Tips for Maximizing Your 401(k) Match

By Karen Wallace | 07-26-16 | 06:00 AM | Email Article

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Many companies match a portion of their employees' 401(k) contributions each pay period as an incentive for their workers to save for retirement. But sometimes the rules aren't clear, and the math can be tricky. Here, we tackle a few common reader questions.

Does my company's matching contribution to my 401(k) count toward my annual contribution limit?
Yes and no. Strictly speaking, the company's matching contribution does not count against your own employee annual contribution limit, which currently stands at $18,000 ($24,000 if you are 50 or older). So you can contribute up to that amount, and whatever your employer matches is irrelevant. If you participate in more than one 401(k) plan, the limit applies to your total contributions to all plans.

However, there is another contribution limit that pertains to both employee and employer 401(k) contributions. Total contributions combined cannot exceed $53,000 per year ($59,000 for older workers). Although this amount may seem out of reach for most workers, it can come into play if a company's match is generous enough or if the plan includes a profit-sharing component.

To maximize company contributions, you'll want to save at least enough to get the full employer match, but you might also need to pace your contributions so you don't hit your own $18,000 cap too early in the year and miss out on company matches in the later months.

Wait ... you mean I could be contributing "too much" to my 401(k)?
Well, it's closer to the truth to say that your contribution percentage may be too high.

If a company offers a dollar-for-dollar match on the first 3% of pay, that means an employee who contributes 5% of pay to the plan ends up receiving a total contribution of 8% of pay when the company match is factored in. But what if you're a super saver and you contribute quite a bit more--say, 20% of pay each pay period? That's where you can run into trouble by hitting the annual contribution limit too early in the year and thus miss out on further matching contributions.

Essentially, there's a sweet spot in terms of 401(k) contribution percentage, where (depending on your salary) you are not exceeding the annual IRS contribution limit ($18,000) before the end of the calendar year, which will also allow you to also nab the full employee match.

Let's say you're an employee who makes $100,000 per year (which makes the math a lot easier). Your employer offers a 3% dollar-for-dollar match. The sweet spot for 401(k) contributions is 18% per pay period, which allows you to sock away the maximum $21,000 in your 401(k)--$18,000 from your pretax contributions, plus $3,000 in match. If you increase your contribution percentage to 20%, you will max out your annual contribution before the end of the year, and you'll miss out on $231 of employer match; your total contribution will drop to $20,769.

If your plan provider doesn't provide one, you can try this online calculator to help figure out your sweet spot. (If you direct a portion of an employee bonus to the company retirement plan, remember to factor that in to your calculation so you don't unwittingly end up hitting the annual contribution limit sooner than expected.)

The above scenario holds true for employers who match 401(k) contributions on a per-pay-period basis. However, there are plan designs that sidestep the problem. For one, some employers offer what's known as a "true-up" provision in their plans, which means the plan calculates the potential maximum match that the employee could have received based on the amount he or she contributed during the year and then fills in any gap. For example, in the scenario we've just described, the company 401(k) plan would provide a one-time contribution of $231 to cover the match that the employee missed out on by hitting the contribution limit too quickly.

Also, some companies offer lump-sum 401(k) matches at year-end. If you're not sure how your plan works, ask your benefits department or consult the plan document.

My company says it will match up to 5% of my maximum contribution, but only at 50%. In this case, should I contribute at least 10% of the maximum, as the employer contribution is only $0.50 for each $1 the employee contributes?
The match math works like this: Let's say you earn $100,000 per year (because, again, I really like easier math). If your employer matches your contribution up to 5% at $0.50 on the dollar, that means that your employer would contribute a maximum of $2,500 per year ($100,000 x 0.05 = $5,000; however, the match is $0.50 of every dollar, so $5,000 x 0.50 = $2,500). Add that to the 5% you contributed, for a total of $7,500.

If you contribute less than 5%, however, your company will only match up to the amount you contribute. Let's say you decide to contribute 3%. You would be contributing $3,000 per year, but your employer would be contributing $1,500. ($100,000 x 0.03 = $3,000; at a $0.50-per-$1.00 contribution rate, that's $1,500.) With your 3% contribution--$3,000--that's a total of $4,500. So, by contributing less than 5% in this scenario, you're effectively leaving $1,000 of 401(k) contributions per year on the table that you could be getting from your employer.

Of course, you could opt to contribute more than 5%, up to a maximum of $18,000 per year, but your company (in this example) will only match a maximum of 50% of 5%, or $2,500.

Have a personal finance question you'd like answered? Send it to TheShortAnswer@morningstar.com.

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