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Speaker 1

Welcome, my name is Andrew Baron and this is, Well… It Depends! The podcast where I present the pros and cons of different financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I asked the question, this maxing out my 401K, enough? But, before we begin a short disclaimer. This is being recorded on March 7th, 2023.

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Please note that the information provided in this podcast is for educational purposes only and is not to be considered investment, tax or legal advice. It is important to consult with a professional before making any financial decisions as to strategies discussed may not be suitable for you specifically. Getting into it, is maxing out my 401K enough? Well… It Depends!

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Many of us have heard that maxing out our 401k is a great way to save for retirement. After all, it's a tax advantaged account that allows you to contribute up to $22,500 per year in 2023 or $30,000 for those aged 50 and over. That's a significant amount of money. And if you start early and invest wisely, it can grow into a substantial nest egg by the time you retire.

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401K, plans are fantastic vehicles for saving for retirement, and if your employer offers a match on contributions, it's important to take advantage of it. Here's how it works, some employers offer to match their employee's contributions to their 401K plans up to a certain percentage or dollar amount. For example, your employer might offer to match 50% of your contributions up to 6% of your salary.

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That means if you contribute 6% of your salary to your 401K, your employer will also contribute an additional 3% of your salary to your account. This is essentially free money and is an important benefit to take advantage of. By not contributing enough to get the full match, you're essentially leaving money on the table. Additionally, 401K plans offer tax advantages that can help you save more for retirement.

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Contributions to a traditional 401K are made with pretax dollars which can lower your taxable income and reduce your current year taxes. The money in your 401K account grows tax free until you withdraw it in retirement, at which point you'll pay taxes on your withdrawals. On the other hand, contributions to a Roth 401K are made with after tax dollars, which means you won't get a tax break today.

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However, the money in your Roth 401k account grows tax free and you won't pay taxes on your withdrawals in retirement. While maxing out your 401K can be a great way to save for retirement. For high income earners, it may only represent a small fraction of their income. For example, let's say you earn $350,000 per year and you are able to max out your 401K at $30,000 per year, including the over 50 catch up provision.

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While that is a significant amount of money, it still represents less than 9% of your annual income. This is well short of the 20 to 25% target traditionally recommended, depending on your retirement goals and lifestyle expectations. You may need to save much more than that to have the retirement you envision. In these cases, high income earners may want to consider other retirement savings options, such as employer sponsored deferred compensation plans if available, which have substantially higher contribution limits than a 401K. If they also want to explore other investment options such as real estate or taxable investment accounts.

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Additionally, high income earners may also face limitations on their ability to contribute to a 401K due to IRS regulations. The IRS limits the amount that can be contributed to a 401K by highly compensated individuals with what is known as the compensation limit, which is $330,000 in 2023. To understand this better, let's combine our two previous examples. So we have an employer with matching contributions of 50% on 6% of income, and we have a high income earner making $350,000.

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This person would only receive matching contributions on $330,000 of their income and not the full $350,000 due to this compensation limit. To recap, 401K plans are great vehicles for saving for retirement, and if your employer offers a match on contributions, it's important to take advantage of this. Be sure to also consider the tax advantages of a 401K and determine if a traditional or a Roth 401K is right for you. While maxing out your 401k can be a great start,

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High income earners may need to consider other retirement savings options and investment strategies to reach their retirement goals. It's important to consult with a financial advisor to determine the best course of action for your individual situation. So to answer the question, is maxing out my 401K enough? Well… It Depends!

Speaker 1: Andrew Baron, CFP®, EA