RETIREMENT

Should You Save First in a 401(k) or an IRA?

As you consider your saving goals for the year ahead, you may be wondering if there is a benefit to saving in one retirement-account type over another, particularly in a 401(k) versus an IRA. Suppose you can do both; should you fund one first, and then the other?

This idea is a variation on a theme known as "asset location"—directing your money into accounts in such a way that your taxes and other considerations are optimized.

This practice is not to be confused with asset allocation, the process of deciding on the right mix of stocks, bonds, and other investments to meet your goals. Asset location is all about which account you put your money in and when.

The Match Rules

If you have access to a 401(k) or a similar account type through your employer and they offer any amount of contribution matching, it's always best to direct savings to your 401(k) first. An employer match is essentially a salary bonus waiting to be claimed. Every employer has a different arrangement, so if it's been a while since you reviewed your company's policy, take a few minutes to check in with your HR department. The contribution limits rise to $19,000 for 2019—$25,000 if you're 50 or older (and that doesn't include your employer match!).

There are other major benefits of 401(k) plans compared with IRAs. 401(k)s are not constrained by income limits:[1] You can contribute the max amount as long as you have earned that much in the calendar year. While traditional IRAs also don't have income limits attached, Roth IRAs do—which may disqualify you from being able to contribute.

After you've maxed out your 401(k) contributions, the next best account is usually a traditional IRA, followed by a Roth IRA (if you are under the income limits). Traditional-IRA contributions are considered "before tax"—which means that you can lower your current-year taxable income by the amount you contribute. Roth accounts also have tax benefits, but you don't capture those until you take withdrawals in retirement.

If your company does not match your 401(k) contributions, you should take a close look at investment fees in your 401(k) program. If your plan happens to have high fees, you may be the rare case where it makes more sense to contribute to the IRA first and then to a 401(k) after you've hit your IRA contribution limits. An IRA typically has access to many low-cost investment options.

Remember—the rules governing retirement accounts are complex and every investor's situation is unique. Speak with your investment and tax professionals before making any decisions.

[1] 401(k)s do have an income limit of $275,000 that may apply to your employer's match, but does not limit your contribution amount. For instance, if you earn $400,000, and your company's policy is to match contributions up to 5% of your salary, they are limited to matching 5% of $275,000, or $13,750. You can still contribute up to $19,000, the 2019 limit, or 25,000, if you've reached the age of 50.

WHICH ACCOUNT IS BEST FOR YOUR **RETIREMENT CONTRIBUTIONS** THIS YEAR?

Match

Does your employer offer a 401(k) match? Always max that out first.

Taxes

Both 401(k) and traditional-IRA contributions can be deducted from current-year taxable income. The contributions to Roth IRAs are taxable up-front, but earnings accrue tax-free.

Fees

No match and your company 401(k) has very high fees? A traditional IRA could be better, or a Roth, if you're under the Roth income limits.

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