Q. How do my 401(k) contributions lower my income taxes?
A. Your 401(k) contributions can be made on a pre-tax basis. This means that they aren’t reported to the Internal Revenue Service as current income on your W-2 form. For example, if you earn $50,000 a year and decide to contribute 10 percent of your salary ($5,000) to your 401(k) account on a pre-tax basis, only $45,000 will be reported as current income for income tax purposes.

Why does the government give you this excellent tax break? Because it wants to encourage individuals to save as much as possible with their own dollars today so that they are better prepared for their retirement in the future.

Q. What is a Roth 401(k)?
A. Roth 401(k) is not a type of plan, but rather a type of plan contribution. If a 401(k) plan offers this feature, employees can designate some or all of their elective contributions as designated Roth contributions, rather than traditional, pre-tax elective contributions. Roth contributions, however, are taxed in the year they are contributed to the plan (i.e., they are made on an after-tax basis). Upon distribution, Roth 401(k) contributions are received tax free. Earnings on Roth 401(k) contributions will not be taxed upon distribution if the Roth account has been open for at least 5 tax years and distribution occurs after 59 1/2, death or disability. Traditional 401(k) contributions and Roth 401(k) contributions are subject to a combined limit of $17,000 for 2012 ($22,500 if age 50 or older).

Q. Am I able to contribute to both a 401(k) and an IRA?
A. Yes. Many individuals contribute to their 401(k) plan and to a traditional Individual Retirement Account (IRA) or Roth IRA. It may be best to maximize your traditional 401(k) contributions first, since they can be made with pre-tax dollars. (Your traditional IRA contributions may or may not be tax deductible, depending on your annual salary and other qualifications.) If your employer offers matching contributions and you qualify for a traditional IRA or Roth IRA, it may make sense to contribute enough to the 401(k) plan to obtain the maximum employer match, and then contribute to a traditional IRA or Roth IRA if eligible. If you have not then exhausted the maximum allowable contribution and can afford to do so, consider contributing additional amounts to your 401(k) plan.

Q. If I change jobs, may I take my 401(k) money with me?
A. Yes. All contributions you have made to your 401(k) account are 100 percent yours. Contributions made by your employer (if any) may be yours depending on a vesting schedule. You will need to check your plan for specific vesting schedules.

In addition, if you do change jobs, it may be a good idea to consider either rolling your 401(k) money over into an IRA or another qualified plan (such as a profit-sharing or 401(k) plan) at your new employer. Otherwise, you may incur taxes and early withdrawal penalties. Be sure to check with your tax adviser before taking any distributions from your 401(k) plan.

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