



## Maximizing Your Retirement: 401(k) and Roth 401(k) Plans

### What is a 401(k) Retirement Plan?

A 401(k) plan is a retirement savings account that is offered by your employer. You cannot open a 401k on your own; you must work for a company that offers this type of plan. Because the plan is provided through your workplace, contributions are made via payroll deduction.

Having contributions go directly into your 401(k) plan makes it easier to save for retirement before you even cash your paycheck. Although many components are common across 401(k) plans, certain features vary by employer. Be sure to consult your plan's rules to understand what applies to you.

### When Can I Contribute?

Each 401(k) plan specifies when you can begin making contributions. Some plans require up to a year of employment, while others allow contributions with your first paycheck. To boost employee participation, many employers offer automatic enrollment once you become eligible.

If you are automatically enrolled, it's important to review your default contribution rate and investment selections to ensure they align with your financial goals and personal circumstances.

### What Are the Income Tax Consequences of Contributing to a 401(k) Plan?

The two most common ways to contribute to a 401(k) are on a pre-tax or after-tax (Roth) basis. Contributing on a pre-tax basis means that your contributions are deducted from your paycheck and deposited into your 401(k) before federal and most state income taxes are calculated. By contributing to your 401(k) plan on a pre-tax basis, you will pay less taxes than if you did not contribute. In addition to not paying income taxes on the amount you contribute, any investment gains that you earn on your contributions would also not be taxable until you take distributions from the plan.

For example, Taylor earns \$65,000 annually and contributes \$5,000 to her employer's 401(k) plan on a pre-tax basis. Because of Taylor's contribution, her taxable income is reduced to \$60,000. She will not pay taxes on the \$5,000 contribution, or any investment earnings, until she withdraws money from the plan.

Most 401(k) plans now allow after-tax contributions, or what is known as *Roth contributions*. Unlike pre-tax contributions, Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA (individual retirement account) contributions. This means you receive no immediate tax break. Your contributions are taken from your paycheck and deposited into the plan after taxes are applied. However, because you already paid taxes on this type of contribution, qualified Roth 401(k) distributions are tax-free when you withdraw them.

For example, Jeremy earns \$65,000 annually. He contributes \$5,000 to his employer's 401(k) plan on an after-tax basis. Because these are Roth contributions, Jeremy's taxable income remains \$65,000. However, if his withdrawals qualify under IRS rules, his Roth 401(k) contributions and all investment earnings on those contributions will be income tax-free when distributed. A Roth 401(k) distribution is considered *qualified* if it meets specific requirements, typically including a five-year holding period and occurring after age 59½, or due to disability or death.

The five-year waiting period for qualified Roth 401(k) withdrawals begins on January 1 of the year you make your first Roth contribution. For instance, if your first Roth contribution is made in December 2026, the waiting period starts on January 1, 2026, and ends on December 31, 2030. This means you could take a qualified distribution starting January 1, 2031, assuming you meet the age and other qualifying conditions.

Withdrawals from pre-tax accounts before age 59½, as well as nonqualified withdrawals from Roth accounts, are generally subject to regular income tax and a 10 percent penalty—unless an exception applies.

## **2025 401(k) Contribution Limits**

Under age 50:

- You may contribute up to \$23,500 to your 401(k).
- Combined employer and employee contributions cannot exceed \$70,000.

Ages 50 through 59 and over 64:

- You are eligible for a catch-up contribution of \$7,500.
- Your total individual contribution limit is \$31,000.

Ages 60 through 63:

- You are eligible for a higher catch-up contribution limit of \$11,250.



- Your total individual contribution limit is \$34,750

Starting in 2026, workers who are over 50 and earn more than \$145,000 will automatically have their catch-up contributions made on an after-tax (Roth) basis.

Whether you contribute to your 401(k) on a pre-tax or Roth basis, the total contribution limits are the same. However, you are allowed to split your contributions between pre-tax and Roth contributions in any proportion you choose.

Keep in mind that if you have more than one job and contribute to another employer's 401(k), 403(b), SIMPLE, or SAR-SEP plan, your combined contributions—both pre-tax and Roth—cannot exceed the annual limit for your age group. If you participate in more than one employer-sponsored plan, it is your responsibility, not your employer's, to make sure you don't exceed these limits.

## **Can I Also Contribute to an IRA?**

Yes. Participating in a 401(k) does not affect your ability to contribute to a traditional IRA. In 2025, you can contribute as much as \$7,000 to an IRA (\$8,000 if you're age 50 or older) as long as you have earned income equal to or greater than the amount you contribute.

