Should you use retirement savings for an emergency?

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When you have an emergency, you might need access to funds fast. However, coming up with the cash can be difficult sometimes.

As a result, many people turn to their retirement savings to help them weather an emergency, said Roger Whitney, a financial planner and retirement expert.

"It's a big chunk of cash just sitting there," he said. "It can be tempting to turn to your retirement account for quick, easy money."

Why you might need funds in an emergency

The Federal Reserve reports that about 39 percent of Americans would have a hard time coming up with $400 for an emergency. Furthermore, a recent Bankrate survey found that a growing percentage of Americans have no emergency savings whatsoever. Finding a source of capital becomes important for those who don't have an emergency fund or the ability to put it on a credit card and pay off the balance.

If you've experienced a financial setback, such as a job loss, major home repair or a car accident, you might need hundreds - or even thousands - of dollars to get through the situation. Even smaller emergencies, like a car repair or the need to replace a broken appliance, can seem overwhelming.

"Many people find themselves in unexpected circumstances and need cash," said Whitney. "However, it's important to be sure that you really need the money before you start tapping into accounts."

In general, raiding your retirement account should be a last-resort type of decision.

"Your retirement savings should never be the first place you look for money in an emergency," said Whitney. "This is money you're planning to live on later in life. Depleting it today should only happen after much careful thought."

Does it make sense to borrow from retirement savings?

Whitney pointed out that many people tap into their retirement savings, especially when it comes to major emergencies, because they'd rather pay interest to themselves. Some take out a loan from their 401(k) plan at work, while others simply withdraw cash from their IRA.

"When you borrow from a 401(k) and repay the money, you're basically loaning yourself money. You pay interest, but that interest is going back into your retirement account," Whitney said.

"Even if you get money from an IRA and you don't have a loan situation, it can still feel good to not borrow and pay interest."

You can get a personal loan, of course. But if you need more money than a few thousand dollars, you might not qualify. A retirement account might be the only place to get a large sum of money.

It's also easier to tap your retirement savings than to get a loan in some cases. Rather than going through a credit check and gathering financial documents for the loan application, you can instead withdraw some of the money from your account.

As long as your company allows a 401(k) loan, and you meet the requirements, you can get the cash you need without a lot of waiting and approvals. But there's a limit to how much you can borrow from your 401(k) or other qualified plan, according to IRS rules. The maximum loan is the greater of $10,000 or 50 percent of your vested balance; or $50,000, whichever is less. For example, if you have a vested balance of $50,000, you can borrow up to $25,000.

"You can't replace the earnings from that money, though," said Whitney, noting that your money can't grow if it's not invested. "Even if you put it back, you've missed out. And, unfortunately, in my experience, I've seen very few people actually put it back. Much of the time, people just end up paying taxes and penalties plus miss out on years of potential gains."

Getting money from your IRA is even simpler. While neither a traditional IRA or Roth IRA allow loans, all you have to do is request a withdrawal from your brokerage and the money will arrive in a few days. But you can't pay the money back to your IRA, according to Merrill Lynch.

Additionally, even if you can get a fast loan online from a lender, the interest rate might be exorbitantly high. Some lenders charge more than 100 percent APR. Getting a payday loan can be even more expensive and trap you in a cycle of debt.

"If you have no place else to turn and you're worried about the cost of interest, it might make sense to go into your retirement savings," said Whitney. "However, you have to realize that there are consequences and penalties, and you miss out on time in the market. You don't want to mortgage your future."

The cons of using retirement savings for an emergency?

The consequences of getting money from your retirement account vary according to the type of plan you have.

If you withdraw money from an account before you reach age 59 ½, you could be subject to a 10 percent penalty on the amount taken. If you have a traditional IRA or 401(k) and simply withdraw the money, you'll also have to pay taxes at your marginal rate. Your withdrawal is seen as income.

However, Whitney said there are ways to get around some of these consequences.

First, there is a 401(k) loan. Generally, according to Whitney, you have five years to repay the loan, so it makes it a little more affordable. However, if you leave your job before the five years are up, the entire remaining balance is due within 60 days. Don't make the deadline? That money becomes a withdrawal and is subject to taxes and penalties.

"There are no IRA loans," said Whitney. "If you take money out of an (traditional) IRA, you have to replace it within 60 days via a rollover to another IRA or you're stuck with taxes and penalties." IRA borrowers, however, can avoid fees and taxes if the withdrawal is for an exemption approved by the IRS, such as a purchase of a first home, qualified higher education expenses or a permanent disability, according to Merrill Lynch.

The exception, Whitney pointed out, is a Roth IRA. You can withdraw your contributions from a Roth IRA at any time. As long as it's money that you put in, you can take it back without penalty. However, once you start dipping into the earnings from your Roth, you become subject to penalties.

Alternatives for emergency funds

Rather than reducing your future wealth by using retirement savings for an emergency, Whitney suggests starting an emergency fund or looking for other alternatives to access cash quickly.

"Start by looking at your other resources," he said. "Do you have time to sell some items, or do you have a family and friends network you can tap for help?"

If you have good credit, you can also apply for a credit card with a 0 percent APR introductory offer and make a plan to repay the money before the end of the promo period. That way you won't pay any interest.

Don't forget to consider community resources, either. When you're in an emergency situation that involves hardship, look to a food bank, as well as charity organizations and even your religious congregation. If you're laid off, applying for unemployment benefits can be another way to help you get through a tough time.

However, Whitney pointed out, it's a good idea to prepare for emergencies ahead of time.

"When you buy a car, set aside a small amount of money each month as a car repair fund," he said. "Or figure out what you can put in an emergency fund. It might not seem like much, but it can keep you from turning to your retirement savings and reducing your future wealth.

Bottom line

While accessing your retirement savings might be an easy way to handle an emergency, it's not always the best option. Unless you don't have another choice, or your other choices are very expensive, it's often better to avoid raiding your retirement savings.