Contributing to Your 401(k) Plan

As part of enrolling in a 401(k), you must decide how much you are going to contribute to the plan each year. There are some limits on the upper end, and your employer may require a minimum contribution if you want to join the plan. But you may find that the critical question is what percentage of your earnings you are willing to commit to retirement savings. Many experts in the retirement field believe a ballpark amount is somewhere around 10 percent of your earnings. But it can be more or less, depending on your personal circumstances. If your company offers a match, you should contribute at least enough to get the full benefit of the match, otherwise you are leaving money on the table. And keep in mind that even if you are automatically enrolled at a certain level (say 3 percent), this is often a minimum amount to save for a secure retirement. Consider increasing this amount, perhaps significantly, to give yourself a better shot at accumulating a robust retirement nest egg.

Nuts and Bolts

When you enroll in a 401(k) plan, you authorize your employer to withhold a certain percentage, or a specific dollar amount, of your gross pay each pay period and put it into an account that's been set up in your name. As a rule, your employer must deposit your contributions into your account within 15 business days after the end of the month in which the money is deducted from your pay. Those deposits should show up on your 401(k) statements. Employers have more leeway, though, in adding any matching contributions they make to your account. In fact, the match may be made as infrequently as once a year. You can raise or lower your contribution rate as often as your employer allows. That may be just once during the year, or it may be more often. For example, if you receive a raise, you may decide that you can afford to put away more toward retirement and boost the percentage you're contributing from 6 percent of your pay to 8 percent or 10 percent. Since your contributions to a traditional 401(k) are tax deferred, they reduce both the amount on which income taxes are withheld each pay period as well as your taxable income for the year. However, contributions to a 401(k) are included in the amount on which FICA taxes for Social Security and Medicare are figured. Contributions to a Roth 401(k) aren't tax deferred, so don't reduce current income taxes. But the withdrawals you take in retirement will be tax free if you're at least 59½ and your account has been open at least five years when you take the money out.

Contribution Limits

As you decide how much of your pretax income you'll contribute to your 401(k), you have to stay within two sets of limits: those set by the federal government and those set by your employer. The government caps your annual contributions at a dollar amount—the most recent caps can be found in the section entitled Annual Contribution Limits. The annual contribution is increased periodically to reflect increases in inflation. Your employer may limit your contributions to a percentage of your salary. You can't contribute more than the percentage of your pay that your employer lets you add to a 401(k) each year, even if that means you can put away less than the government's cap. On the other side of the scale, your employer may require a minimum contribution from any employee who wants to participate in the plan.