

403(b) Frequently Asked Questions

What is a 403(b)?

The 403(b) is a tax deferred retirement plan available to employees of educational institutions and certain non-profit organizations as determined by section 501(c)(3) of the Internal Revenue Code. Contributions and investment earnings in a 403(b) grow tax deferred until withdrawal (assumed to be retirement), at which time they are taxed as ordinary income. See [IRS Publication 571](#) for IRS details on the 403(b). You can also obtain this document by calling 1-800-829-3676.

When was the 403(b) established?

The 403(b) was established in 1958 by the federal government to encourage employees in certain tax-exempt organizations to establish retirement savings programs. The name refers to the relevant section in the Internal Revenue Code.

Who can contribute to a 403(b)?

Employees of tax-exempt organizations established under section 501(c)(3) of the Internal Revenue Code. These organizations are usually referred to as section 501(c)(3) organizations or simply 501(c)(3) organizations. Participants include teachers, school administrators, school personnel, nurses, doctors, professors, researchers, librarians, and ministers.

Why Contribute to a 403(b)?

A Healthy Retirement - Most employees of educational institutions and other non-profit organizations are provided with a pension upon retirement. Few pension plans, however, provide an amount equal to salary. A 403(b) plan can provide a healthy supplement to a pension.

Lower Taxes - 403(b) contributions are made on a pre-tax basis which can greatly reduce your tax bill. Generally, if you contribute \$100 a month to a 403(b) plan, you've reduced your Federal income taxes by roughly \$25 (assuming you are in the 25% tax bracket). In effect, your \$100 contribution costs you only \$75. The tax savings are magnified as your 403(b) contribution increases.

More Tax Savings - all dividends, interest and capital gains accumulate in a 403(b) account on a tax-deferred basis. This means your earnings will grow tax-free until time of withdrawal.

How does a 403(b) plan work?

You set aside money for retirement on a pre-tax basis through a salary reduction agreement with your employer. You choose from among the vendors offered by your employer where your money is to be invested. The money grows tax free until withdrawal at retirement.

Will participation in a 403(b) plan reduce Social Security benefits?

No. Salary reduction contributions to a 403(b) reduce taxable compensation for federal (and in most instances, state) income tax purposes only. Those contributions do not reduce wages for the purpose of determining FICA taxes or determining social security benefits.

Will participation in a defined benefit plan (pension/TRS) affect one's ability to contribute the maximum elective deferral limit to a 403(b) plan?

No. The elective deferral limit is a taxpayer limit, meaning that your maximum contribution to all plans cannot exceed the annual limit. However, your mandatory contribution to the state defined benefit plan is not considered an elective deferral, so it doesn't reduce your annual limit. Therefore, you are able to participate in your state's defined benefit plan and contribute the maximum allowable to your 403(b) plan.

Is there a special tax credit for low-income savers?

Yes. Eligible savers will receive a tax credit of up to 50 percent on up to \$2,000 in contributions to an IRA, 403(b), 457, SIMPLE, 401(k) plan and other tax-favored plans. For 2008, the full credit is available to joint filers whose adjusted gross income (AGI) is less than \$53,000, and for singles whose AGI is under \$26,500.

Are part time employees eligible to contribute to a 403(b)?

In order to meet nondiscrimination requirements of the law, once a plan sponsor permits any employee to elect a salary deferral into the 403(b), the opportunity must be extended to all employees of the organization. This is known as **universal availability**. However, certain employees may be excluded. Employees who may be excluded include: employees who will contribute \$200 annually or less; those who are participants in an eligible deferred compensation plan [457 or 401(k)] or participants in another TSA; non-resident aliens; and certain students and employees who normally work less than 20 hours per week. Employers must take special care to comply with this requirement. Non-compliance could result in the entire 403(b)/TSA losing its tax-favored treatment. Note: the opportunity to participate may be extended to employees who work less than 20 hours a week.

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What does a 403(b) plan cost and who is paying for it?

Typically, the plan has two kinds of expenses: administrative costs and investment management fees. Investment management fees are usually charged by the investment company as a percentage of the total assets under management — the total value of your account. These fees range from about 0.2% on the low end to 3% on the high end. For example, if you had \$100 invested, a fee of 0.2% would cost you 20 cents a year, while a fee of 3% would cost you \$3 a year. See: [Fees and How They Affect Your 403\(b\)](#).

How much can I contribute annually?

For 2008 workers are able to contribute the smaller of:

1. the elective deferral limit of \$15,500 (which is unchanged from 2007), or
2. up to 100% of includable compensation (must be less than the elective deferral limit), or
3. for those with employer matches or other employer contributions, limits are \$46,000 or 100% of compensation (whichever is less). The employee is still limited to the employee elective deferral limit (\$15,500 for 2008). An employer can add up to another \$30,500.
4. in addition, if you are 50 or older at any time during 2008, you may contribute an additional \$5,000.

