

Understanding Salary Deferral Contributions

Deciding if you want to contribute to your company's retirement plan? Let's look at a few of the benefits:

- Tax Savings
- Increased Immediate Spendable Income
- Increased Future Funds Available at Retirement

Tax Savings

Let's say you are an eligible employee who is 30 years old and receiving an annual salary of \$25,000, paid bi-weekly. The following example illustrates how making a deferral contribution affects your overall take-home pay. Tax rates are estimates for illustration purposes only.

Deferral Contribution %	0%	4%	6%	8%
Gross Pay (bi-weekly)	\$962	\$962	\$962	\$962
- Pre-tax Deferral	- \$0	- \$38	- \$58	- \$77
Taxable Gross Pay	\$962	\$924	\$904	\$885
- FICA (7.65%)	- \$74	- \$74	- \$74	- \$74
- Federal Tax (15%, single tax bracket)	- 144	- \$138	- 136	- \$133
- State Tax (5.7%)	- \$55	- \$53	- \$52	- \$50
Take-Home Pay	\$689	\$659	\$642	\$628

If you contribute 4%, or \$38 bi-weekly, you actually only take home \$30 less each pay period. Even if your salary and deferral rate didn't change over the years, and assuming an 8% rate of return, your account balance in the plan would grow to \$6,063 after 5 years; \$15,102 after 10 years; and \$189,870 at an assumed retirement age of 65.

The sooner you start saving, the better chance you have of reaching your retirement goal. By waiting another year to join the plan, at a 4% contribution rate and an 8% rate of return, you would lose out on approximately \$15,524 over time even though you would only save \$780 by not contributing to the plan for that year (\$30 x 26 paychecks).

Increased Immediate Spendable Income

Let's look at the increase in your spendable income if, instead of contributing to a savings account at your local bank, you contribute to your 401(k) plan. Tax rates are estimates for illustration purposes only.

	Savings Account	401(k) Plan
Gross Pay	\$25,000	\$25,000
- 401(k) Contribution (4%)	- \$0	- \$1,000
Taxable Pay	\$25,000	\$24,000
- FICA (7.65%)	- \$1,913	- \$1,913
- Federal Tax (25%, married filing jointly)	- \$6,250	- \$6,000
- Bank Savings	- \$1,000	- \$0
Spendable Income	\$15,837	\$16,087

Increased Future Funds Available at Retirement

If you compare your savings account to your 401(k) plan account over time, you'll really see the difference! Assume bi-weekly pay periods, a 4% rate of return on the savings account and an 8% rate of return on your 401(k) account. You can contribute the full \$1,000 annually to your retirement plan, but to retain the same spendable pay you can only contribute \$750 to the savings account. In 35 years you will have accumulated only \$57,508 in your savings account, but **\$189,870** in your 401(k) Plan!