

Take Charge of Your Future With a 401(k) Plan

As the average retirement becomes longer, 2025 sees contribution limits grow.

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Readers of *BetterInvesting Magazine* are certainly familiar with the benefits of saving and investing for the long term. As science and health care continue to lengthen our lives, proper planning and saving for retirement becomes more crucial. Believe it or not, for many retirement will be a 30- or 40-year proposition!

As we navigate through our careers, more immediate financial goals such as the purchase of a home, educating our children or starting a business become a priority. It can be hard to balance day-to-day financial needs while also setting money aside for what seems to be the distant future.

In the 20th century, pensions were often provided by our employer. Now it's up to us to contribute to an employer sponsored retirement plan, typically a 401(k) or 403(b) plan. In this article we focus on 401(k) plans, but the concepts generally apply to both types of plans. Thus, it is now your responsibility to make sure you have enough set aside for a comfortable retirement.

CONTRIBUTION LIMITS INCREASE FOR 2025

The amount you can contribute to a traditional 401(k) plan increased in 2025. In addition, a new increased catch-up contribution of \$11,250 went into effect for those aged 60 to 63. In 2025, you can contribute as much as 100% of your salary up to the limits shown in the chart below at left.

Note that if you work for a school system, hospital or other nonprofit you are likely covered by a 403(b) plan and the same general limits apply. Some 403(b) plans allow an additional \$3,000 contribution if you have been with the same employer for at least 15 years. Check with your benefits department to see if your plan includes this provision.

The amount you contribute to a traditional 401(k) plan is excluded from current federal and state taxation, which means Uncle Sam actually helps you save for retirement. This makes the traditional 401(k)

	Under age 50	Over age 50	Ages 60–63	Age 64 and up
Maximum contribution	\$23,500	\$31,000	\$34,750	\$31,000

option particularly attractive to those in higher tax brackets, due to the tax savings.

For instance, if you contribute \$100 a month for a total of \$1,200 annually and are in the 22% federal tax bracket, your out-of-pocket cost would really be \$78 a month, or \$936 annually. If you were in the 32% tax bracket, your federal tax savings would be \$384 and your out-of-pocket cost just \$816. If you live in a state that taxes income, you will save on state taxes as well. In addition to the tax savings, the dividend income and growth generated by your retirement account investments is sheltered from current taxes.

When you reach retirement, the money that you withdraw from a traditional 401(k) is taxed at your ordinary income rate, similar to a paycheck. You can have taxes withheld from the distributions or you may satisfy your tax obligation through quarterly estimated tax payments to the Internal Revenue Service.

START EARLY

There is a real advantage to starting contributions to your retirement plan as early as possible. Take the case of two investors — Lisa, who starts saving at age 25 by contributing \$150 per biweekly paycheck to her plan, and Steve, who waits until age 40, but contributes twice as much (\$300 per paycheck), in order to try and catch up. For this example, we assumed an investment return of 7% per year. See chart below at right.

Under this scenario, by age 65 Lisa will have contributed \$156,000 to her account and the account will have grown to \$778,576. Steve, meanwhile, will have contributed \$195,000 to his account by age 65, but would end up with a balance of \$493,342. Thanks to

	Lisa	Steve
Starts contributing at age	25	40
Biweekly contribution	\$150	\$300
Total contributions by age 65	\$156,000	\$195,000
Balance at age 65	\$778,576	\$493,342

Assumes annual growth rate of 7%. This is a hypothetical example and is for illustrative purposes only. No specific investments were used in this example. Actual results will vary. Past performance does not guarantee future results.



the power of compounding, Lisa was able to contribute less but retired with a larger nest egg because her money had an additional 15 years to grow, thus proving the adage that money can't buy time.

THE ROTH 401(K) OPTION

Today many 401(k) plans are now providing a Roth option as well. This option essentially reverses the tax structure of the traditional 401(k). With a Roth 401(k) you contribute money after it has been taxed at your current rate. These contributions don't reduce your current year's taxes in any way but similar to a traditional 401(k), the money in the plan grows tax-free. However, in retirement, any and all withdrawals from a Roth 401(k) are completely tax-free, after an initial five-year holding period.

Thus, the decision to choose a traditional or Roth 401(k) often comes down to a decision to pay taxes now or later. For people early in their careers, who expect to have higher income in the future, they may benefit from choosing the Roth option and paying taxes now at a relatively low rate.

Having said that, one attractive feature of the Roth 401(k) is that unlike a Roth IRA (individual retirement account), there is no income limit. While contributing to a Roth IRA is only available to those with modified adjusted gross income of less than \$165,000 (or joint filers below \$246,000), Roth 401(k) options have no income limits. Thus, they can be attractive for high earners otherwise prevented from making Roth contributions.

YOUR EMPLOYER'S MATCH

The majority of employers match a portion of your contributions to the plan. If your employer matches, it's important to contribute at least enough to get the maximum employer match.

The money your employer contributes is tracked separately and typically becomes yours to keep over what is called a vesting schedule. While some matching contributions vest immediately, it's common for an employer to use a vesting schedule that results in matching contributions becoming "fully vested" over a period of two to six years.

When you're fully vested, you can take all matching contributions plus their earnings with you, should you change jobs. Note that you're always 100% vested in your own contributions plus their earnings.

NEW ROTH MATCHING CONTRIBUTIONS AND MORE CHANGES COMING

As of 2024, employers can allow you to designate matching contributions as Roth contributions as well. The mechanics of this are tricky, and plan sponsors weren't given much notice of the change, so at this point, it's still fairly uncommon to see this feature.

If your plan does allow you to designate a matching contribution as a Roth contribution, you're responsible for paying the tax on the contribution. In order to choose this option, you must already be fully vested in the plan.

For example, if you receive a Roth matching contribution of \$3,000 in April 2025, you will include \$3,000 income on your 2025 tax return. Unlike contributions



made through your paycheck, there will not be any tax withheld from this contribution, so you need to be prepared to pay the tax when you file your return. In some cases, you may need to make an increase to the amount withheld from your paycheck or make an estimated tax payment before you file your return, in order to pay the tax in a timely manner.

It's often the case that matching contributions are made to your account after year-end. Even if the matching contribution made in 2025 is a match for the 2024 year, you still owe the tax in 2025.

Starting in 2026, if your wages are higher than \$145,000, you will be required to make any catch-up contribution as a Roth contribution. Thus, those higher wage earners will be able to shelter less from tax, as the Roth catch-up contribution will go in after-tax.

If you are a high wage earner over 50, 2025 may be your last year to shelter the full amount from taxation.

REVIEW YOUR PLAN REGULARLY

As time progresses and your compensation increases, it's crucial that you build in the habit of increasing your 401(k) contributions. When you receive a raise or a bonus, designate a portion towards increased retirement plan contributions.

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