

How a 403(b) Plan Can Help You Save

School employees can participate in a plan that will provide retirement funds in addition to the benefits from the Public School Employees Retirement System. The plan is called a 403(b) and is named for the section of the Internal Revenue Code that governs this benefit. A 403(b) is a tax sheltered annuity or qualifying custodial account which by federal law is only available to employees of educational institutions and other certain non-profit organizations. These plans have been allowed by federal law since 1958 for 501(c) (3) employers and 1961 for public education employers. The private sector often uses 401(k) deferred compensation plans as a similar plan, but schools cannot provide a 401(k) plan unless, as is true in some states, a grandfathered 401(k) plan established before May of 1986 has been retained.

What is a 403(b)?

Simply stated, a 403(b) allows you to set aside money for retirement on a tax-deferred basis using a payroll deduction process through the business office. The funds withheld from your paycheck are then invested with a 403(b) provider that you can choose from our list of approved companies included in our Plan Document. You will control how your funds are invested by consulting with a representative from the provider you select.

Your invested funds will grow tax free until withdrawal. When you withdraw your funds, they will be taxed as normal income.

Additionally, if permitted by your employer, contributions can be made on an after-tax basis to the Roth 403(b), and, if held for at least 5 years, distributions may be free from federal income tax upon attainment of age 59 ½ or disability, or upon death to your beneficiaries.

What are the advantages of a 403(b)?

The Internal Revenue Service in Publication 571

(<http://www.irs.gov/publications/p571/index.html>) lists the following benefits of 403(b) plans:

- “The first benefit is that you do not pay tax on allowable contributions in the year they are made. You do not pay tax on allowable contributions until you begin making withdrawals from the plan, usually after you retire.”
- “The second benefit is that earnings and gains on amounts in your 403(b) account are not taxed until you withdraw them.”

How are my 403(b) contributions tax deferred?

Let’s assume you are in the 30% tax bracket for federal income tax purposes. If you want to contribute \$100 per month, your net payroll deduction will only be \$70 monthly from a federal income tax perspective. To illustrate, let’s take a look at a hypothetical example.

	Without 403(b) Plan	With 403(b) Plan
Monthly Wages	\$3,500	\$3,500
403(b) Contribution	0	100
Taxable Income	\$3,500	\$3,400

Federal Income Tax (30%)	\$1,050	\$1,020
Monthly Take Home Pay	\$2,450	\$2,380
Investment	0	\$100
Federal Income Taxes Saved	0	\$30
Your actual out-of-pocket cost to make a \$100 investment	n/a	\$70

Many individuals find themselves in a lower tax bracket during their retirement years. For those who do, the tax consequences for withdrawals may also be less. In those cases, there can be an additional tax benefit to deferring federal income taxes to retirement.

How much can I contribute?

For 2008, you may contribute up to \$15,500. The maximum contribution limit may be adjusted upwards for inflation. In certain situations, you may be eligible to make additional contributions to your 403(b). The IRS allows so-called catch-up contributions. You should contact your provider for additional details.

When can I withdraw my funds?

You own your 403(b) contributions immediately; there is no vesting period. However, IRS rules provide that, generally, you may withdraw your contributions and earnings beginning at age 59 ^{1/2} to avoid early withdrawal IRS penalty taxes. However, there are other circumstances, including disability and financial hardship, that may qualify you to withdraw your funds earlier without incurring that IRS penalty tax. The IRS penalty tax for early withdrawal is significant so make sure you understand the tax consequences. You may also be subject to contractual withdrawal fees from your investment provider as well.

Who can contribute to a 403(b)?

The IRS “universal availability” requirement indicates that if one employee is provided with the opportunity to contribute to a 403(b), then all employees must be provided with that opportunity, with certain exceptions. Among those possible “exceptions” are: employees who wish annually to contribute \$200 or less, and employees who normally work fewer than 20 hours per week. Under new tax regulations, this 20-hour-per-week exclusion is applied by asking whether the individual worked at least 1,000 hours in the previous year; or, if they were hired more recently, whether they are expected to work at least 1,000 hours in their first year.

ACKNOWLEDGEMENT

This document was co-created by members of the Association of School Business Officials (ASBO) International and Pennsylvania Association of School Business Officials (PASBO). Additional information and resources about the IRS 403(b) regulations can be found on the ASBO International Web site, www.asbointl.org, and the PASBO Web site www.pasbo.org.

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Additional information can be obtained from the PA Association of School Business Officials at www.pasbo.org and (717) 540-9551.

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