What is a 401(k)?

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This FAQ has been created to better explain the benefits and workings of a 401(k) Plan. This is not an exhaustive explanation but an overview. As with any tax oriented program you are encouraged to seek advice from competent independent legal and accounting counsel prior to Plan implementation.

Q. What is a 401(k) Plan?

A. The 401(k) is an employer sponsored qualified plan. Known as “qualified” because contributions qualify for income tax deductions.

Q. Where does the 401(k) plan get its name?

A. From Section 401, subsection (k), of the Internal Revenue Code. Established in 1978, with formal rules described in 1981.

Q. How are contributions made to a 401(k) plan?

A. Contributions may come from either the sponsoring employer, the participating employee, or both. Employer contributions may be discretionary or obligatory. The employee contributions come in the form of salary deferrals.

Q. Why is a 401(k) known as a Defined Contribution Plan?

A. IRC 415 (Section 415 of the Internal Revenue Code) defines, or limits, the amount of contributions by either an employer or employee.

Salary Deferral may be up to $24,500 (2026), or anything less.

For participants age 50-59, 64+, an additional $8,000 catch-up contribution is permitted (2026), totaling $32,500.

For participants age 60 to 63, an additional $11,250 catch-up contribution is permitted (2026), totaling $35,750.

The employer contribution may be up to 25% of eligible payroll, not to exceed $72,000 for any one participant (2026), or $80,000 when a participant age 50-59, 64+ makes their catch up contribution, or $83,250 when a participant age 60-63 makes their catch up contribution.

Regardless of the contributions made by either an employee or employer, the combined total annual addition to any participant's account cannot exceed $72,000 (2026), $80,000 (2026) for those age 50-59, 64+, or $83,250 (2026) for those age 60-63.

Q. Explain the Catch-up contribution.

A. It is an additional amount an eligible participating employee may defer from salary. To be eligible, the participant must be age 50 or older. Once the participant has made their full salary deferral of $24,500 (2026), individuals age 50-59 and 64+ may contribute up to $8,000 (2026) in addition to the $24,500. Individuals age 60-63 may contribute up to $11,250 (2026) in addition to the $24,500.

Q. What are the benefits of a 401(k) plan?

A. Contributions are tax deductible. Whether the employer contribution or the employee salary deferral, contributions may be deducted from taxable income. These contributions reduce taxable income which, in turn, reduces the tax levy. However, some younger, lower paid employees may be in a lower tax bracket and derive little benefit from the current tax deduction. Therefore, often a Roth feature is included in the Plan. While employee salary deferrals to the Roth account are not deductible, distributions are withdrawn income tax free (within limits).

Tax-deferred growth: A participant's account is not currently taxed. Tax deferral allows the account to grow more rapidly due to the fact taxes are not charged annually. Taxes are levied when withdrawn (exception, the Roth account).

Asset protection features: ERISA plans have benefits that are "inalienable" meaning judgment creditors cannot attach one's pension account.

Portability: When a participant leaves employment, their distribution is eligible for an IRA rollover or, in many instances, eligible to roll over to their next employer's plan.

Q. What is an Employer Match?

A. A match may come in many forms. Safe Harbor match is quite common, but there are many others. A match is an employer's way of encouraging employees to contribute. "You put money in, we will put some in too." It helps the participating employee's account grow more rapidly.

Q. What is vesting?

A. Vesting addresses the portion of the account that the participant “owns”. For example, the salary deferral is always 100% vested. Any Safe Harbor contributions are always 100% vested. Vesting applies to the discretionary employer contributions. The discretionary contribution is “earned” over time, generally six years. If a participant terminates and is partially vested, the non-vested portion is forfeited and remains in the plan. Forfeitures are allocated proportionally among the remaining employee participants.

FOR MORE INFORMATION OR AN ILLUSTRATION:

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