



401(k) plans: the basics

Retirement plans established under Section 401(k) of the Internal Revenue Code, commonly referred to as “401(k) plans,” have become one of the most popular types of employer-sponsored retirement plans.

WHAT IS A 401(K) PLAN?

A 401(k) plan is an employer-sponsored retirement savings plan that offers significant tax benefits while helping you plan for the future. You contribute to the plan via payroll deduction, which can make it easier for you to save for retirement. One important feature of a 401(k) plan is your ability to make pre-tax contributions to the plan. Pre-tax means that your contributions are deducted from your pay and transferred to the 401(k) plan before federal (and most state) income taxes are calculated. This reduces your current taxable income – you don’t pay income taxes on the amount you contribute, or any investment gains on your contributions, until you receive payments from the plan.

For example, Melissa earns \$50,000 annually. She contributes

\$5,000 of her pay to her employer’s 401(k) plan on a pre-tax basis. As a result, Melissa’s taxable income is now \$45,000. She isn’t taxed on her contributions (\$5,000), or any investment earnings, until she receives a distribution from the plan.

You may also be able to make Roth contributions to your 401(k) plan. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. Unlike pre-tax contributions to a 401(k) plan, there’s no upfront tax benefit – your contributions are deducted from your pay and transferred to the plan after taxes are calculated. But a distribution from your Roth 401(k) account is entirely free from federal income tax if the distribution is qualified. (See the section below on income tax consequences for more detail.)

HOW MUCH CAN I CONTRIBUTE?

Generally, you can contribute up to \$20,500 (\$27,000 if you’re age 50 or older) to a 401(k) plan in 2022 (unless your plan imposes lower limits). If your plan allows Roth 401(k) contributions, you can split your contribution between pre-tax and Roth contributions any way you wish.

Keep in mind that if you also contribute to another employer's 401(k), 403(b), SIMPLE or SAR-SEP plan, your total contributions to all of these plans – both pre-tax and Roth – can't exceed \$20,500 in 2022 (\$27,000 if you're age 50 or older). It's up to you to make sure you don't exceed these limits if you contribute to plans of more than one employer.

WHEN CAN I CONTRIBUTE?

While a 401(k) plan can make you wait up to a year to participate, many plans let you begin contributing with your first paycheck. Some plans also provide for automatic enrollment. If you've been automatically enrolled, make sure to check that your default contribution rate and investments are appropriate for your circumstances.

CAN I ALSO CONTRIBUTE TO AN IRA?

Yes. Your participation in a 401(k) plan has no impact on your ability to contribute to an IRA (Roth or traditional). You can contribute up to \$6,000 to an IRA in 2022 (\$7,000 if you're age 50 or older) if you have at least that much in earned income. Your ability to make deductible contributions to a traditional IRA may be limited if you participate in a 401(k) plan, depending on your salary level.

WHAT ARE THE INCOME TAX CONSEQUENCES OF CONTRIBUTING TO A 401(K) PLAN?

When you make pre-tax 401(k) contributions, you don't pay current income taxes on those dollars. But your contributions and investment earnings are fully taxable when you receive a distribution from the plan. In contrast, Roth 401(k) contributions are subject to income taxes upfront, but qualified distributions of your contributions and earnings are entirely free from federal income tax. A distribution is qualified if it meets the following requirements:

- It is made after the end of a five-year waiting period
- It is made after you turn 59 1/2, become disabled, or die

The five-year waiting period for qualified distributions starts on January 1 of the year you make your first Roth contribution to the 401(k) plan. For example, if you make your first Roth contribution to your employer's 401(k) plan in December 2021, your five-year waiting period begins January 1, 2021, and ends on December 31, 2025.

Withdrawals from pre-tax accounts prior to age 59 1/2 and nonqualified withdrawals from Roth accounts will be subject to regular income taxes and a 10% penalty tax, unless an exception applies.

WHAT ABOUT EMPLOYER CONTRIBUTIONS?

