Can You Use IRA Accounts as Collateral?

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IRAs – individual retirement accounts – are some of the most popular retirement plans used today. Close to 48 million American households feature some kind of IRA; many have more than one. Traditional IRAs lead the way, but today more and more are moving toward Roth IRAs which give you some pretty nice tax advantages.

Many people who use IRAs or who are considering IRAs wonder if their balances can be used as collateral for loans. That's a good question – so much of your net worth will eventually become tied up in your account, meaning you may need to take out a loan for a car, a down payment for a home, college expenses, or some other reason.

Here, I'll talk about using your IRA accounts as collateral and what that means for you.

IRA Accounts as Collateral

By the time you retire, your retirement account will more than likely be the largest single source of your wealth. In fact, it'll be the biggest source of wealth for you long before you retire. Unfortunately, you can't start withdrawing these funds until the age of 59 ½ without paying a stiff 10% penalty (which no one wants to do).

The next best option for most people, then, is to use the assets in the IRA as collateral for a loan. Unfortunately, the IRS frowns upon this; if they find out that you've collateralized your IRA, then they'll consider the entire amount as disbursed – which means you'll take a 10% penalty on the entire amount.

For example, if you want to use $15,000 of your $75,000 IRA account to help pay for a new car, the IRS can consider the entire amount as distributed. That means instead of paying 10% on $15,000, you'd instead pay $15,000 on $75,000 – *plus* taxes.

As you can imagine, this option isn't very wise. But, there is a way you might be able to use these assets to help you with your purchase anyway.

Using a 401k Transfer

The solution is to use a 401k transfer.

Under IRS regulations, you are allowed to transfer funds from an IRA into a 401k account. There are two caveats, though: you have to have a 401k account with your employer, *and* your 401k plan administrator has to agree. But, if both of these are met, you can take the assets you have in your current IRA and make them available for a 401k.

Here's how. First, find out if your 401k plan allows what are called ***IRA rollovers***. If they do, you can then request distribution from your IRA account by contacting your IRA administrator and filling out the required paperwork. It can take up to 60 days to liquidate your assets and have them distributed to your 401k, but once that happens, you can start loan paperwork with the 401k plan.

Under IRS regulations, you can take out a loan against the value of your 401k account. You have up to five years to repay this loan, with interest, but you're repaying yourself and the interest goes back into your account anyway. (You may not have to repay your loan within five years if you use the loan for buying a primary home).

Of course, there are limitations to this route. What if you need more money than what is available in your account and the only way to get that money is through a secured loan – one that requires collateral? If so, you're in the same position – you aren't allowed to use 401ks as collateral for secured loans, either. The closest you can get is using the funds in your 401k as a loan to yourself.

Should you go this route? If you need to make a major purchase, and have no other way of getting a loan or securing money, taking out a loan isn't a bad idea. Be wary of doing this and not repaying the loan, though. Failing to repay a loan through a 401k – even to yourself – results in stiff penalties that you're better off avoiding.

So, to recap:

- You ***cannot*** use an IRA *or* a 401k as collateral for any secured loan
- You ***can*** transfer funds from an IRA to a 401k
- You can take a loan using the funds in a 401k as long as you repay the loan plus interest within five years

If you have an IRA, and *don't* have access to a 401k, then you may have to obtain an unsecured loan from an institution or private lender instead of getting a secured loan with an IRA as collateral.