Understand the Power of Pre-Tax Contributions

As an employee, you may pay toward many of your benefits through payroll deductions. Some of these deductions, including contributions to your retirement plan, are made before taxes are withheld from your income; they're called **pre-tax contributions**. In fact, pre-tax contributions are often called "salary reduction" because they reduce the portion of your income that's taxable. As a result, you pay less in current taxes. **Post-tax contributions** are just the opposite; payroll deductions made from the amount remaining after taxes are withheld.

Pre-tax contributions to your retirement savings plan are not subject to federal income tax or state and local income taxes (except in Pennsylvania, New Jersey, and certain municipalities).

Following is a simplified example of the difference between pre-tax and post-tax contributions that assumes a gross annual income of $30,000, in a 28% tax bracket. First, let's look at the effect of a $3,000 **post-tax** retirement plan contribution:

Gross income	$30,000
28% income tax	-8,400
Subtotal	$21,600
Post-tax contribution	-3,000
Net income	$18,600

Now look what happens to the same $3,000 contribution made on a **pre-tax** basis:

Gross income	$30,000
Pre-tax contribution	-3,000
Subtotal	$27,000
28% income tax	-7,560
Net income	$19,440

In the example, there's a difference of $840, or 5%, in net income, i.e., "take-home pay".

To provide a clearer picture of the distinctions between pre- and post-tax contributions, there are a few other considerations of which you should be aware:

- "Pre-tax" doesn't mean "tax-free". Contributions to your retirement savings plan **are** pre-tax, but they're also **tax-deferred.** This money won't be subject to current taxes, but will be taxed when you withdraw it from your plan.
- Tax laws limit the amount you may contribute to your tax-favored retirement savings plan.

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How much you benefit from these pre-tax contributions depends on your income, tax rate, number of dependents, company benefits and other factors. In addition, other types of pre-tax contributions may be treated differently than pre-tax contributions to your retirement savings plan.

To take full advantage of the power of pre-tax contributions, contact your representative to discuss your retirement goals and objectives and the contributions that most effectively respond to your retirement needs.

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