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401(k) vs. IRA Accounts: What's the Difference?

Essential insights about retirement accounts and how they can help achieve your retirement goals.

Different retirement accounts offer unique advantages, requirements, and other considerations that can impact your financial goals and retirement strategy. In this piece, we help break down the details for traditional 401(k), Roth 401(k), traditional IRA, and Roth IRA accounts, to help you better prepare to select the most effective solution for your financial situation and retirement goals.

Let's Start With the Basics:

Definitions

Pre-Tax Contribution:
Contributions that reduce your taxable income for the current year and are taxed when you withdraw from your account.

Employer-Sponsored Retirement Plan:
These are retirement plans that employers can offer to their employees. They work by deducting a certain percentage of your income from your paycheck and depositing it into a retirement account. Your employer may also contribute to the account, either by matching a portion of your contributions or by making a flat contribution. To help the retirement account grow, funds can be allocated to different investment options, like mutual funds.

After-Tax Contribution:
Contributions that allow for tax-free withdrawals in retirement because they are taxed during the current year.

Required Minimum Distribution (RMD):
A required minimum distribution is the minimum amount of money that must be withdrawn from a retirement account each year, once you reach a certain age.

401(k) and Roth 401(k)

These are retirement plans that allow you to set aside part of your paycheck into an account sponsored by your employer. You can choose where to place those funds among the plan's investment options. Employers may offer to match a portion of their employees' contributions. Traditional 401(k) contributions are made with **pre-tax dollars**. Roth 401(k) contributions are made with **after-tax dollars**.

IRA and Roth IRA

"IRA" stands for "individual retirement account." These account types are often set up and funded independently, so they tend to offer more flexibility and a wider range of investment options. Traditional IRAs have the potential to grow your investments while **reducing your taxable income during the current year**. Roth IRAs, on the other hand, provide greater flexibility because you can withdraw your contributions at any time without penalty or taxes, as you've already paid taxes on the money when you contributed. Eligibility and contribution limits may apply.

Keep in Mind: A Financial Advisor can help provide education and explain the differences between retirement account solutions in greater detail—and can help define your retirement savings strategy to help take advantage of tax benefits, meet your financial goals, and guide you toward retirement.

Summary Snapshot

	401(k)	Roth 401(k)	IRA	Roth IRA
Tax Treatment	Pre-tax contributions	After-tax contributions	Pre-tax contributions	After-tax contributions
Withdrawal Rules	Taxed as ordinary income	Tax-free withdrawals when conditions met	Taxed as ordinary income	Tax-free withdrawals when conditions met
Eligibility	Employer-specific	Employer-specific	Income restrictions	Income restrictions
Contribution Limit*	Higher limit	Higher limit	Lower limit	Lower limit
Required Minimum Distributions	Starting age varies, generally 72-73[1]	None during lifetime	Starting age varies, generally 72-73[1]	None during lifetime

*Contribution limit details are included in the following section.

Let's Take an Even Closer Look:

401(k)

With a traditional 401(k), you set aside money from your paycheck to put toward your retirement. It's funded with pre-tax money, so you pay taxes when you retire.

Who Is Eligible:

401(k)s are available to employees of organizations that offer the plan. Contribution limits can change from year to year. For 2025, contribute up to $23,500 annually (and, if your plan permits, an additional $7,500 catch-up contribution for those 50 or older, and $11,250 for those 60-63).[2]

What It Means for Taxes:

Contributions:
Made with **pre-tax dollars, or what you earn before you're taxed**. This can reduce the amount of income that is considered taxable that year.

Withdrawals:
Taxed as ordinary income during retirement—meaning that you'll pay taxes on the money when it's taken out of the account in the future. The amount of taxes will be based on what your tax rate is at that point in time. Early withdrawals (those taken before you reach 59½) or those that do not qualify for another exception, may result in an additional income tax of 10% of the withdrawal amount.

The Benefits:

Employer Match:
Many employers match employee contributions to their 401(k), which means your employer also adds funds to your retirement account. Over time, that can help boost your retirement savings.

Higher Contribution Limits:
401(k)s allow for higher annual contributions compared to IRAs.

Tax-Deferred Growth:
401(k) investments grow without requiring you to pay taxes on them until you retire.

Additional Benefits:
You may be able to take a loan and borrow money from your 401(k) account balance.[3]

Traditional IRA

An IRA is a self-funded and self-managed account that helps you save for retirement and enjoy tax advantages while you're still working. The growth is tax-deferred. In other words, as your money grows, it isn't taxed—until you retire.

Who Is Eligible:

IRAs are available to anyone with earned income. Contribution limits can vary from year to year. For 2025, the limit is set to $7,000, with an additional $1,000 catch-up contribution for those aged 50 and older.[2]

What It Means for Taxes:

Contributions:
May be **tax-deductible, which means you may be able to deduct a portion of your contributions** from what you owe in taxes, depending on your income and other factors.

