

What Is the Difference Between a 401(k) and an IRA?

The terms 401(k) and individual retirement account (IRA) are bandied about quite a bit when discussing retirement planning, but what are the actual differences between the two? The main distinction is that a 401(k) -- named for the section of the tax code that discusses it -- is an employer-based plan, while an IRA is an individual plan, but there are other differences as well.

Both 401(k)s and IRAs are retirement savings plans that allow you to put away money for retirement. You may begin taking distributions from these plans at age 59 ½. There are two main types of IRAs: Roth and traditional. With a traditional IRA, you don't pay taxes when you make contributions (and in fact may benefit from a tax deduction) because the taxes are paid only when you withdraw the money, whereas with a Roth IRA, you pay the taxes up front and any gains accumulate tax-free. In addition, with a traditional IRA and 401(k), you are required to start taking minimum distributions at age 70 ½, but with a Roth IRA there is no requirement to take minimum distributions.

Participation

In order to have a 401(k), you must work for an employer that offers this type of plan as part of its benefit package. Because it is a benefit, your employer may limit which employees may join the plan. Contributions are usually made through deductions from your paycheck.

Any individual who is younger than 70 ½ and earning an income can set up an IRA through a bank or other financial institution. You as an individual are responsible for establishing the plan and contributing to it.

Contributions

Employees can contribute up to \$17,500 (in 2014) to a 401(k). Participants who are 50 or older can make an additional \$5,500 contribution to a 401(k). In addition, employers may match all or part of the contributions of their employees.

Most individuals can contribute a maximum of \$5,500 (in 2014) to an IRA or \$6,500 if you are 50 or older. Some of the contributions may be tax-deductible, depending on your income and marital status.

Investments

401(k)s offer a limited number of investments that are usually mutual funds. With an IRA, you may have a broader range of investment opportunities, including stocks, bonds, and real estate.

Loans

Employees usually can take a loan or hardship withdrawal from a 401(k), while loans are generally not permitted with IRAs. You may be able to take out money from an IRA on a limited basis if you return it to the IRA or another IRA within 60 days.

Beneficiaries

Under federal law, your spouse is automatically your beneficiary when you sign up for a 401(k) even if you listed someone else. If you wish to name someone other than your spouse as beneficiary, your spouse needs to consent in writing. If you are single, you will need to name a beneficiary.

With an IRA, you can designate whomever you want to be your beneficiary without obtaining spousal consent.

With either type of plan you need to make sure that you have both primary beneficiaries and back up or contingent.

For additional information contact:

Elizabeth Schmitz, Attorney at Law 614-785-4980 eschmitz@eschmitzlaw.com