

What is a 401(k)? A 401(k) is a type of retirement plan that allows employees to save and invest for their own retirement. Through a 401(k), you can authorize your employer to deduct a certain amount of money from your paycheck before taxes are calculated, and to invest it in the 401(k) plan. Your money is invested in investment options that you choose from the ones offered through your company's plan. The federal government established the 401(k) in 1981 with special tax advantages, to encourage people to prepare for retirement. They get their catchy name from the section of the Internal Revenue Code which established them (you guessed it, section 401(k)).

How does a 401(k) plan work? You decide how much money you want deducted from your paycheck and invested during each pay period, up to the legal maximum (the IRS sets an annual dollar limit each year). You also decide how to invest that money, choosing from your plan's different investment options. The money you contribute to your 401(k) account is deducted from your pay before income taxes are taken out. This means that by contributing to a 401(k), you can actually lower the amount you pay each pay period in current taxes. For example, if you earn \$1,000 each paycheck, and you contribute, say 5% (\$50), you are only taxed on \$950. You don't owe income taxes on the money until you withdraw it from the plan, when you could be in a lower tax bracket.

What's the difference between investing money in my company's retirement plan and putting money into a taxable savings or investment account? Taxes, taxes, taxes! An ordinary savings or investment account doesn't allow you to save on a tax-deferred basis. So in a taxable account, you're saving money that has already been taxed, and you continue to pay tax annually on the earnings of that account, too. The money you contribute to your company's 401(k) retirement plan, however, comes out of your paycheck before taxes are taken out. Plus, you don't pay income tax on the money you contribute to your 401(k) account or on any earnings until you take it out, which is usually at retirement, when you may be in a lower tax bracket. The bottom line: More of your money is working for you instead of going toward current taxes. Keep in mind, however, that investing in your company's retirement plan is only a part of building a sound retirement saving plan. It is still important to have personal savings aside from your retirement savings, too.

What's the difference between a 401(k) plan and my company's profit sharing plan? A "profit sharing plan" is a type of retirement plan. It allows an employer to share profits of the company with employees by contributing a percentage of the company's annual profits to the plan. The amount of the contribution can change each year, or may not be made at all, depending on the company's circumstances. A 401(k) plan is a feature of a profit sharing plan or a stock bonus plan. Unlike a profit sharing plan, however, employees can contribute a percentage of their own salaries (up to certain limits) to the plan for retirement savings. 401(k)s also allow employers to contribute money to its employees' accounts in the form of "company match" contributions, usually as an incentive to get employees to participate in the plan. Current income taxes are deferred on both employer and employee contributions and all investment earnings, until the money is withdrawn from the plan. The maximum pre-tax amount that you can contribute to a 401(k) in 2009 is \$16,500. After 2009, these contribution limits may be increased to factor in the effects of inflation. It's important to remember that your company's plan may have additional limits.

What if my company goes bankrupt? How is my 401(k) money protected? The Employee Retirement Income Security Act (ERISA) of 1974 established guidelines for how money in 401(k) plans is maintained. The upshot of it is that your 401(k) plan account is not considered an asset of your employer—it is held in trust in a separate account for you. This means that your plan money (which includes all your own contributions and all vested company contributions) is not commingled with your company's money. And, your company cannot access your plan money for any purpose related to maintaining its business.

