Save for retirement by getting the most out of your 401(k) plan

Socking away money in a tax-advantaged retirement plan can help you reduce taxes and help secure a comfortable retirement. If your employer offers a 401(k) or Roth 401(k), contributing to the plan is a smart way to build a substantial nest egg.

If you're not already contributing the maximum allowed, consider increasing your contribution. Because of tax-deferred compounding (tax-free in the case of Roth accounts), boosting contributions can have a major impact on the amount of money you'll have in retirement.

With a 401(k), an employee makes an election to have a certain amount of pay deferred and contributed by an employer on his or her behalf to the plan. The amounts are indexed for inflation each year and not surprisingly, they're going up quite a bit. The contribution limit in 2023 is $22,500 (up from $20,500 in 2022). Employees age 50 or older by year end are also permitted to make additional "catch-up" contributions of $7,500 in 2023 (up from $6,500 in 2022). This means those 50 and older can save a total of $30,000 in 2023 (up from $27,000 in 2022).

Contributing to a traditional 401(k)

A traditional 401(k) offers many benefits, including:

- Contributions are pretax, reducing your modified adjusted gross income (MAGI), which can also help you reduce or avoid exposure to the 3.8% net investment income tax.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions pretax.

If you already have a 401(k) plan, take a look at your contributions. In 2023, you may want to try and increase your contribution rate to get as close to the $22,500 limit (with an extra $7,500 if you're age 50 or older) as you can afford. Keep in mind that your paycheck will be reduced by the amount of the contribution only, because the contributions are pretax — so, income tax isn't withheld.

Contributing to a Roth 401(k)

Employers may also include a Roth option in their 401(k) plans. If your employer offers this, you can designate some or all of your contributions as Roth contributions. While such amounts don't reduce your current MAGI, qualified distributions will be tax-free.

Roth 401(k) contributions may be especially beneficial for higher-income earners, because they don't have the option to contribute to a Roth IRA. That's because your ability to make a Roth IRA contribution is reduced or eliminated if your adjusted gross income exceeds certain amounts.

Looking ahead

Contact us if you have questions about how much to contribute or the best mix between traditional and Roth 401(k) contributions. We can also discuss other tax and retirement-saving strategies in your situation.