Note: There is a provision of the Internal Revenue Code that temporarily increases the elective deferral limit for those eligible employees. This increase is known as the 15-year-rule. This special provision increases your elective deferral limit by as much as \$3,000 more than the current \$15,500 limit (as of 2008). To qualify you must have completed at least 15 years of service with the same employer (years of service need not be consecutive), and you cannot have contributed more than an average of \$5,000 to a 403(b) in previous years. The increase in your elective deferral limit cannot exceed \$3,000 per year under this provision, up to a \$15,000 lifetime maximum. If you have 15 or more years of service with your employer, it is highly recommended that you consult with a tax professional concerning the limits on your contributions. Note that if you are eligible to contribute to both the age 50 catch-up and the 15-year-rule the IRS will first apply any contribution above normal limits to the 15-year-rule.

Contribution Calculators

See the calculators in our [ResearchWise](#) section.

What investment options are available to 403(b) participants?

1. Annuity and variable annuity contracts with insurance companies.
2. Custodial account made up of mutual funds. This is known as a 403(b)(7).
3. Retirement income accounts for churches. This is known as a 403(b)(9).

What is a fixed annuity?

Fixed annuities are contracts with insurance companies that guarantee that you will earn a minimum rate of interest during the time that your account is growing. The insurance company also guarantees that the periodic payments will be a guaranteed amount per dollar in your account. These periodic payments may last for a definite period, such as 20 years, or an indefinite period, such as your lifetime or the lifetime of you and your spouse (source: SEC).

What is an equity indexed annuity?

Equity indexed annuities are a special type of contract between you and an insurance company. During the accumulation period — when you make either a lump sum payment or a series of payments — the insurance company credits you with a return that is based on changes in an equity index, such as the S&P 500 Composite Stock Price Index. The insurance company typically guarantees a minimum return. Guaranteed minimum return rates vary. After the accumulation period, the insurance company will make periodic payments to you under the terms of your contract, unless you choose to receive your contract value in a lump sum (source: SEC).

Additional equity indexed annuity information: [SEC "Fast Answer" on Equity Indexed Annuities](#) and [NASD's Equity Indexed Annuities — A Complex Choice](#).

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What is a variable annuity?

Variable annuities are contracts with insurance companies under which you make a lump-sum payment or series of payments into a tax deferred account. In return, the insurer agrees to make periodic payments to you beginning immediately or at some future date. You can choose to invest your purchase payments in a range of investment options, which are typically mutual funds. The value of your account in a variable annuity will vary, depending on the performance of the investment options you have chosen (source: SEC).

SEC variable annuity tip: Make sure that the features you are buying when you invest in a variable annuity are worth the money you are paying. If you invest in a variable annuity through a tax-advantaged retirement plan (such as a 403(b) plan), be aware that you receive no additional tax advantage from the variable annuity.

Additional variable annuity information from the SEC: [Variable Annuities: What You Should Know](#)

What is a mutual fund?

Mutual funds are pools of money invested in many different securities and are managed according to set objectives. They are similar to the investments underlying variable annuities, but do not have the associated insurance fees of an annuity. With mutual funds, you can choose among aggressive funds for growth to more conservative funds for stability similar to that of a fixed annuity. When comparing similar investments, it is important to consider all factors of an investment, including performance, fees, risk, flexibility, time horizon and your own confidence in the investment or insurance company.

Additional mutual fund information from the SEC: Mutual funds come in many varieties. For example, there are [index funds](#), [stock funds](#), [bond funds](#), and [money market funds](#) to name a few. Also see [Invest Wisely: An Introduction to Mutual Funds](#)

Before committing to any 403(b) investment option, what questions should I ask?

The following recommendations come from Mutual Fund Magazine's [Making More of Your 403\(b\)](#).

1. Will I be penalized for pulling my money out?

"This is the most important question you can ask," says Marianne Shine, a certified financial planner in Deerfield Beach, Fla. Annuities typically penalize investors who bail out. During the first few years of the contract, you may have to pay surrender charges if you transfer your money elsewhere. Often the surrender fees start at 7% or 8% and decline by a percentage point every year. If you switch employers and move the money out of an annuity with a surrender charge, you will have to pay the penalty. Certain surrender fees, however, refuse to vanish. You'll typically discover this nasty surprise with "two-tier" annuities. With one of these, you'll pay a penalty if you decide not to annuitize your payments upon retirement. If you prefer to withdraw your money and invest it elsewhere, you can, in some cases, face a 20% or higher penalty. Unless you're approaching retirement age, it's best to flee from a two-tier annuity, Shine advises.