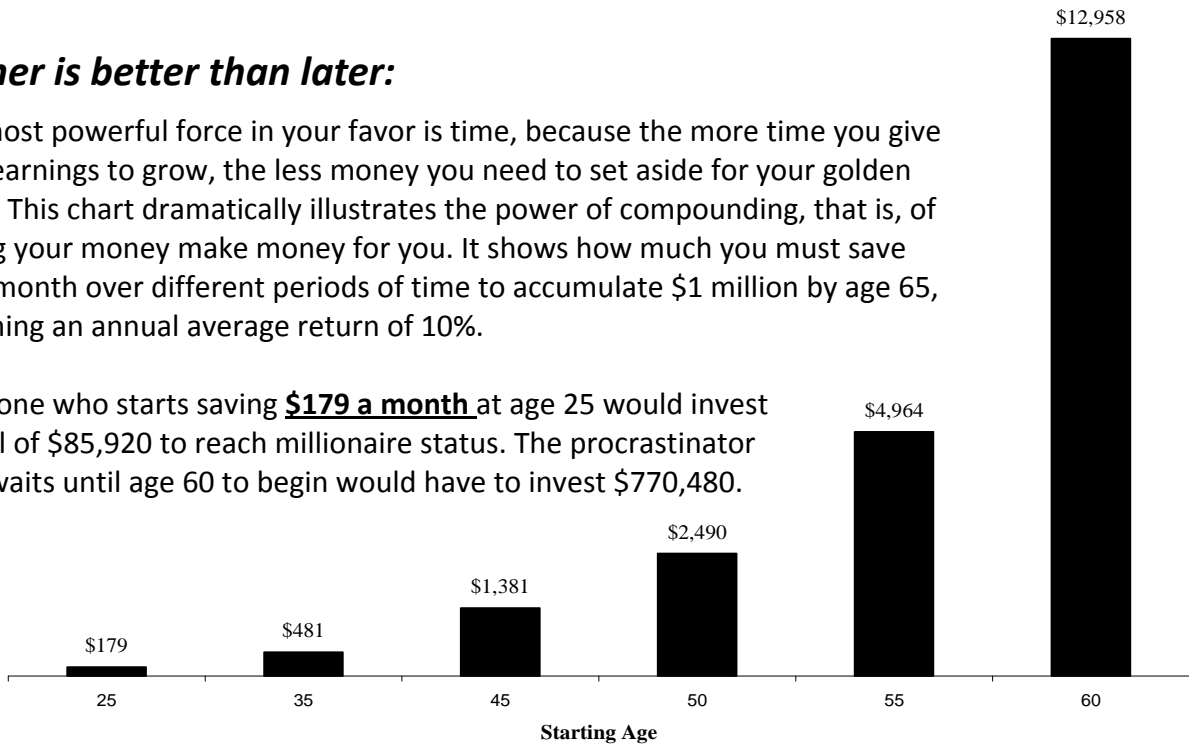
Source: www.401k.com

Why contribute to a 401(k)?

Sooner is better than later:

The most powerful force in your favor is time, because the more time you give your earnings to grow, the less money you need to set aside for your golden years. This chart dramatically illustrates the power of compounding, that is, of letting your money make money for you. It shows how much you must save each month over different periods of time to accumulate \$1 million by age 65, assuming an annual average return of 10%.

Someone who starts saving **\$179 a month** at age 25 would invest a total of \$85,920 to reach millionaire status. The procrastinator who waits until age 60 to begin would have to invest \$770,480.



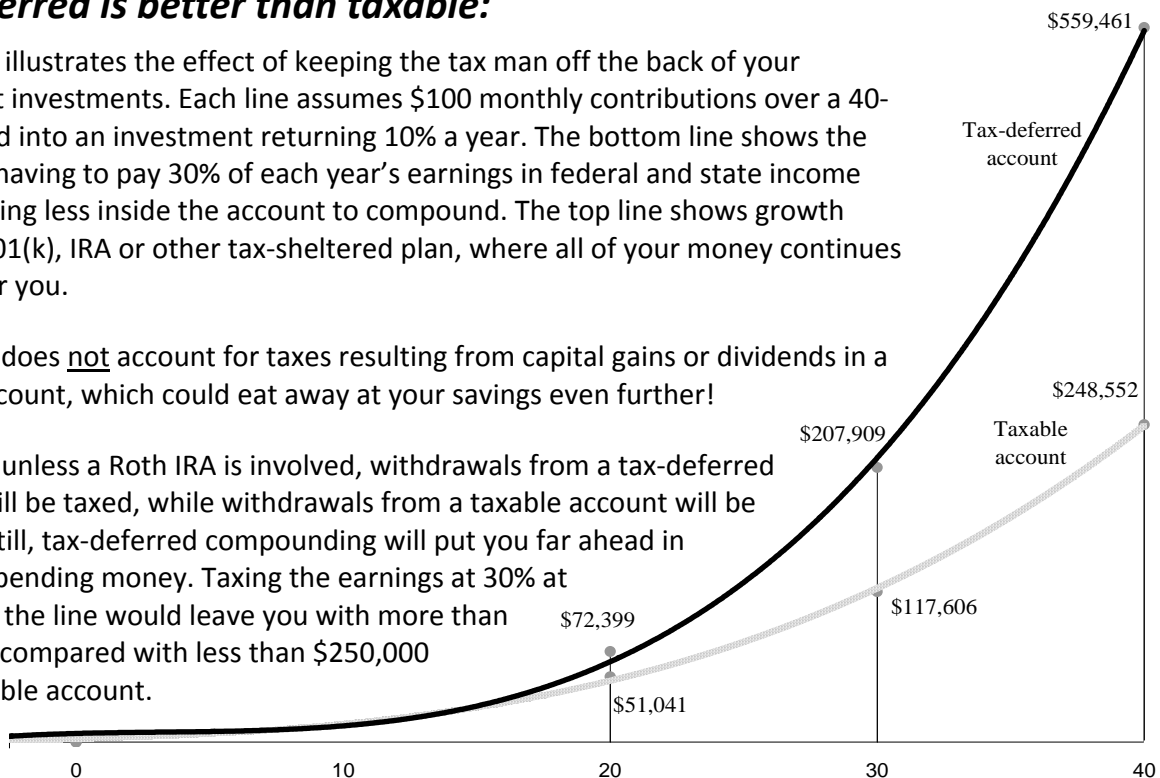
These are hypothetical illustrations and are not intended to reflect the actual performance of any particular security. Results will vary and cannot be guaranteed.

Tax-deferred is better than taxable:

This graph illustrates the effect of keeping the tax man off the back of your retirement investments. Each line assumes \$100 monthly contributions over a 40-year period into an investment returning 10% a year. The bottom line shows the impact of having to pay 30% of each year's earnings in federal and state income taxes, leaving less inside the account to compound. The top line shows growth within a 401(k), IRA or other tax-sheltered plan, where all of your money continues to work for you.

The graph does not account for taxes resulting from capital gains or dividends in a taxable account, which could eat away at your savings even further!

To be fair, unless a Roth IRA is involved, withdrawals from a tax-deferred account will be taxed, while withdrawals from a taxable account will be tax-free. Still, tax-deferred compounding will put you far ahead in terms of spending money. Taxing the earnings at 30% at the end of the line would leave you with more than \$400,000, compared with less than \$250,000 in the taxable account.



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