

63%

of people are
confused by 401(k)
plans, but you
don't have to be.



401(k): The Breakdown

Most of us have heard about a 401(k), but how well do you actually understand it?

The thought of saving for retirement can be intimidating. However, it doesn't have to be. We've broken down everything you need to know about a 401(k) below.

What is a 401(k)?

A 401(k) is an employer-sponsored retirement savings plan, typically included in your company's benefits package. It offers a tax break when you contribute a portion of your income toward retirement. Employers often match a portion of their employees' contributions, making it an even more valuable savings tool.

Depending on your target retirement date and financial goals, you can select the type of investment funds within the plan that make the most financial sense for you.

There are two types of accounts available: a traditional 401(k) and a Roth 401(k). The key difference between them is when you pay taxes on your contributions.

Traditional 401(k)

Contributions to a traditional 401(k) are conveniently taken out of your paycheck before income taxes are even calculated. This means those contributions immediately help reduce

your taxable income, giving you an upfront tax advantage. The funds are then carefully invested in mutual funds and other diversified investments, allowing them to grow steadily over time. However, when you eventually withdraw money from your traditional 401(k) in retirement, you will pay ordinary income tax on those withdrawals. This system allows your savings to grow tax-deferred, but you'll face taxes when you finally tap into that hard-earned nest egg.

Roth 401(k)

With a Roth 401(k), you make contributions using money that has already been taxed, so you don't get a tax break when you put money in. However, like a Roth IRA, you won't pay taxes on qualified withdrawals. This means that if you take money out after age 59½ and your first contribution was made at least five years earlier, those withdrawals will be tax-free. This can be a great option if you think you might be in a higher tax bracket when you retire.

401(k) contributions

You have the flexibility to choose how much of your income to contribute to a 401(k) account each year, as long as you stay within the IRS limits. When you begin a new job, you can select a percentage of your annual salary to save. You also have the option to change your contribution amount up or down, depending on the rules of your specific plan.