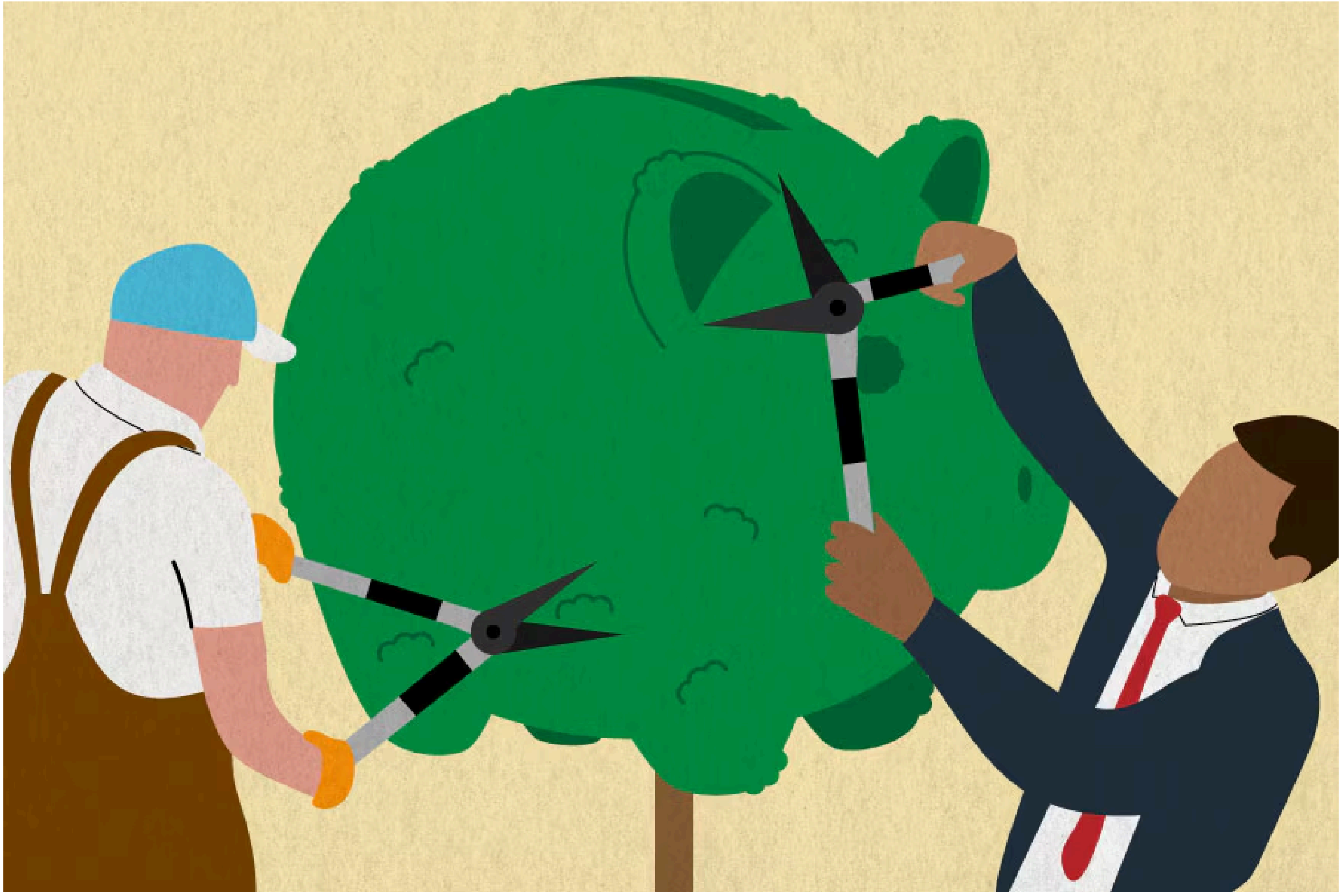

If you're like most Americans, when you think "retirement planning," you first turn to the 401(k) plan offered by your employer. After all, it's the most common type of retirement plan out there. However, 401(k) plans can be complex, and it's not always easy to understand exactly how these retirement savings plans work.