2. What are my investment choices?

The underlying investments within a variable annuity will be mutual funds. An insurance agent will probably refer to them as "subaccounts." What is the performance record of these funds? How does each compare with its appropriate benchmark? If a large-cap growth fund has consistently underperformed the Standard & Poor's 500 Index, for example, stay away.

3. What annual fees will I pay?

You should check the yearly expense ratios for annuities as well as traditional mutual funds. Fees can dramatically erode returns over time.

4. How is an insurance company rated?

If you are investing in a fixed annuity, you need to know how financially sound the insurance carrier is. You'll want to review the ratings from at least two insurance-rating services such as A.M. Best, Moody's, and Duff & Phelps. You might assume that your money is protected within a fixed annuity, but there's no real guarantee. That's because the money in a fixed annuity is not segregated and therefore can be at risk if the insurer declares bankruptcy.

How do I set up a 403(b)?

Ask your employer for a list of the participating investment companies available to you. This is typically known as the vendor list. Select several investment companies from this list. Then, most

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importantly, research these choices with an eye toward performance and cost. Next, determine the amount of money you wish to contribute monthly. Most companies require at least \$50 per month. Finally, return to your employer with the necessary investment paperwork and you're on your way. For more information see: [Start a 403\(b\)](#)

Do I have to use an agent or advisor to set up a 403(b)?

No. This site believes that with financial education, patience and realistic expectations, individuals are perfectly capable of managing a 403(b) on their own. It is important to point out, however, that agents and advisors can provide valuable services to their clients. These services can include: retirement planning, information about state retirement plans, and analysis of other financial needs. Such agents and advisors rightly deserve to be compensated for their services. The key is to figure out exactly what services you are receiving, and exactly what fees you are paying for these services. Only then can you determine the true value of using a representative. Keep in mind that when you work with an individual who represents a particular company that individual is going to recommend products from that company which severely limits your options. Plus, in such a situation there is an inherent bias built into the advice. For quality advice free of bias we recommend employing a Certified Financial Planner (CFP®) who is paid on an hourly basis (as opposed to receiving commission for selling a particular product). The CFP® designation is the most recognized designation and is awarded by the CFP® Board of Standards, an independent certifying body, upon successful completion of a 10-hour, two-day exam and three years of client service (with bachelor's degree; five years without). You can get more information on CFPs® and check a CFP's® status [here](#).

Additional information on advisors: [The Garrett Planning Network](#) is a group of fee-only advisors who primarily charge for their services by the hour. [The National Association of Financial Advisors](#) (NAFP) is an organization made up of fee-only financial planners, the majority of whom are CFPs®. Lastly, you can investigate brokers and advisors at the [SEC](#).

Can I change the amount I contribute?

Yes. But you might have to wait for a specific date. Some employers limit the number of changes during a year. It's best to ask about this before you begin contributing.

Can I stop contributing altogether?

Yes. You may stop contributing at any time.

How long after my 403(b) contribution is deducted from my paycheck should it take to be credited to my 403(b) account?

Employers are required to transmit employee contributions to retirement plans as soon as they can reasonably be segregated from the employer's general assets, but not later than the 15th business day of the month immediately after the month in which the contributions were withheld or received by the employer. Translation: the maximum time it should take is 45 days, however, employers can and should complete this process much quicker. It is not uncommon for employers to complete this process the same day that paychecks are issued.

What investment companies can I invest with?

Your employer can provide you with a list of the companies which they have approved for participation.

Can I invest in a vendor of my choice?

If your preferred vendor is not currently on your employer's list, request that it be added. This may be all it takes. Cooperation and regulations vary among employers. In some cases, more intense lobbying will be required. See:

- [Get Better 403\(b\) Choices](#) [403(b)wise]

You may want to download a copy of the 403(b)wise 403(b) Bill of Rights. It's a wish list of options and services many in the 403(b) community would like to see. Click [403\(b\) Bill of Rights](#).

What is a "Hold Harmless" Agreement?

A legal agreement that some school districts demand financial providers sign in order to sell 403(b) products. Many mutual fund companies object to these agreements and choose instead not to offer their products to these districts.

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Do I need my employer's consent to contribute to a 403(b)?

Yes. Your employer must agree to make contributions to your 403(b) in accordance with a salary reduction agreement. This is an agreement between the employer and employee under which the employee agrees to take a reduction in salary or to forego a salary increase and the employer contributes that amount to a 403(b) for that employee.

How is a 403(b) different from a TSA (tax-sheltered annuity)?

As far as the IRS is concerned a 403(b) is a TSA, and a TSA is a 403(b). The terms are interchangeable. Either way, participants can contribute to annuities, variable annuities or mutual funds.

