You may not have your first real job yet, but it's never too soon to start thinking about retirement. I dream about it every single day. The traveling, the beaches-- well, you get the idea. Imagine you're fresh out of college, you just turned 25, and you're earning $50,000 a year. If you saved just 10% of that a year-- or $5,000 per year-- and invested it in something that earned a 7% real rate of return, you'd have nearly $1 million saved up by the time you turn 65. But this takes consistency and starting early. It also takes being smart about taxes.

There are several tools that can help you save. In this video, I'll describe retirement accounts you can open through your employer, and others you can open on your own if your employer doesn't offer any plans. Actually, you may want to open one on your own even if your employer does have a plan. We'll compare the different options. Specifically, I'll talk about the 401K retirement plan that you may be eligible to set up through your employer. And I'll talk about Individual Retirement Accounts, IRAs, you can set up on your own, not through your employer.

I opened my first IRA while I was still in graduate school and I know high school students who are opening them, too. It's never too early to start thinking about retirement. Many of you have probably heard the term 401K before. In the nonprofit sector, the equivalent is a 403B. These traditional retirement accounts are special account set up through your employer into which you invest your income before you actually pay income tax on it. Don't get too excited, though. It's a tax-deferred retirement account, meaning that you will pay tax on that income and in the investment gains you make once you withdraw that money when you retire. It's taxed as ordinary income when you withdraw it from that account when you retire. But what you should get excited about is that many-- not all, but many-- companies offer a match for part of the money you contribute to your 401K. In a typical matching scheme, an employer might contribute 50% of every dollar that you contribute, up to 6% of your salary. 6% of a $50,000 salary is $3,000. So if you contributed $3,000, your employer would contribute an additional $1,500. Some companies might actually match 100% of your contributions, and some might make contributions to your account even if you do not add any of your own earnings. These matches are amazing-- free money, don't leave it on the table.

The other thing to keep in mind is there is a limit on how much of your salary you can contribute every year. In 2015, the maximum was $18,000. If you're 50 or older, you can contribute a few thousand dollars more. If you leave your company, don't worry, you can take the money you have contributed to your 401K with you. You can roll it over into an individual retirement account or you can possibly put it in your new employer's 401K. Or you can leave it in its current 401K. The important point is your contributions are your money and you're the boss of it, you get to keep it. That doesn't necessarily go for the money your employer has put into your 401K, though. Your company's vesting schedule determines how much of the company's contributions you are able to keep when you leave.

ERISA, the Employment Retirement Income Security Act of 1974, states that you're entitled to all of your employer's contributions after six years, but different companies get there in different ways. Some
might allow you to keep 100% of the company contributions immediately. Others might allow you to keep 20% of the company contributions for every year you have worked at the company. So if you worked there for four years, you would get 80% of the company's contributions when you leave. But it's worth repeating, you get to keep all of the money you contributed to your 401K no matter when you leave.

Now don't worry if your employer doesn't offer a 401K plan, you still have other options. You can open up an Individual Retirement Account, an IRA. You can open this up through a brokerage company like Vanguard or Fidelity or a ton of other places. It works in much the same way as a traditional 401K. You don't pay income tax on the money you contribute to it now, but you do have to pay income tax on the contributions and any earnings you make later when you take the money out of the retirement account. There are a few key distinctions between a traditional individual retirement account and a 401K. First of all, there's no employer match with an IRA, an Individual Retirement Account. Second of all, the maximum amount you can contribute to an IRA is a lot lower. It's only about $5,500 this year instead of the $18,000 limit for an employer's 401K. Regardless, an IRA is still a good option for saving for retirement. Remember that word retirement, though. There are penalties if you take your money out of these accounts before you turn 59 and 1/2. You'll have to pay tax and you will typically have to pay a penalty of 10%. Some plans offer exceptions to the penalty for certain specific hardship reasons.

