

How Pre-Tax Contributions Affect Your Paycheck – Video Transcript

Are you thinking about making pre-tax contributions to your employer's retirement savings plan? If so, that's good news. Participating in your employer-sponsored plan is a convenient way to save for retirement.

But if you're like many people, you may be worried about taking home less money each pay period. Well, here's some more good news: Contributing to your plan reduces your take-home pay by less than you might think.

That's because your contributions are deducted from your pay *before* taxes are calculated, so the amount of tax you pay is actually lower than if you don't make contributions at all. Let's take a closer look at a simplified example.

Let's say you earn \$2,000 in gross pay each pay period, and your federal tax rate is 22%. If you make no retirement plan contributions, your taxable income is \$2,000 and your federal tax obligation would be \$440, leaving you with \$1,560 in your pocket.

Now let's say you contribute 6% of your pay, or \$120, to your retirement plan each pay period. That would reduce your taxable income to \$1,880 and your federal tax obligation to about \$414. After accounting for both the contribution and taxes, the amount left in your pocket is \$1,466.

Even though you've contributed \$120 to your plan, the out-of-pocket difference is just \$94 – all because of the pre-tax benefit. That's an extra \$26 going to you instead of Uncle Sam each pay period.

Keep in mind that this example is used for illustrative purposes and does not consider other deductions that may affect your personal situation. It is meant to be a simplified illustration of the benefits of pre-tax contributions.

Eventually, you will be taxed on those contribution dollars and earnings when you withdraw the money. But hopefully that will be in retirement, when you could be in a lower tax bracket.

For more information about pre-tax contributions or plan participation in general, consult your employer's plan documents or make an appointment with your financial professional.

There is no guarantee that working with a financial professional will result in financial success.