Employers don't have to contribute to 401(k) plans, but many will match all or part of your contributions. Your employer can match your Roth contributions, your pre-tax contributions or both. But your employer's contributions are always made on a pre-tax basis, even if they match your Roth contributions. That is, your employer's contributions, and investment earnings on those contributions, are always taxable to you when you receive a distribution from the plan.

Try to contribute as much as necessary to get the maximum matching contribution from your employer. This is essentially free money that can help you pursue your retirement goals.

SHOULD I MAKE PRE-TAX OR ROTH CONTRIBUTIONS (IF ALLOWED)?

If you think you'll be in a higher tax bracket when you retire, Roth 401(k) contributions may be more appealing, since future withdrawals, assuming they're qualified, will generally be tax-free. However, if you think you'll be in a lower tax bracket when you retire, pre-tax 401(k) contributions may be more appropriate because your contributions reduce your taxable income now. Your investment horizon and projected investment results are also important factors.

WHAT HAPPENS WHEN I TERMINATE EMPLOYMENT?

When you terminate employment, you generally forfeit all contributions that haven't vested. (Vesting means that you own the contributions.) Your contributions and the earnings on them are always 100% vested. But your 401(k) plan may require up to six years of service before you fully vest in employer matching contributions and associated earnings (although some plans have a much faster vesting schedule).

When you terminate employment, you can generally leave your money in your 401(k) plan, although some plans require that you withdraw your funds once you reach the plan's normal retirement age (typically age 65). Your plan may also "cash you out" if your vested balance is \$5,000 or less, but if your payment is more than \$1,000, the plan generally must roll your

funds into an IRA established on your behalf, unless you elect to receive your payment in cash. (This \$1,000 limit is determined separately for your Roth 401(k) account and the rest of your funds in the 401(k) plan.)

You can also roll all or part of your Roth 401(k) dollars over to a Roth IRA, and your 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. You may also be able to roll your funds into another employer's plan that accepts rollovers.

Finally, you may also be able to take a cash distribution of your contributions and earnings, as well as any vested employer amounts. However, keep in mind that any tax-deferred funds will be subject to income taxes and a possible 10% penalty tax if you're under age 59 1/2, unless an exception applies.

Note: When considering a rollover, to either an IRA or to another employer's retirement plan, you should consider carefully the investment options, fees and expenses, services, ability to make penalty-free withdrawals, degree of creditor protection, and distribution requirements associated with each option.

WHAT ELSE DO I NEED TO KNOW?

- If your plan allows loans, you may be eligible to borrow up to half of your vested 401(k) account (to a maximum of \$50,000) if you need the money.
- You may also be able to make a hardship withdrawal if you have an immediate and heavy financial need. But this should be a last resort – hardship distributions are generally taxable to you.
- Distributions from your plan before you turn 59 1/2 (55 in some cases) may be subject to a 10% early distribution penalty unless an exception applies.
- You may be eligible for an income tax credit of up to \$1,000 for amounts you contribute, depending on your income.
- Your assets are generally fully protected in the event of your, or your employer's, bankruptcy.
- Most 401(k) plans let you direct the investment of your account. Your employer provides a menu of investment options (for example, a family of mutual funds). But it's your responsibility to choose the investments most suitable for your retirement objectives.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // RAYMONDJAMES.COM

Content prepared by Broadridge Investor Communication Solutions, Inc. This information, developed by an independent third party, has been obtained from sources considered to be reliable, but Raymond James does not guarantee that the foregoing material is accurate or complete. This information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. The information contained in this report does not purport to be a complete description of the securities, markets or developments referred to in this material. This information is not intended as a solicitation or an offer to buy or sell any security referred to herein. Investments mentioned may not be suitable for all investors. The material is general in nature. Past performance may not be indicative of future results. Raymond James does not provide advice on tax, legal or mortgage issues. These matters should be discussed with the appropriate professional. Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.