Withdrawals:
Taxed as ordinary income during retirement—just like 401(k)s. This means you'll pay taxes on the money when it's taken out of the account in the future. The amount of taxes will be based on what your tax rate is at that point in time. Early withdrawals (those taken before you reach 59½) or those that do not qualify for another exception, may result in an additional income tax of 10% of the withdrawal amount.

The Benefits:

Investment Flexibility:
This account option typically offers a wider range of investment options compared to employer-sponsored plans like 401(k)s.

Tax-Deferred Growth:
IRA investments grow without requiring you to pay taxes on them until you retire.

Roth 401(k)

A Roth 401(k) combines features of a traditional 401(k) with the tax benefits of a Roth IRA. It's funded with after-tax money, which means that your withdrawals are tax-free during retirement.

Who Is Eligible:

Much like a traditional 401(k), Roth 401(k)s are available to employees of companies that offer the plan. The total combined contribution limit, across traditional 401(k)s and Roth 401(k)s, is $23,500 for 2025, with a $7,500 catch-up contribution for those 50 or older, and $11,250 for those 60-63.[2]

What It Means for Taxes:

Contributions:
These are made with **after-tax dollars**, meaning that you already paid taxes on that money. Your contributions do not reduce taxable income during the contribution year.

Withdrawals:
Qualified withdrawals are **tax-free** in retirement, since you already paid taxes on them, provided that the account has been held for at least five years and the account holder is at least 59½.[4]

The Benefits:

Tax-Free Withdrawals:
Earnings and withdrawals are tax-free, as long as you meet the necessary conditions.

Employer Match:
Many employers provide matching contributions, which are made on a pre-tax basis and are taxed when you make a withdrawal.

Higher Contribution Limits:
Like traditional 401(k) limits, Roth 401(k)s allow for higher annual contributions compared to IRAs.

No Required Minimum Distributions:
New in 2024, Roth 401(k)s are no longer subject to RMDs during the account holder's lifetime.[5]

Additional Benefits:
You may be able to take a loan and borrow money from your Roth 401(k) account balance.[3]

Roth IRA

A Roth IRA is an individual retirement account that offers **tax-free growth** and tax-free withdrawals in retirement, as long as you meet the necessary conditions.

Who Is Eligible:

Roth IRA contributions are subject to income limits, unlike traditional IRAs. For 2025, that means that individuals with modified adjusted gross income ("MAGI") above a certain amount ($165,000 for single, $246,000 for married filing jointly) may be ineligible to contribute directly.[2]

What It Means for Taxes:

Contributions:
These are made with after-tax dollars, meaning that your contributions do not reduce taxable income during the contribution year.

Withdrawals:
Qualified withdrawals are **tax-free** in retirement, provided that the account has been held for at least five years and the account holder is at least 59½.[4]

The Benefits:

Tax-Free Withdrawals:
Earnings can be withdrawn tax-free if conditions are met.

No Required Minimum Distributions:
Roth IRAs don't involve RMDs during the account holder's lifetime.[5]

Flexible Contributions:
Contributions can be withdrawn at any time without taxes or penalties, so you are able to access the funds you put into the account as needed.[6]

Ready to begin thinking about strategies for your retirement?

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1. The age at which an individual must start taking RMDs ("RMD Age"), depends on the individual's date of birth. RMD Age is (a) age 70½ for individuals born before July 1, 1949, (b) age 72 for individuals born after June 30, 1949, but before 1951, and (c) age 73 for individuals born after 1950, but before 1960, and (d) age 75 for all others.

2. Source: "401(k) limit increases to $23,500 for 2025, IRA limit remains $7,000." Page last reviewed or updated 12 November 2024. https://www.irs.gov/newsroom/401k-limit-increases-to-23500-for-2025-ira-limit-remains-7000

3. You may be able to take a loan and borrow money from your 401(k) account balance, if allowed by your plan. You should consider the various factors for each account type including, but not limited to, the differences in investment options, fees and expenses, services, the exceptions to the early withdrawal penalties, protection from creditors and legal judgments, required minimum distributions, the tax treatment of employer stock (if held in the qualified retirement plan account), and the availability of plan loans. For additional information, view the FINRA Website.

4. Source: "Retirement plans FAQs on designated Roth accounts." Page last reviewed or updated 11 September 2024. https://www.irs.gov/retirement-plans/retirement-plans-faqs-on-designated-roth-accounts

5. Source: "Retirement plan and IRA required minimum distributions FAQs." Page last reviewed or updated 10 December 2024. https://www.irs.gov/retirement-plans/retirement-plan-and-ira-required-minimum-distributions-faqs

6. Source: IRS Pub. 590-B, "Distributions from Individual Retirement Arrangements (IRAs)." Page last reviewed or updated 25 October 2024. https://www.irs.gov/pub/irs-pdf/p590b.pdf

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