FRANKLIN TEMPLETON

Retirement Reimagined® | 2020

ADVANTAGES OF A 401(k) PLAN

Key benefits:

Employers may match contributions up to a certain limit

Effective way to reduce current taxes while saving for retirement

Full and immediate vesting of employee contributions (employer contributions may be subject to a vesting schedule)

Who can participate in a 401(k) plan?:

A 401(k) plan is designed for eligible employees at businesses of all sizes, ranging from large corporations to single-employee companies.

How do 401(k) plans work?:

Employees determine a percentage of their pre-tax salary to contribute, which can be changed at any time. Many employers match contributions up to a certain amount. Pre-tax contributions and account earnings are not taxed until withdrawal.[1]

[1] 401(k) plans are permitted to allow you to designate some or all of your elective deferrals as "Roth elective deferrals" that are generally subject to taxation under the rules applicable to Roth IRAs. The information contained herein pertains to traditional pre-tax elective deferrals and not to after-tax Roth elective deferrals.

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Does your employer sponsor a 401(k) plan? If so, contact your human resources department to see if you are eligible to participate.

Funded by your own pre-tax contributions, a 401(k) plan can be an effective way to invest, save money and plan for your financial future.

Highlights

Eligibility requirements

Employees of an employer sponsoring a 401(k) plan are eligible to contribute if they are 21 years or older and have worked at the company for at least one year. These requirements may be less restrictive depending on the employer.

Investments

A participant-directed 401(k) plan gives the account owner control over his or her investments. Employers decide on a range of investments for employees to choose from that often include company stock, mutual funds and money market funds, among others.

Contributions

Both employees and employers can make pre-tax contributions to an employee's 401(k) account:

- Annual pre-tax employee elective deferral contributions of up to $19,000 in 2019 and $19,500 for 2020 are permitted.
- If age 50 or older, employees can make additional catch-up contributions of $6,000 for 2019 and $6,500 for 2020.
- Overall annual additions, including employee and employer contributions, cannot exceed the lesser value of either 100% of the participant's compensation or $56,000 for 2019 ($57,000 for 2020). Including catch-up contributions, the amount cannot exceed $62,000 for 2019 ($63,5000 for 2020). The amount of compensation that can be taken into account when determining employer and employee contributions is limited to $280,000 in 2019 ($285,000 in 2020).

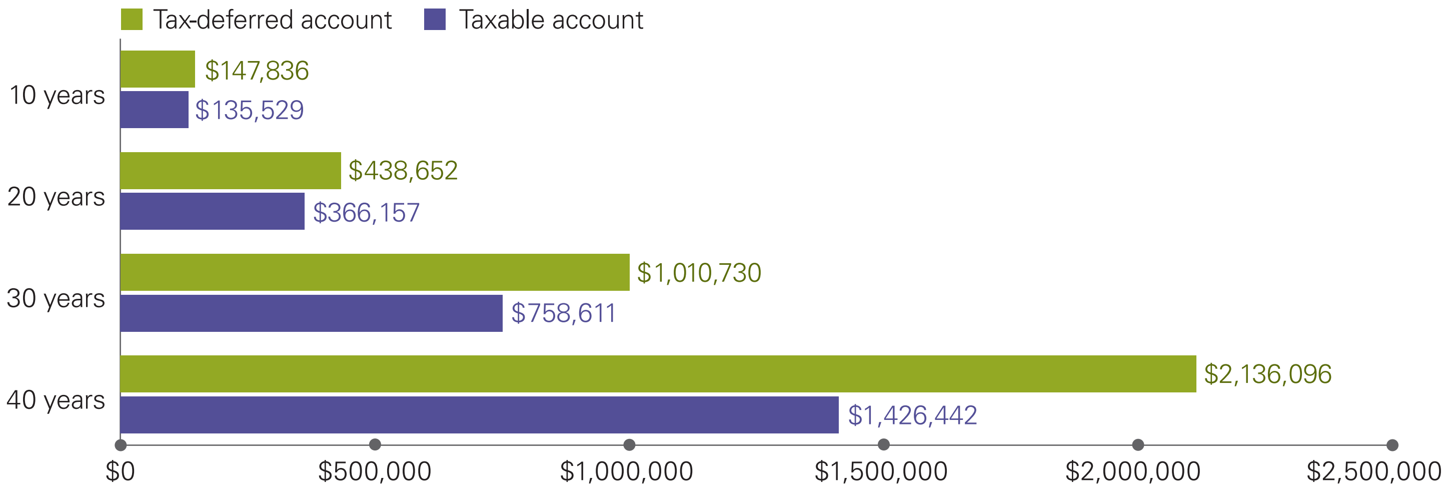
Any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.
Source: IRS Notice 2019-59.
All investments involve risks, including loss of principal.
This document does not address state or local tax rules concerning 401(k) plans.