However, your ability to make *deductible contributions* to a traditional IRA may be limited if you or your spouse participates in a 401(k) and your modified adjusted gross income (MAGI) exceeds certain thresholds. Similarly, your ability to contribute to a Roth IRA may be restricted if your MAGI exceeds certain levels.

## **What About Employer Contributions?**

Employers are not required to make contributions into 401(k) plans. However, many offer matching contributions to encourage participation and provide an employee benefit. Your employer may choose to match contributions made on a pre-tax basis, on a Roth basis, or both. Some employers match catch-up contributions for those age 50 and older, while others do not.

No matter what match your company may offer, their contributions to your 401(k)—even if they match your Roth contributions—are always made on a pre-tax basis. This means both the contributions and any earnings they may generate will be taxable when you take a distribution from the plan.

A company match is essentially free money, making it a valuable way to grow your retirement savings. Be sure to contribute enough to take full advantage of your employer's matching contributions.

## **Should I Make Pre-Tax or Roth Contributions?**

Choosing between pre-tax and Roth contributions can feel overwhelming. A simple guideline is this:



- **If you expect to be in a higher tax bracket when you retire than you are now**, Roth 401(k) contributions may be more appealing. You pay taxes now at a lower rate, and qualified withdrawals in the future are generally tax-free.
- **If you expect to be in a lower tax bracket when you retire than you are now**, pre-tax contributions may be more appropriate. They reduce your taxable income today, and withdrawals will be taxed later at a lower rate.

Because future tax rates are uncertain, a mix of pre-tax and Roth contributions can provide flexibility for retirement income planning. Other factors to consider include your investment time horizon and projected investment returns.

## What Happens If I Terminate Employment?

Before you decide what to do with the money in your 401(k) after leaving your job, review your company's vesting schedule to determine how much of the balance is yours to keep. Your own contributions and any earnings on them are always 100 percent vested (you always own these). Depending on your company's vesting schedule and how long you have worked there, you may be partially vested or fully vested in your employer's matching contributions and associated earnings. The longest vesting schedule allowed is six years.

After you figure out how much money in your 401(k) is yours, you will have some options for what you would like to do with that money.

- **Keep your money in your workplace 401(k) plan.** Be aware of limitations. Some plans require withdrawals at the plan's standard retirement age—usually 65. If your vested balance is \$5,000 or less, your plan may automatically cash you out.
- **Roll over your funds to IRAs.** You can move Roth 401(k) dollars to a Roth IRA and non-Roth dollars to a traditional IRA. You may also be able to convert your non-Roth dollars to a Roth IRA, but income taxes will apply to any tax-deferred amounts in the year of conversion.
- **Roll over your funds to another employer's plan** if the new plan accepts rollovers.
- **Take a cash distribution of your balance.** This includes your contributions, earnings, and any vested employer amounts. Keep in mind that any tax-deferred funds will be subject to income tax and may incur a 10 percent penalty tax if you are under age 59½, unless an exception applies.

Note: When deciding whether to roll over your retirement savings to an IRA or another employer's plan, it's important to carefully evaluate each option's investment choices, fees and expenses, available services, rules for penalty-free withdrawals, level of creditor protection, and distribution requirements.

## What Else You May Need to Know



If your plan permits loans, you can typically borrow up to 50 percent of your vested 401(k) balance, with a maximum limit of \$50,000. These loans are not taxable and are repaid through payroll deductions. In cases of immediate and severe financial need, a hardship withdrawal may be permitted, but this should be a last resort because hardship distributions are usually taxable.

Since 401(k) plans are intended for retirement, taking money out before age 59½ (or 55 in certain cases) could trigger a 10 percent early withdrawal penalty unless you qualify for an exception. Depending on your income, you may also be eligible for a tax credit of up to \$1,000 on the amounts you contribute.

Your assets in a 401(k) are generally protected in the event of your or your employer's bankruptcy. Most plans allow you to choose how your money is invested, typically from a selection of mutual funds offered by your employer. While they provide the choices, it's up to you to pick the investments that best align with your retirement goals.

### **Sources:**

[401\(k\) plans | Internal Revenue Service](#)

[401\(k\) plan overview | Internal Revenue Service](#)

[Individual retirement arrangements \(IRAs\) | Internal Revenue Service](#)

[Roth IRAs | Internal Revenue Service](#)

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