Taking Stock: Some retirement plans make excellent collateral

by Malcolm_Berko

Dear Mr. Berko: I have had to spend a lot of money to refurbish my office. I tried to borrow about $42,000 from my bank of 16 years (I have a 675 credit score) but they hemmed and hawed and sort of let me know they did not want to make me a loan, especially when they said my loan could cost me 14 percent. I considered a home equity loan, but our home is worth about $27,000 less than our mortgage. My wife, who has been my business partner for 12 years, suggested we use our retirement account as collateral at the bank for the $42,000. The value of our plan is $314,000, we are the only participants and $142,000 of it is in a Charles Schwab Money Market account, which has no risk. So our question to you is: Can we use our pension account as collateral at the bank for a personal loan, and would the money be tax deductible? We have a good business and have made a decent income every year since I started this company in 1992. â€” D.S., Cleveland

Dear D.S.: Jeez! I can't give you an answer unless I read your pension plan, something I will go to great lengths to avoid. Some plans allow the participants to borrow, some don't, and those that allow it probably have restrictions and limitations. I strongly recommend you take this retirement plan to the attorney who drew it up â€” most are cookie-cutter plans â€” to be "posolutely and absurtively" certain that your plan has the necessary language to authorize loans to a plan participant.

However, even if your plan provides for a loan, it could limit the amount you are allowed to borrow. The maximum a plan can permit as a loan is either "the greater of $10,000 or 50 percent of your vested account balance or $50,000, whichever is less." And in almost all cases with which I'm familiar, your loan must be repaid within five years and the payments must be "made in substantially equal amounts" and must be made at least on a quarterly basis. Because you and your better three-quarters are the only participants, your vested interests at this time must be 100 percent. That's good for you because the plan has all the cash you need and then some.

If your lawyer gives you the thumbs up, have him prepare a plan loan agreement. Depending upon how the loan is structured, you might be able to deduct all the interest from your earned income. If that's so, then ask your lawyer what's the most the plan can charge you on that loan. If the plan can charge you 10 percent on that $42,000, you will get an approximate $4,000 tax deduction from your personal income and your pension plan will earn a clear 10 percent or $4,000 during the first year of that loan. You might even get a second deduction for capital improvements. Also make sure you discuss this with your CPA. I wish you good luck.

Now I'm perplexed that your bank won't lend you the $42,000. If you've been in business for 16 years, if you have a pension plan valued at $314,000 (which was certainly worth more 12 months ago) if you've been in business for 16 years and always made a profit, and if your credit score is 675, there's no reason your bank should refuse that business loan.

I understand that many bankers are boring people who lack creativity, imagination, vision and resourcefulness, but that' why they are hired to be bankers. I also know that many banks are being urged to make loans to spread the money. So unless there is evil in your backgrounds, such as being accused of heterosexuality, having been seen attending various thespian gatherings, you're known as an avowed oenophile, a libertarian, an active vividisectionist or engage in percussionism, there's no reason on this green earth your bank should refuse that loan. Get rid of that bank and those banksters and be quick about it. There are hundreds of banks in Cleveland that would wash your feet if you opened a business and personal account with them.

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