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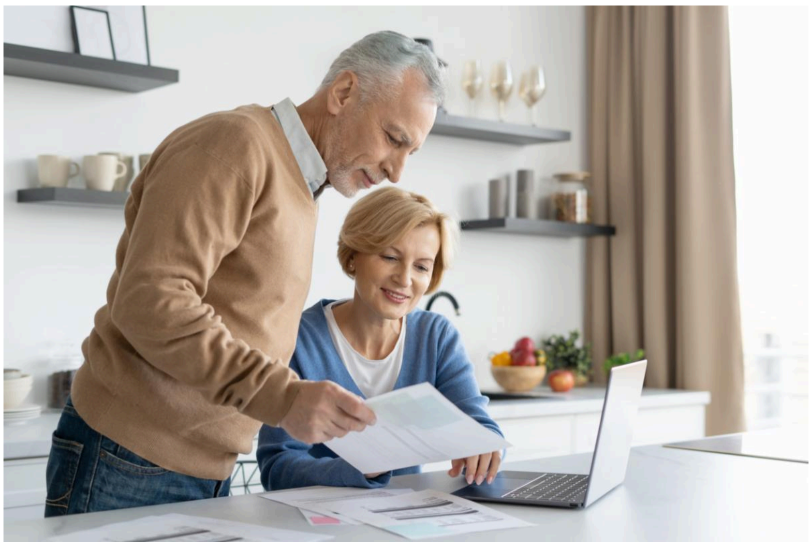
What to Know About 401k and 403b Retirement Plans



Are you thinking about your financial future? Planning for retirement might seem like a distant goal, but it's never too early to start considering your options.

Understanding the fundamentals about 401k and 403b retirement plans can help you get a better grasp on what they entail and how they can benefit you in the long run.

What are 401k and 403b Retirement Plans?

Let's start with the basics. Both the 401k and 403b are retirement savings plans that are offered by employers to their employees.

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401k plans are typically offered by for-profit companies, while 403b plans are offered by certain nonprofit organizations, schools, and other tax-exempt entities. They are designed to help individuals save and invest for their retirement while offering some tax advantages along the way.

Employee-sponsored 401k and 403b retirement plans allow employees to deduct money from their paychecks, deposit it in a retirement account and earn interest tax-deferred.

Tax-deferred means this saved income is not taxable until you withdraw the funds.

How 401k and 403b Retirement Plans Work

You decide how much money you want deducted from your paycheck and deposited to the plan based on limits imposed by plan provisions and IRS rules.

Your employer may also choose to make contributions to the plan.

These plans enable employees to choose various investment accounts including mutual funds, stocks, bonds and money market accounts. 401k plans are offered by for-profit companies, and 403b plans are offered by non-profit companies.

It is your responsibility to decide if you want to participate in the plan and, if so, how much you will contribute each pay period.

Note that 401k and 403b plans often facilitate automatic payroll deductions, making it easy for individuals to contribute regularly without actively managing their contributions. This automated process encourages consistent savings without the need for constant manual intervention.

Ask your employer about the specifics of your plan, especially when it comes to contribution limits since both plans have annual contribution limits set by the IRS. It's important to know these limits and try to contribute as much as you can, especially if your employer offers matching contributions.

This simple example can help understand how these plans work. If you earn $1,000 each pay period and elect to defer 5 percent of your pay, $50 will be taken out of your pay and placed in the retirement plan. These contributions are deducted from your salary on a pre-tax basis. This means that by contributing to a 401k or 403b, you actually reduce your taxable income. For example, instead of being taxed on the full $1,000 per pay period, you are only taxed on $950. You don't owe income taxes on the money contributed until you withdraw it from the plan.

Withdrawing from Employee-Sponsored Retirement Plans

As noted, both 401k and 403b plans offer tax-deferred growth, meaning you won't pay taxes on your contributions or earnings until you start making withdrawals during retirement. This can be a significant advantage in building your retirement nest egg over time.

The IRS allows penalty-free withdrawals from retirement accounts after age 59½ and requires withdrawals after age 72. (These are called required minimum distributions, or RMDs). There are some exceptions to these rules for 401k plans and other qualified plans.

An employee will pay income taxes and possibly an early withdrawal penalty if they withdraw their money from the plan before the required dates.

Your benefits administrator will have your specific information. Familiarizing yourself with rules can help you avoid unnecessary fees and taxes.

Read the rest of the article for more tips.

- Why it Pays to Participate in Your 401k and 403b
- A Retirement Plan is Not for Emergencies
- Understand Your Employer's Plan
- You Have Options if You Leave Your Employer

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