Here’s Everything You Need to Know About 401(k) Contribution Limits for 2023



Contributing to a 401(k) may be one of the smartest things you can do to set yourself up for a comfortable retirement in your golden years.

However, unlike simply stashing money in a savings account, you can only put so much into your 401(k) retirement plan each year due to 401(k) contribution limits.

Unfortunately, things get a little more complex because the government changes the contribution limits for 401(k)s yearly. Here, you’ll get all the necessary information about 401(k) contribution limits for 2023.

What are 401(k) contribution limits?

Put simply, 401(k) contribution limits are federally capped maximum contribution amounts that you can put toward a 401(k) retirement plan. In other words, you can't funnel every extra dollar you have in your salary toward your 401(k) plan beyond your annual contribution limit.

There are tax advantages for retirement plans, and higher-paid workers can afford to allocate more funds toward 401(k) and other plans. Limits are put in place to prevent these wealthy individuals from disproportionately benefiting from these plans, which offer tax advantages at the expense of the U.S. Treasury.

When you invest in a 401(k), you put money toward your future by:

- Giving your money to the managers of a 401(k) retirement plan.
- Those managers then use that money to invest in various stock market assets, like mutual funds.
- 401(k) managers traditionally invest in relatively safe, slow-growth assets that aren't ideal for earning a lot of money quickly. But they are beneficial to you in ensuring you have enough money to enjoy your golden years.

Plan limits prevent individuals from gaming the system, especially by taking advantage of employer-matched contributions.

The IRS also does this to prevent highly compensated employees (HCEs) from taking advantage of employee contributions to inflate their after-tax savings or to scheme the income tax system.

Many 401(k) plans allow your employer to match your contribution to a set limit (usually a certain percentage or dollar amount).

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For instance, if an employer volunteers to match your 401(k) contribution up to 3%, and you earn $2,000 every month for your salary, you can put 6% of that salary's value toward your 401(k), or about $120.

If there weren't any compensation limits, people could try to take more money from their employers by contributing more and more money into their retirement accounts.

To recap, 401(k) contribution limits stop people from taking advantage of 401(k) plans and their monetary benefits. However, contribution limits for 401(k)s don't usually stay the same. Instead, they change continuously to keep up with inflation and other economic circumstances.

Do These Limits Apply to Other Retirement Plans?

Yes. Generally, 401(k) contribution limits apply to any other "defined contribution plans."

These are plans that have defined contribution limits or policies, and they include:

- 403(b) plans, which are retirement plans typically used by nonprofit and educational workers.
- 457 plans, which local and state government employees use.
- Thrift Savings Plans, which the federal government offers.

401(k) contribution limits for 2023

With that said, it’s essential to know the 401(k) contribution limits for 2023 so you can plan for how much you’ll invest or how much you’ll deduct from your employment paychecks.

Here’s a breakdown of the 2023 401(k) income limits:

- $22,500 – maximum salary deferral or automatic contribution limit for workers.
- $7,500 – maximum catch-up contributions for any workers aged 50 and up.
- $66,000 – total contribution limit for the year overall.
- $73,500 – total contribution limit, including the catch-up contribution mentioned above.

In other words, you can divert a certain percentage of your salary with each paycheck up to $22,500 plus $7500 if you are 50 or older. However, your employer can contribute extra money to your 401(k) up to a maximum of $66,000.

How did 401(k) contribution limits change from 2022?

Because inflation has affected the US economy, the 401(k) contribution limits above have changed from 2022.

For instance, the 2022 salary deferral limit for workers was $20,500, representing a $2,000 increase in 2023. Similarly, the catch-up contribution limit for all workers 50 and older was previously $6,500 but is now $7,500.

The total contribution limit was $61,000 and $67,500 for total contribution limits and total contribution limits plus catch-up contributions, respectively. As you can see, the 401(k) contribution limits changed for 2023 by adding a few thousand dollars here and there.

It’s not a massive change, but if you invested early and wisely, that money could be worth hundreds of thousands or millions of dollars by the time you withdraw it after retirement.

Employer contribution limits for 2023

In most 401(k) plans, employers contribute to their employees’ retirement plans up to a certain amount. Employers have much higher maximum contribution limits.

The maximum amount you can contribute to a 401(k) plan (between you and your employer) is $66,000 in 2023. This limit was $61,000 in 2022.

Because of this, employers can contribute much more money to your 401(k) plan than you can, but this isn’t typically what happens. Instead, most employers offer relatively meager or moderate 401(k) matching contributions.

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Don’t expect to add $66,000 to your 401(k) plan yearly. However, if an employer does offer a retirement benefit to this effect, consider taking them up on a job offer to maximize your retirement savings.

Are there differences between traditional and Roth 401(k) contribution limits?

No. Whether you have a traditional 401(k) or a Roth 401(k), your contribution limits are the same. The only difference between these two types of 401(k) retirement plans is whether

you are taxed on your contributions or tax on your withdrawals.

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Your contributions are tax-deferred with a traditional, employer-sponsored 401(k) plan, and you can deduct those contributions from your gross income each tax year. This elective deferral may let you max out your contributions each year.

However, when you withdraw money from your traditional 401(k), you must pay taxes on those contributions.

If you end up in a higher tax bracket when you retire because of how much money you have saved up, you could have to pay much more in taxes than if you had initially paid taxes on your deductions.

Roth 401(k) plans are the opposite. With a Roth 401(k), you pay taxes on any of your retirement plan contributions in the tax years you earn them. In exchange, you don't have to pay any taxes on your Roth 401(k) withdrawals later down the road.

Therefore, Roth 401(k) plans are usually more profitable and affordable in the long run, but they place more of a financial burden on you in the short term. But remember, there aren't any changes or differences in contribution limits between both plan types.

What is the ideal amount to contribute to your 401(k) plan?

Generally, you should contribute as much to your 401(k) plan as possible up to the contribution limit. But the ideal retirement contribution percentage can vary depending on your age, the cost of living, and your personal finances.

For example, it may be a good idea to contribute between 10% and 15% of all your gross income toward retirement. You can contribute this amount toward a 401(k) or a 401(k) combined with an IRA (individual retirement account) in your 20s and 30s.

If you are behind in retirement savings in your 40s or 50s, consider contributing more to your 401(k) account. If you've already hit your 401(k) plan limit, look into alternatives like IRAs or Roth IRAs.

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Both IRAs and Roth IRAs also have contribution limits. But IRA contribution limits are separate from your 401(k) contribution limits. For instance, if you can only contribute $22,600 to your 401(k), you can still contribute another $6500 toward your IRA (the contribution limit for traditional IRA and Roth IRA accounts in 2023).

Don't forget Social Security, too. Depending on how many calendar years you worked and your taxable income, you could receive additional funds in retirement.

Summary

Contribution limits for 401(k) plans have increased since 2022. Since these limit changes are meant to keep up with inflation, that's a good thing for millions of Americans who rely on 401(k)s to help them save money for retirement.

Still, there's much more to saving successfully for retirement than simply putting cash in your 401(k).

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