



Understanding 401(k) plans and the differences between IRAs

Since the government doesn't make anything easy, we'd like to give you a short and easy-to-understand overview of two of the most common retirement plan types — 401(k)s and IRAs — and how to choose the right plan for you.

401(k) retirement plans

Traditional pensions have been shown the door by many employers, who often offer a 401(k) retirement plan instead.

For-profit companies can sponsor 401(k) plans, meaning they can offer them to their employees. Nonprofits and state and local governments can sponsor similar retirement plans, known as 403(b) plans and 457(b) plans, respectively.

The name “401(k)” is a reference to the section of federal law that defines 401(k) retirement plans. The same is true of “403(b)” and “457(b).”

Employer matching funds: Many employers will match a portion of the money you contribute, or add, to your 401(k). In other words, they will put some company money in your 401(k) if you put some of your paycheck in it.

For example, an employer might match every dollar you contribute, up to an amount equal to 3 percent of your income.

Employer matches make 401(k)s the ideal place to save money for retirement. If your employer offers a match, contribute whatever it takes to pick up the maximum match. Otherwise, you're leaving free retirement money on the table.

Be aware, however, that some companies require you to work for them for a certain length of time before you are considered vested. Being vested simply means that, if you leave a job, you will get to keep all the money the employer contributed to your 401(k).

401(k) Contribution limits:

In 2026, you can contribute:

- Up to \$24,500 to regular 401(k) plans. If you are 50 or older, you can also contribute an additional \$8,000 as a “catch-up” contribution.
- Up to \$17,000 to SIMPLE (Savings Incentive Match Plan for Employees) 401(k) plans, which are generally available to small businesses. If you are 50 or older, you can contribute an additional \$4,000.

Once money is placed in a 401(k), it generally cannot be withdrawn until you reach age 59½ without having to pay a penalty.

IRA retirement plans

After a 401(k), the second-most ideal place to save money for retirement is probably in an IRA, which stands for “individual retirement account.”

An IRA works like a 401(k) in that you are investing money and letting it grow until retirement. Again, you generally can’t withdraw money without penalty until age 59½.

Your employer does not need to sponsor an IRA for you to take advantage of one, though. You can set up an IRA on your own.

IRA Contribution limits: For 2026, you can contribute up to \$7,500 to IRAs. If you’re 50 or older, you can contribute an additional \$1,100 to “catch-up.”

These contribution limits apply regardless of how many IRAs you have. So if you’re 45 and have two IRAs, you could put \$3,000 in one and \$4,500 in the other.

Roth IRA vs. Traditional

There are two types of IRAs and two types of 401(k)s: traditional and Roth.

We recommend you check out the Internal Revenue’s website comparing Roth and Traditional IRAs.

Visit: <https://www.irs.gov/retirement-plans/traditional-and-roth-iras>

Traditional plans are sometimes also referred to as “regular” plans.

Roth plans are relatively new. They are named in honor of William Roth Jr. The former Delaware senator was instrumental in establishing the federal law that established Roth plans in 1997.

Taxes: One key difference between Roth and traditional plans is how contributions are taxed.

You can invest pre-tax income in traditional accounts. So one advantage of traditional accounts is that when you contribute money, you can generally write off the contribution as a tax deduction, thereby lowering your tax bill.

One disadvantage of traditional plans is that you pay taxes on the money as you withdraw it.

You can invest after-tax income in Roth accounts. When you contribute to a Roth account, you don’t get a tax deduction. But you don’t have to pay taxes on your withdrawals in retirement.

Here’s why a Roth should be part of your retirement investment mix:

1. You get tax-free growth and withdrawal

Unlike a traditional IRA, contributions to a Roth are made using money that’s already been taxed. While there’s no tax benefit up front, your earnings within the account grow tax-free, and withdrawals made during retirement are also tax-free.

There are two rules you must follow to ensure that all the money you withdraw comes out tax-free. For starters, you must be at least age 59½ when you make your withdrawal. Also, the first withdrawal cannot occur until five years after you have made your initial Roth IRA contributions.

2. You can withdraw contributions at any time

The waiting period we describe in point No. 1 applies to your Roth IRA earnings — that is, the investment gains on your contributions. However, the money you contribute to a Roth IRA can be removed at any time for any reason without paying a penalty.

Although it's not a great long-term investment strategy, you always can access the money you've contributed. Because of this fact, some investors use a Roth IRA as an emergency savings fund, knowing that as long as their contributions are invested in a money market or cash-equivalent account, the funds are easily accessible and available penalty-free.

3. You can contribute as long as you're working, regardless of age

You can keep adding to your Roth IRA well into retirement. No matter your age, if you earn a paycheck or receive 1099 wages for contract work, you can still contribute to your Roth. By contrast, with a traditional IRA, contributions must stop when an earner reaches age 70½.

4. You can avoid required minimum distributions

Unlike a 401(k), 403(b) or traditional IRA, Roth IRAs don't mandate minimum distributions during the lifetime of the original owner. That can be a big relief for those who don't need additional income in retirement or for those who'd rather have a Roth to bequeath as part of their estate.

5. You get added tax flexibility

The biggest and best benefit of a Roth IRA is hidden in plain sight—namely, the ability to choose whether you take your income in retirement tax-free or taxed.

Who qualifies?

It's important to note that not everyone qualifies to invest in a Roth IRA, and for those who do, there are annual contribution limits. For 2026, the upper income limit for single filers to make a full contribution is \$153,000.

As income increases, the amount that can be contributed diminishes and goes to zero at an income of \$168,000. For couples who file jointly, the income limit is \$242,000 for a full contribution, with an upper limit of \$252,000 for a partial one.

If you exceed those income limits, you can't contribute new money to a Roth IRA, but you are allowed to convert money from an existing traditional IRA or other qualified plan to a Roth.

For those who can contribute the maximum to a Roth, that amount is \$7,500 (\$8,600 if you're age 50 or older).

So by skipping the tax break during your working years, you get tax-free money when you take it out.

Required minimum distributions: Traditional IRAs generally require participants to begin withdrawing fixed amounts each year — known as required minimum distributions, or RMDs — by age 73. RMD amounts depend on multiple factors, like the balance of the account. Failure to withdraw the RMD can result in hefty fines.

Roth IRAs are not subject to RMDs — another benefit of that type of retirement plan.

All employer-sponsored retirement accounts, including 401(k)s, are generally subject to RMDs by age 73.

Picking the right account

Assume you deposited \$5,000 and assume it's grown to \$50,000 by the time you retire. With a Roth plan, you'll have paid taxes on the \$5,000 you originally deposited, but you'll pay nothing on the rest. With a traditional account, you'll pay taxes on the entire \$50,000. Now you see the appeal of the Roth.

However, using a Roth also means missing out on lots of potential tax deductions during your working years. The math is complicated, but a 2014 report from T. Rowe Price found that putting money in a Roth IRA almost always gives you more disposable income in retirement than if you had put the same amount in a traditional IRA.

There are also tons of online calculators that can help you decide which way to go. Simply do a web search for “Roth vs. traditional calculator.”

Sunset Credit Union offers a variety of IRAs for investment. If you have more questions or would like more information on IRAs and which one would be best for you, contact Sunset Credit Union at 503.643.1335