So far we have talked about traditional 401K plans and traditional IRAs. There are a couple of counterparts to these, also retirement accounts but their tax advantage works in a slightly different way. They are the Roth 401K and the Roth IRA. What does Roth mean? Well it's just the guy's name, the guy who came up with these cool accounts. With a Roth account, you pay income tax on the money you deposit in the year you earn that income, but you don't have to pay any income tax on that money later when you withdraw it in retirement. And you don't have to pay tax on any of the gains that you made from investing that money, as long as you take it out in retirement. So basically, your money is taxed now but not later. In this Roth world, what's better? A Roth 401K or a Roth IRA? Roth 401K plans are relatively new, so not many companies offer them. Roth IRAs have been around a lot longer. Like I said, I opened up one in grad school and that was quite a while ago. So most people will have more access to a Roth IRA. However, one thing to keep in mind about a Roth IRA is that if you earn too much money-- about $130,000 this year-- you're not allowed to contribute to a Roth IRA. These income limits don't hold, however, for a Roth 401K. There's something else that's pretty cool about the Roth IRA. Any money that you contribute, you can take out of that account-- tax and penalty free-- any time, for any reason. So if you desperately need that trip to Hawaii, you could raid your Roth IRA. I'm definitely not suggesting you do this, but my point is that it can act as an emergency fund. But if you take out any of your investment gains before your 59 and 1/2, you will have to pay penalties and taxes on those gains. There are a few cases when you can withdraw those investment earnings without paying taxes and penalties, however, such as the purchase of a first home, for some education expenses, and also for some specific hardship cases. The rules governing early withdrawal from a Roth 401K are similar but slightly more complicated and not quite as generous. The other thing you'll want to be sure to consider are the rules your employer has set up for early withdrawals from your Roth 401K. They may be different than for a traditional 401K. The devil is always in the details on that.

Now that you're planning to open one of these accounts, what can you actually invest in? It depends on your company. There are usually a variety of mutual funds to choose from for a 401K plan. Be sure to
check your company options to make sure they're offering funds with low costs and fees. Some companies have more options than others. Some offer the possibility of investing in any stock out there. Not that it's a good idea to invest in individual stocks, but it demonstrates the breadth of possibilities. If you don't have good options, you might want to talk to your human resource manager about that.

So how do you choose among all the retirement account possibilities? What's better, a 401K, a Roth IRA, where do you start? Do you have to choose just one type of these accounts? You can actually have a mix of all of these accounts, but there are some rules to be aware of. For example, in 2015 you could only contribute up to $5,500 to your IRAs. Part could go to a traditional IRA and part to a Roth IRA, but the total of what you put in both of those IRAs can't exceed $5,500. This limit may go up from year-to-year. The other thing to keep in mind is that you have access to a 401K at work, you may not get the full tax benefits of the traditional IRA. So how do you prioritize? Just to repeat, one particularly great thing about the 401K is the potential employer match. Whatever you do, don't leave any of that match money on the table. That's a huge immediate return.

So step one is to invest enough in your 401K plan to get the maximum company match. Again, since few companies offer a Roth 401K, this is likely to be in a traditional 401K. After you do that, consider what your tax rate will be now versus what it will be in the future. Most students will likely face a pretty low tax rate now when they're fresh out of school, but may face higher tax rates as they age. If you fall into this category, then step two is to invest any additional money you can in a Roth IRA. You'll pay a low tax rate on that now and won't be taxed in the future. If you're in a higher tax bracket now but expect to be in a lower tax bracket in the future, a traditional retirement plan might make more sense than a Roth. Another reason to prefer a traditional retirement account over a Roth is if you want to lower your taxable income now so that you can take advantage of some income-contingent tax breaks. But to repeat, for most young people the first thing you should do is maximize your company match, then invest up to the maximum you can in a Roth IRA. If you still have more money to invest in retirement, put more in your company's 401K. Obviously, that's a general rule of thumb and you'll want to consider the specific details of your own situation and the details of these accounts, since we really only scratched the surface of them. But hopefully the basics that we have covered in this video give you a good starting point. So go check your employer's retirement option, get that match, and keep on saving.