeing warnings on electrical appliances, tools, cleaning products, and other things that can be harmful if mishandled. Although your retirement plan doesn’t have a warning label, you should be cautious with your money if you change jobs.

More Now, Less Later

You might like the idea of having some extra cash to pay bills, buy a car, or do something else. Who wouldn’t? But remember this: Spending money you’ve earmarked for retirement *before you retire* will eventually mean less income *after you retire*. Even if your balance is relatively small, the impact could be significant. Take a look at the chart to see what the “cost” of withdrawing just $8,000 at age 30 might be by the time a person reaches age 65.

Don’t Forget Taxes

Using your retirement money early can also have an immediate — and potentially substantial — tax cost. The money in your plan is tax deferred only until it is distributed. In addition to income taxes, a *10% early withdrawal penalty* may also apply. Let’s say you’re changing jobs at age 40, you’re in the 25% federal tax bracket, and you decide to take $10,000 from your retirement plan. After paying the penalty and federal taxes, you’d pocket just $6,500. And that doesn’t take into account any state income taxes you may have to pay.

Keep Your Money Working

If you decide you want to preserve your tax-deferred retirement savings, you may be able to leave your money in your present employer’s retirement plan. Check to see whether this option is available to you.

Your other choice will be to “roll over” your retirement money into your new employer’s retirement plan or an individual retirement account (IRA). If you arrange for a direct trustee-to-trustee transfer, the plan administrator will move the money for you, and you’ll avoid tax problems. If you take the money in a check, your plan must withhold 20% to pay federal income taxes, even if you intend to complete the rollover yourself. You’ll have to replace the missing 20% to accomplish a tax-free rollover of 100% of your funds.

If the day ever comes when you have to decide whether to take your retirement money early, picture that warning label: *Don’t touch.* Then avoid the threat to your future financial well-being by preserving your cash in a tax-deferred retirement account.

The Long-term Cost of an Early Withdrawal

Retirement Account Balance at Age 30	$8,000	$8,000
Withdrawal at Age 30	$8,000	$0

Contributions Age 30-65	$100 per month	$100 per month
Balance at Age 65*	$180,105	$272,154

Cost of withdrawing $8,000 — $92,049

*Assumes 7% average annual total investment return. Money will be taxed upon withdrawal. This is a hypothetical example with investment returns compounded monthly. Your investment returns and contributions will be different.

Source: NPI