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

The power of tax-deferred compounding

In a tax-deferred account, you will not pay taxes on your contributions or account earnings until you take withdrawals — which can make a significant difference over time. To understand how much of a difference, consider the following hypothetical illustration:

Growth of annual contributions of $10,000 at a hypothetical annual return rate of 7%



Source: Legg Mason, 2020. The above illustration assumes a $10,000 annual investment, and a hypothetical annual return rate of 7%, compounded annually over 10-, 20-, 30- and 40-year periods, and does not represent an actual investment. For purposes of the illustration, it has been assumed that the taxable account will generate a combination of long-term capital gains and qualified dividends taxable at a rate of 15% under current federal income tax law,[2] and short-term capital gains and interest taxable as ordinary income (taxable at a rate of 24%), resulting in an annual blended federal tax rate of 22%. This illustration assumes that no distributions are made from the tax-deferred account during or at the end of such period, and that taxes applicable to the taxable account are paid out of such account each year. Actual investments may include fees, charges and other expenses that would affect an investment's return. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. This illustration is not representative of any investment product. Actual returns will vary. The assumed rate of return is not guaranteed. Withdrawals from a tax-deferred account are taxable as ordinary income in the year made, and early withdrawals prior to age 59½ are generally subject to a 10% additional federal tax. The impact of taxes on tax-deferred withdrawals is not reflected in the above illustration. If reflected, such impact would make the accumulations of assets in the tax-deferred account relative to the accumulation of assets in the taxable account look less favorable.

Consider the following hypothetical example

- Annual $10,000 payroll contributions are made to a tax-deferred account. Assuming 40 years of contributions, a 7% hypothetical return, the tax-deferred account will have a pre-tax value of about $2.1 million at retirement, representing approximately $1.7 million in growth ($2,136,096 pre-tax value minus $400,000 investment amount[3]).
- If the $10,000 is received as current taxable compensation and invested into a taxable account subject each year to a blended 22% federal tax rate, the account would accumulate about $1.4 million over the same period, with growth that just exceeds $1,000,000 ($1,426,442 taxable account value minus $400,000 investment amount[3]).
- The growth of the tax-deferred account beats the taxable account by over $700,000 due to the power of tax-deferred compounding. Please note that distributions from a tax-deferred account are taxed as ordinary income in the year made and early withdrawals prior to age 59½ generally are also subject to a 10% additional federal tax. The impact of such taxes is not reflected in the above illustration.
- Your actual experience will vary depending on your actual investment returns and your specific tax rate (which may be more or less than the figures shown). Capital gains and qualified dividends may receive more favorable tax treatment within a taxable account relative to a tax-deferred account due to the lower rates currently applicable to long-term capital gains and qualified dividends and the fact that all distributions from a tax-deferred account are taxed as ordinary income. You should consider your investment time horizon and tax brackets, both current and anticipated. **All investments involve risk, including possible loss of principal.**

[2] The tax rate on long-term capital gains and qualified dividend income is 20% for high-income taxpayers. Capital gains and dividend income are subject to an additional 3.8% tax on "net investment income" for taxpayers with modified adjusted gross income over $200,000 (single persons)/$250,000 (married persons filing jointly).

[3] The $400,000 investment amount was calculated by multiplying the annual $10,000 investment by 40 years. Please note that for the taxable account, in order to be able to invest $400,000 you will have had to earn a higher amount because your investment is made on an after-tax basis.

Information herein is current as of January 2020, is subject to legislative changes and is not intended to be legal or tax advice.

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