Ahead, we'll answer important questions about 401(k) plans, including:

- What's the difference between a traditional 401(k) and a Roth 401(k)?
- How does employer matching work?
- How much should I contribute to my 401(k)?
- And more

What is a 401(k) and how does it work?

A **401(k)** is an employer-sponsored retirement plan that comes with tax benefits. Basically, you put money into the 401(k) where it can be invested and potentially grow tax free over time. In most cases, you choose how much money you want to contribute to your 401(k) based on a percentage of your income. Your employer will then automatically withhold a portion of each paycheck and puts it into the account, making it easy to regularly contribute to your account.

What's the difference between a traditional 401(k) and a Roth 401(k)?

With a **traditional tax-deferred 401(k)**, the money is taken out of your paycheck before federal income taxes are figured, providing you the chance to reduce your taxes today. You pay ordinary income taxes on the pre-tax contributions and growth when you make a withdrawal in retirement. Note: You must be older than 59 1/2 (age 55 if you separate from your current employer) to avoid penalties on withdrawals.

Most employers now offer a **Roth 401(k)**, also known as a designated Roth account. Contributions to Roth accounts are made with after-tax dollars, which means you don't get a tax deduction. Instead, your money can potentially grow tax free and be withdrawn in retirement without any taxes. Note: To avoid penalties and/or taxes on withdrawals, you must hold the account for at least five years and be older than 59 1/2 (age 55 if you separate from your current employer).

How are 401(k) funds invested?

Generally, you can choose from a range of investments to fit your risk tolerance and time to retirement. Each 401(k) plan tends to offer different investment options, including mutual funds, exchange-traded funds (ETFs), target-date funds, index funds, money market funds, and individual stocks and bonds. You may also have the option to choose your own investments or have your account managed for you.

How does employer matching work?

If your employer offers a match, it means they'll put money into your retirement account based on the amount you put in. How the matching works will depend on the specifics of your employer's plan. For example, an employer could offer a dollar-for-dollar match up to a certain dollar limit. Or, an employer match can be based on a percentage of the contribution you make and a percentage of your wages.

For example, let's say you earn $6,000 per month, and your employer matches 50% of your contributions up to 6% of your wages. If you wanted to get the full employer match, you'd need to contribute at least $360 per month (6% of your monthly wages) to your account, and your employer would kick in an additional $180 (50% of $360) to match your contribution. As a result, your retirement account would see a combined contribution of $540 per month.

Here's another scenario to illustrate how employer matching works.

Employer match	Employee's salary	What employee puts in (6%)	What employer puts in	Total contributions for the year
50%, up to 6% of employee's salary	$72,000	$4,320/yr	$2,160/yr	$6,480/yr

In this example, your employer's matching contributions gave you an additional $2,160 as you saved toward your retirement goal.

What is 401(k) vesting?

One of the most important things to understand is how 401(k) vesting works. **Vesting** is a term that describes how much of the money in your account is actually yours if you were to leave the company or take a distribution.

Employee contributions are immediately vested and considered yours. However, most companies, matching or other employer contributions aren't considered yours until you've remained with the company for a set period of time. So, if the company has a vesting schedule, you might not be able to keep all the money your employer invests on your behalf until after you've stayed at the company for the required time period. Check with your plan administrator for the vesting requirements in your particular 401(k) plan.

What are the contribution limits for 401(k) plans?

Your maximum contribution to a 401(k) depends on the annual limits set by the IRS. The IRS looks at inflation to determine the annual contribution limits. For 2025, the employee elective deferral limit is $23,500. For those 50 or older, the IRS allows 'catch-up' contributions of up to $7,500, for a total contribution of $31,000 starting in 2025. In addition, those age 60 to 63 are now able to make a catch-up contribution of $11,250 for a total elective deferral of $34,750. Note: Your employer's contributions do not count towards your annual elective deferral limit.

With a 401(k), you need to make your contributions during the calendar year. So, if you want time to boost your retirement account and benefit from the special tax treatment, you need to get that extra money into your account before yearend.

It's a good idea to review the contributions you set up on your account annually to ensure you're putting away as much as possible.

How much should I contribute to my 401(k)?

