

403(b) Plans Explained

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A 403(b) plan is similar to a 401(k) plan in that it's an easy way to save for retirement and benefit from pre-tax savings.

403(b)s are retirement savings plans that allow employee contributions to grow tax deferred until withdrawn at retirement. The plans are designed for employees of eligible tax-exempt organizations, including:

- Public education institutions - elementary and high schools, colleges and universities
- Churches or church-related organizations
- 501(3)(c) tax-exempt organizations, such as
 - Nonprofit hospitals
 - Social and welfare organizations
 - Museums and others

Sometimes called tax-sheltered annuities, tax-deferred annuities or tax-sheltered custodial accounts, 403(b)s are offered through your employer and the contributions you make come out of your paycheck before taxes. Because the money is coming out of your paycheck pretax, your taxable income is lower and your tax burden is decreased. Plus, since the money is coming out of your paycheck before you get it, you'll never even see it to miss it!

Why a 403(b) is a Smart Option

- Tax-deferred growth is one of the primary advantages of a 403(b) over other savings vehicles. Tax-deferral on income and growth generated by your account allows your account to grow faster.
- At retirement, chances are, you'll probably be in a lower tax bracket than you are now, and you'll pay less in taxes on the money you're earning now.
- Contributing to a 403(b) is practically painless - the money is taken out of your paycheck before taxes, so you never even see it to miss it.
- A 403(b) plan gives you control over your retirement plan by letting you choose from a variety of investments that may match your goals.
- Investing regularly over a long period of time allows you to purchase more mutual fund shares when prices are down and fewer when prices are high. This process is called dollar cost averaging.¹ Over the long run, it reduces the effects of market volatility on your share purchases. In essence, you're making the market's ups and downs work for you rather than against you.

Contribution Limits

The tax law signed by President Bush in June of 2001 makes it easier than ever for you to save for your retirement through a 403(b) plan. You may contribute (on a salary deferred pre-tax basis) either 100% of your compensation or \$15,000, whichever is less. The salary deferral limit is scheduled to gradually increase to \$15,000 as follows:

2004: \$13,000

2005: \$14,000

2006: \$15,000

2007: \$15,500

This limit will be indexed for inflation in \$500 increments after 2006.

The tax law also includes an added savings incentive for participants age 50 or older permitting them to make annual "catch-up" contributions. The catch-up amount is \$4,000 in 2005 and then increases by \$1,000 per year until reaching \$5,000 in 2006 (indexed in \$500 increments after 2006).

On top of that, a special rule for 403(b) participants allows certain employees with 15 or more years of service to contribute up to an additional \$3,000 from their salary.²

Taking Distributions

You can begin taking normal distributions from a 403(b) plan at age 59½. A distribution taken before age 59½ may be subject to a 10% penalty. In addition, the IRS requires an automatic 20% withholding for federal income taxes from distributions that are not directly rolled over to another 403(b) or IRA. All withdrawals are taxed as ordinary income in the year received.

The exceptions to this rule are that you may take an early distribution penalty free if you lose your job, if you become disabled or die or if the distribution is taken as part of a series of approximately equal payments.

Remember, though, that you must begin taking distributions by April 1st of the year after you reach age 70½ or retire, whichever is later. These distributions are commonly referred to as **required minimum distributions (RMDs)**.

After that, you must take distributions annually by December 31. If you don't take the RMDs on time, the IRS will assess you a penalty of 50% of the amount that should have been withdrawn.

Taking a Loan From a 403(b)

Although permitted, not all plans offer loans. Generally, you may borrow up to half of your vested account balance to a maximum of \$50,000 without tax consequences as long as the loan is paid back within five years (unless it is for the purchase of a home, in which case the loan period may be extended). In general, the minimum loan allowed is \$1,000. Your plans' loan provisions will vary.

For more information on 403(b) plan, talk to Jon Heddleson today. I would like to be the one that helps you reach your financial goals. You may reach me toll-free at **1-888-401-2980 x8163** or at my direct line **216-532-8163**. I am also accessible through email at [**jheddleson@vanfin.com**](mailto:jheddleson@vanfin.com).

¹ Since such plans involve continuous investments regardless of price levels of fund shares, investors should consider their financial ability to continue purchases through periods of low price levels.

² Please contact your financial or tax advisor to see if you qualify for the special 15 year catch up provision