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6 Little-Known 401(k) Perks

A tax break and company match aren't the only benefits your 401(k) is providing.

By Emily Brandon

Most people know that you can shield a lot more money from taxes in a 401(k) than an IRA. In addition, 401(k)s often come with valuable employer contributions. Here are a few lesser-known perks that 401(k)s provide.

Earlier penalty-free withdrawal age.

Retirees can begin taking penalty-free withdrawals at an earlier age with 401(k)s than with IRAs. Retirees who leave their jobs in the year they turn 55 or older (or age 50 for public safety employees) can make 401(k) withdrawals without having to pay the 10 percent early withdrawal penalty. If you roll that money over to an IRA, you must wait until age 59½ to take penalty-free distributions. "If you are 55 years old and you separate from your job either because you retire or quit or lose your job, you can often take your 401(k) or 403(b) money out at 55 without incurring the early withdrawal penalty," says Jean Dorrell, an estate planner and founder of Senior Financial Security in Ocala, Fla. "If you transfer your 401(k) balance away from the current custodian and you're under 59½, then you are going to have an early withdrawal penalty of 10 percent."

Longer tax deferral.

A 401(k) may allow you to defer taxes longer than you can in an IRA. Withdrawals from traditional retirement accounts generally become required after age 70½. But if you are still working and don't own at least 5 percent of the company, you may be able to continue to delay 401(k) withdrawals until you actually retire. "As long as you are an active participant in the 401(k) and not the owner of the company, then you can defer taxes even longer," says Rick Salmeron, a certified financial planner and founder of Salmeron Financial in Dallas. "IRAs will still be subject to the required minimum distribution rule. However, that person could transfer that balance into the 401(k) if their plan allows it and not have to take a required minimum distribution on that 401(k)."

Bigger catch-up contributions.

Employees can contribute up to $16,500 to a 401(k) and $5,000 to an IRA in 2011. Workers age 50 and older can additionally defer taxes on another $5,500 in 401(k) plans, compared with an extra $1,000 older workers can deposit in an IRA.

Institutionally priced investments.

Large companies sometimes negotiate institutionally priced investments within their 401(k) plans, which have lower costs than most individuals can get on their own from retail IRAs. "Large companies have institutional pricing so participants are able to invest with lower fees, but at small companies this doesn't apply," says David Wray, president of the Profit Sharing/401(k) Council of America. Compare the expense ratios of funds offered within your 401(k) to similar investments you could purchase outside the plan to determine if your 401(k) plan is an especially good deal.

Special treatment for employer stock.

Stock of the company you work for gets special tax treatment when held in an employer-sponsored 401(k). When you withdraw company stock from the 401(k) plan, the appreciation of the stock is not taxed until you sell it, and the sale will often qualify to be taxed at the long-term capital gains rate of 15 percent. If company stock

is rolled over to an IRA, the appreciation will be taxed at the typically higher ordinary income tax rate of up to 35 percent upon withdrawal. "Receiving that tax benefit can be quite beneficial, so converting your company stock to cash to roll over to an IRA is probably not the best practice," says Wray.

Loans.

Retirement account participants are generally allowed to take a 401(k) loan of up to 50 percent of the vested account balance or $50,000, whichever is less. While a 401(k) loan won't help you to build a nest egg any faster, you will probably be better off than if you simply withdrew the money, paid the taxes, and, if under age 59½, the early withdrawal penalty on the money. The balance of the loan must be paid back with interest. A 2009 Government Accountability Office report found that loans paid back to the plan in regular installments are the least damaging way to tap your retirement savings early because participants who stick to the repayment schedule are able to recover most of their losses.