How much you should contribute to your 401(k) depends on your retirement goals and how much you hope to accumulate in your nest egg by the time you retire. While you don't have to contribute the maximum allowed by the IRS, it's worth noting that the more you invest now, the greater the head start you'll likely have toward a comfortable retirement.

The longer you wait to save, the more you'll need to save annually for retirement. Every situation will vary, but here are age-based guidelines on how much you should save based on when you start saving for retirement:

- If you start in your 20s, save 10% - 15% of your salary, including employee match, per year for retirement.

- If you start in your 30s, save 15% - 20% of your salary, including employee match, per year for retirement.
- If you start in your early 40s, save 25% to 35% of your salary, including employee match, per year for retirement.
- If you start later, save as much as possible, and consider other strategies, such as retiring later, to manage retirement.

If you have more questions, be sure to ask a tax professional or financial advisor for more information about savings strategies for your 401(k).

Should I max out my 401(k)?

One of the best ways to help achieve your retirement goals is to maximize your 401(k) contributions.

Maximizing your contributions, meaning you contribute up to the annual IRS contribution limits, allows your investments to potentially benefit from tax-free compound growth. The sooner you put compounding to work for you, the better. If you're not able to max out your 401(k), consider increasing your contribution (over the employer match) as often as you can. If you get a raise or bonus, consider using this additional money to help fund your retirement goals.

401(k) contributions are, of course, only one part of creating a solid financial foundation. To learn more about how to prioritize your savings and retirement goals, check out these eight savings fundamentals.

What do I do with my 401(k) if I change jobs?

There are several ways to handle a 401(k) when leaving a job, including leaving your money in the old 401(k), rolling it into your new employer's 401(k) plan, rolling it into an individual retirement account (IRA), or converting it to a Roth IRA. You can also cash out, but if you are younger than 59½, cashing out triggers early withdrawal penalties, 20% federal tax withholding, and potentially state taxes, as well. (Learn more in our guide to 401(k) rollovers).

What happens if I make a 401(k) early withdrawal?

Generally, if you take money from your 401(k) account before you reach age 59 ½, you'll have to pay taxes on the pre-tax contributions and any growth, plus pay a 10% penalty. But there are some exceptions to the early withdrawal penalty.

One exception is known as the Rule of 55. Under this rule, if you lose or leave your job at age 55 or older and take distributions from the 401(k) associated with your most recent job, you won't have to pay the 10% penalty. Other circumstances that might allow you to avoid the 10% penalty include:

- Certain qualified birth or adoption expenses
- A series of substantially equal payments
- Permanent disability

You may need to provide documentation to avoid penalty in these cases, so make sure you're prepared to do so. To learn more about the exemptions to the 10% penalty, see the IRS website.

Can I contribute to an IRA and 401(k)?

Yes, it's possible to contribute to both an IRA and a 401(k). However, if you're eligible to contribute to a 401(k), then your IRA tax deduction may be limited, but your IRA contribution will not. Whether you actually contribute to the 401(k) is irrelevant—merely being eligible for a 401(k) means you'll have to review your modified adjusted gross income to determine if your IRA contribution is eligible for a tax deduction. But the IRA contributions you make won't affect your 401(k) contributions. Check out IRS Publication 590-A for an explanation of the IRA deduction rules.

What are required minimum distributions?

In general, once you reach age 73 (or 75 if you were born in 1960 or later), you must begin taking required minimum distributions (RMDs) from all tax-deferred retirement accounts, including 401(k)s. Generally speaking, you can calculate your RMDs for a given year by taking your 401(k) account balance on December 31st of the prior year and dividing it by your "distribution period"—a number the IRS assigns to each age.

For example, let's say you're 75, single, and ended last year with $1 million in your 401(k). According to the IRS, your distribution period is 24.6—which means your RMD for the year would be $40,650 ($1,000,000 ÷ 24.6).

If you have multiple tax-deferred retirement accounts, RMDs must be calculated separately for each one. Many financial institutions, including Schwab, will help calculate your RMDs for you—and may even offer automated withdrawals—but typically only for the accounts held at their firms. (Learn more in our comprehensive guide to RMDs).

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