

## Understanding Your 401(k)

A large percentage of your post-retirement income may come from your own investments, including your 401(k) plan. So, it's important to understand how your plan works and the advantages it offers. Understanding the basics can help you better prepare for a comfortable retirement.

How much do you know about your 401(k) plan? To find out, take the following True/ False quiz.

### **Contributions are always subject to federal income taxes.**

**False.** Your pretax salary deferrals are not included in your current taxable income. The same is true of the investment earnings your deferrals generate. These tax benefits make the full amount of your contributions and earnings available for investment. Taxes won't be due until you begin receiving money from the plan, usually at retirement.

### **Participation in a 401(k) plan can reduce current taxes.**

**True.** Your contributions are deducted from your pay before federal income taxes are owed. This means you actually save more in the plan than you sacrifice in take-home pay. For example, if you are in the 15% tax bracket, you save 15 cents in taxes for every dollar you put into your plan, so your out-of-pocket cost is just 85 cents.

### **Federal law requires that all plan contributions belong to the participants as soon as they are made.**

**False.** The contributions *you* make to your plan are yours to keep from day one. However, if your employer contributes money to your plan, there may or may not be a "waiting period" before the contributions your employer makes become nonforfeitable. Your plan's "vesting schedule" spells out how this works.

### **Taxes and penalties always apply when 401(k) money is distributed from the plan.**

**False.** You may be able to avoid paying taxes and the 10% early withdrawal penalty (if applicable) on a distribution by rolling over your money to a new employer's plan that accepts rollovers or an individual retirement account (IRA). This strategy will allow you to preserve the tax-deferred status of your account until you start making withdrawals. If you arrange for a direct transfer of your 401(k) money, the plan will not have to withhold federal income taxes from the distribution.

### **Stock investments have historically offered the best protection against inflation over time.**

**True.** While no investment return is certain, stock investments have had the best long-term record of generating returns greater than inflation. But, even though stocks have outperformed other asset classes in the past, there is no guarantee that this pattern will repeat itself.

An informed retirement plan participant makes for a more successful investor. That's a good reason for you to learn as much as possible about your 401(k) plan. Armed with this knowledge, you'll be better prepared to reach your retirement goals.