focus on Retirement

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Making the Most of Your 401(k) Plan

According to a recent report, nearly half of all American workers participate in retirement plans offered by their employers, and about two thirds of those plans are defined contribution plans, such as 401(k). For many, making the most of a 401(k) plan is the key to saving for retirement.

There are many advantages to a 401(k) plan. For one thing, once you sign up for your company's plan, your deferrals come directly out of your paycheck automatically. So, you "set it and forget it", only making changes when you want to increase or decrease your contributions. This takes the human element out of the investing equation, which is one of the best ways to increase investment performance.

Even better, your 401(k) contributions and the earnings attributable to them are tax deferred. What that means is that you don't pay taxes on the money until you withdraw it, which is a big advantage over a traditional investment account.

As an example, if you earn $40,000 per year and put $10,000 into your 401(k), your taxable income drops to $30,000. If your tax rate is 25%, you would save $2,500 in taxes. You won't be taxed on that $10,000 contribution (or any earnings on it) until you take the money out (hopefully not until retirement), so your investment has a chance to grow even faster than in a regular investment account.

If your company has a match, that is another huge advantage for you. Give yourself a raise by taking advantage of it. For example, if your company matches 25% up to 4%, you should defer at least up to 4% in order to receive the maximum match from your employer. Why would you want to leave it on the table?

Although 401(k) may be one of the best ways to save for retirement, there are a few things that you need to be aware of (that may be considered a disadvantage.)

Remember that once you put the money into a 401(k), you can't easily access the cash . Most 401(k)'s do not allow for distribution before age 59 1/2, except in the case of a financial hardship. If you do end up terminating employment and taking a cash distribution prior to 59 1/2, there is a 10% penalty for early withdrawal. In addition, there is a requirement to automatically withhold 20% of the distribution for Federal Income taxes.

In addition, any employer contributions (including the match) are often subject to a vesting schedule, based on your years of service with the company. This may mean that if you leave the company prior to becoming fully vested, you will only receive a portion of the employer match or profit sharing. Please remember that any money that you have put into the plan yourself is always 100% yours.

In order to make the most of your 401(k), here are a few suggestions:

Understand the Rules—All plans are set up differently, but your Summary Plan Description should explain most everything you need to know as far as contributions, vesting, distributions, etc. You should have received your copy of the SPD when you first became eligible. If you can't find your copy, ask your employer for one.

Making the Most of Your 401(k) Plan-cont'd

Review your Investment Options—If you have the ability to direct your own investments, talk to your employer to find out how to get in touch with the plan's investment advisor. They can help guide you in order to make the choices that are right for you in order to help reach your retirement plan goals.

Pay yourself first—"If you don't see it, you don't spend it". If you are serious about boosting your retirement savings, invest first and live on what is left over, not the other way around. It's too easy to come up with other uses for the money otherwise.

Take advantage of the employer match—This is a no brainer. You wouldn't turn down a raise if your employer were to offer you one, would you?

Bank your raises—One of the best ways to increase your savings is to set aside money from a raise, rather than increase your spending to match.

Don't touch the money—Remember this is for the long term...your retirement. If your plan allows loans or hardships, do your best to not withdraw money to buy a house or boat. Do not shift from investment to investment on a regular basis-"set it and forget it".

New Limits for 2013

If you are looking to maximize your retirement plan savings, here are the new retirement plan limits for 2013:

401(k) Deferrals—$17,500
Age 50 Catch Up -$5,500
SIMPLE IRA—$12,000
SIMPLE IRA Catch Up—$2,500
Annual Additions—$51,000
IRA Contribution Limit—$5,500

"A journey of 1,000 miles begins with a single step"-Lao Tzu

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