

Difference Between Pension Plan and Retirement Plan

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Key Difference - Pension Plan vs Retirement Plan

Planning for income during the retirement age is crucial for all individuals and a number of options are available to make such arrangements. The terms pension plan and retirement plan are often used interchangeably. However, they are different from one another. The key difference between pension plan and retirement plan is that **a pension plan is a defined benefit plan in which an employer contributes with a guaranteed lump-sum on employee's retirement** whereas **a retirement plan is a savings and investment plan that provides income after an employee has ceased employment.**

What is a Pension Plan?

A pension plan is a defined benefit plan in which an employer contributes with a guaranteed lump-sum on employee's retirement that is predetermined based on the employee's compensation history, age, number of years of service and other various factors. At retirement, employees can receive the pension funds as a lump sum or a monthly payment upon discretion. The pension plan is called a defined benefit because it entitles you to receive a specific amount.

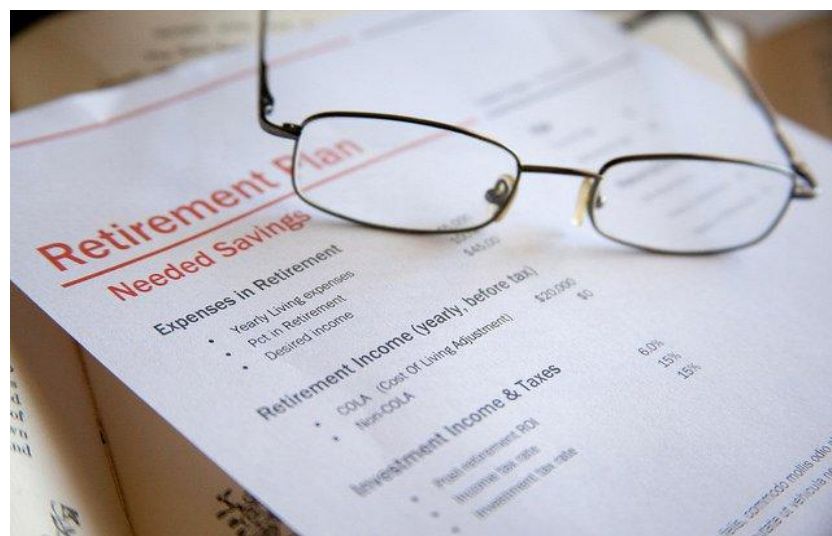
E.g. an employee will receive 2% of average [salary](#) for the last 15 years of employment for each year employed

Varieties can be found in pension plans where employee contributions are also common, especially in the public sector. Pension benefits are fully taxable if no contributions were made by the employee and if the employer did not withhold contributions from employee's salary. In that case, the funds will be included in the total amount due as [income tax](#). Further, in case that the employee retires before the age of 55 years, the pension could be subject to a 10% tax as a penalty. Having said that, there are some exceptions for illness and disability as well in certain cases.



What is a Retirement Plan?

A retirement plan is a savings and investment plan that provides income after an employee has ceased employment. A retirement plan is a defined contribution plan where both the employee and the employer make contributions. These contributions are tax deferred (tax payments can be delayed to a future date) until the withdrawals are made. In a retirement plan, there is no guaranteed fixed pension. A retirement plan can be started at a very young age, and unlike in pension plan, a number of options are available to choose from.



Some of the most popular retirement plan types are as follows.

Individual Retirement Account (IRA)

With an [IRA](#), the employee invests a certain amount of money for retirement savings in an account set up through the employer, a banking institution or an investment firm. In IRAs, funds are dispersed into different investment options to generate a return

401 (k) plan

401(k) plan is an investment plan established by employers to make salary deferral contributions for eligible employees on a pretax basis. 401 (k) is generally subjected to high contribution limits, and have limited flexibility.

403 (b) plan

403(b) plan is a retirement plan similar to 403 (b) for employees of public schools and tax-exempt organizations. This is also referred to as Tax Sheltered Annuity (TSA) Plan.

Retirement plans are also subjected to an early withdrawal tax of 10% if the funds are withdrawn before the age of 59 years.

What are the similarities between Pension Plan and Retirement Plan?

- Funds in both pension plan and retirement plan are subjected to a tax of 10% on early withdrawal

What is the difference between Pension Plan and Retirement Plan?

Pension Plan vs Retirement Plan

Pension plan is a defined benefit plan in which an employer contributes with a guaranteed lump-sum on employee's retirement.

Retirement plan is a savings and investment plan that provides income after an employee has ceased employment.

Nature of the Plan	
Pension plan is a defined benefit plan.	Retirement plan is a defined contribution plan.
Contribution	
In general, the employer makes contributions to the pension plan.	Both employer and employee make contributions to the retirement plan.

Summary- Pension Plan vs Retirement Plan

The difference between pension plan and retirement plan mainly depends on who funds the plan. While pension plan is usually funded by the employer, retirement plan is based on making periodic contributions. Retirement plan is more flexible compared to pension plan since it gives the investor a wide variety of options to choose from. However, both types of plans are initiated to fulfill a similar objective, which is to ensure the availability of a lump sum at the retirement period.

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