Annuity Investment Vs. 401(k)

Annuities and 401(k)s are investment strategies designed to accomplish certain financial goals, like providing additional income (to Social Security) during retirement.

Both Annuities and 401(k)s offer you a way to save and grow your money, and they each have pros and cons to consider. When considering your investment vehicles, you need to understand both the similarities and also the differences before you make a financial decision.

If you're getting close to retirement, ask yourself a question, do you have enough money to last a lifetime… and that's probably the biggest difference between a 401K and an Annuity, as a retirement investment, because with some Annuities the payout is for life, and doesn't stop, even after all the funds are exhausted the payout still continues for the life of the individual.

How does an annuity work

How does an Annuity Work

An annuity is offered by an insurance company. You can fund an annuity all at once with a lump sum or you can add funds to it over time to grow its value before you start taking money out the account. While some employers provide options for annuities in their retirement package, usually annuities are purchased directly from an insurance company.

- **Annuities provide guaranteed lifetime income.** Many annuities will provide you with payments for the rest of your life. Some annuities will continue to pay out to your beneficiaries after you pass away. With an annuity, you don't have to worry about losses in the market because your income is guaranteed by the contract you signed with the provider.
- **Annuities are usually after-tax savings vehicles.** Funding an annuity with taxed income means that you won't pay tax on the principal when you start taking payments. Instead, you only pay taxes on any gains during annuitization.
- **There are no limits on contributions.** Unlike 401(k)s, the government doesn't cap contributions to non-qualified annuities. Contributing to a non-qualified annuity if you've met the cap on your 401(k) can help you continue to save for retirement and provide additional income later.

How does a 401k work

- **401(k)s are made up of different financial products.** These can include stocks, bonds, mutual funds, and money market funds.

- **Some employers will contribute to your 401(k).** As an employee benefit, some employers will match a percentage of your 401(k) contributions, and over time, your account can grow much larger than you'd be able to do on your own.

- **There are limits on contributions.** The government sets yearly limits on how much money a person can contribute to their 401(k).

- **There are limited investment options.** These plans have set allocations that you can't change.

- **You could see uncapped returns (and losses).** Because a 401(k) is funded by investments, there are no limits on the amount you can gain or lose. While these plans are designed to grow at a predictable rate, there are no guarantees. Inflation can lessen the benefits of your 401(k).

Similarities in both a 401k and Annuities

- **Long-term savings -** Both options enable you to grow your monies over time.

- **Both tax-deferred -** You won't pay any taxes on the money you put into them until you make a withdrawal. Roth 401(k)s works different, because the monies you use to fund the account has already been taxed.

- **Penalties for withdrawing money early.** Because these products provide you with tax-deferred benefits, you can be penalized for withdrawing funds before the age of 59.5.

- **Avoiding probate.** By naming a beneficiary, the assets in an annuity or 401(k) can be transferred right to them instead of having to go through the probate process.

Differences between a 401k and Annuities

- **401(k)'s are Employer-Sponsored**

  401(k) plans are available only to individuals whose employers offer them. Annuities are not employer-sponsored and can be purchased by anyone.

  It's common knowledge that contributing the maximum amount to an employer-sponsored 401(k) plan is a very effective means of accumulating saving for retirement, because many employers offer a contribution match that boosts your savings amount.

- **Contribution limits**

  For 2022, the individual 401(k) contribution limit was $20,500, or $27,000 if age 50 or older. The 2023 401(k) contribution limit for individuals is $22,500, or $30,000 if over 50.

- **Taxes**

  Contributions to 401(k) accounts may be deducted on your taxes for the years they're made. However contributions to annuities are not tax deductible. Both annuities and 401(k) accounts provide the ability to defer paying taxes on earnings until the money is withdrawn.

- **Taxes on withdrawals**

  401(k) withdrawals are taxable in their entirety, but only the portions of annuity withdrawals that represent earnings are taxable.

The Bottom Line:

Some people chose to roll all or part of their 401(k) savings into annuities as a means of providing a stream of income to fund their retirement.

The Setting Every Community Up For Retirement Enhancement (SECURE) Act, which was passed into law in December 2019, gives employers greater leeway to include annuities in their workplace-sponsored retirement plans.

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