How is a 403(b) different from a 401(a)?

The main difference between a 401(a) and a 403(b) is eligibility. A 401(a) can be established just for administrative staff, or even as narrowly defined as for the cafeteria workers only. A 403(b) on the other hand requires [universal availability](#).

How is a 403(b) different from a 401(k)?

The 401(k) is a tax-deferred retirement plan for private sector employees, while the 403(b) is a tax-deferred retirement plan for employees of educational institutions and certain non-profit organizations. There are other differences. For more information see:

[How Do 403\(b\) Plans Compare to 401\(k\)s, IRAs and Keoghs?](#) [TIAA-CREF]

What is a 403(b)(7)?

The IRS created the 403(b) in 1958. In 1974 Congress added paragraph (7) which allowed employees to set up retirement plans directly with mutual fund companies. Prior to this change contributors were limited to investment choices offered by insurance companies. Throughout this site the term 403(b) is intended to mean all of the following: 403(b), 403(b)(7) and TSA.

When can 403(b) money be accessed without penalty?

Generally, penalty-free distribution from a 403(b) cannot occur until the participant:

- Reaches age 59 1/2
- Separates from service in the year turning 55 (and must be retired)
- Retire before age 55 — eligible for Substantially Equal Periodic Payments (SEPP). Participants who have retired early (before age 55), but want access to their 403(b) without penalty can do so using SEPP. This provision requires that you take a series of substantially equal periodic payments. The key is that once you start these payments they must continue for five years or until you reach 59 1/2, whichever takes longer. If you start at age 58 you must continue until you are 63 (minimum 5 years).
- Becomes disabled (as defined in section 72(m)(7) of the Internal Revenue Code)
- Through a loan (some investment companies allow this, some do not)
- Dies

Consulting a tax professional before accessing 403(b) money is highly recommended.

Loans

Another way to access 403(b) money early is to take out a loan. Though not all vendors oblige, loans are permitted from a 403(b). Many mutual funds do not allow loans. This can be both an advantage and a disadvantage. The advantage is that access to your funds is limited and you are less likely to take out a loan, thus allowing your money to continue to grow. The disadvantage is that you may really need the money and the only way to get it is through a hardship withdrawal which has tax consequences (explained below). Other rules governing loans exist but vary by vendor, so consult your vendor for details. You may also want to read this story on loans: [The 403\(b\) Loan: The New Debtors Prison?](#).

Consulting a tax professional before taking out a 403(b) loan is highly recommended.

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Under what circumstances may a hardship withdrawal be made?

This provision allows withdrawal of funds from a 403(b) if under severe financial distress. The participant must have no other resources available. A hardship withdrawal may be made for:

- Un-reimbursed medical expenses of the participant or his/her spouse and dependents.
- Down payment on primary residence.
- Tuition and fees for higher education needs, and only for the next 12 months.
- Eviction or foreclosure on your primary residence

Hardship withdrawals are not exempt from an IRS 10% penalty. Furthermore, withdrawals are subject to ordinary income taxation in the year withdrawn. To qualify you must certify that you have no other recourse, including the possibility of taking a loan. You also are prohibited from contributing to a 403(b) for the next six months. The IRS makes it tough to access money this way for a reason: they don't want you to use the 403(b) as a form of short term savings. For exact details on your situation it is recommended that you contact both your vendor and a tax professional before proceeding.

Also, while the IRS permits withdrawals, it is allowable for a plan sponsors (the employer) to not permit them. The employer has some responsibility in making hardship withdrawals. The employer has to "OK" the hardship, based on written information provided by the employee as to the nature of the hardship. The employer has to determine, based on the facts, whether the employee has an "immediate and heavy financial need."

Consulting a tax professional before making a hardship withdrawal is highly recommended.

What are the options for a 403(b) when switching jobs?

1. Move the money into your new employer's 403(b) plan. Note, as of 2002 a 403(b) can be rolled into a 401(k) and vice versa. Not all plans allow such transfers, so check with your employer (former and present) and plan provider (former and present).
2. Roll it into an IRA. See: [Rolling a 403\(b\) into an IRA](#)
3. Leave it where it is, especially if you like your investment choices. If the balance is below \$5,000 some employers require you to move the money. Check with your employer.
4. Take a lump sum payment. Beware! This is not Wise at all. This will trigger all kinds of fees and penalties, and worse, ridicule and scorn from your Wise friends.

For more detailed information refer to IRS Publication 571. You can obtain this document by calling 1-800-829-3676 or it may be downloaded by clicking on [IRS Publication 571](#).

What happens to 403(b) money in the event of a divorce?

Generally, distributions of funds in a salary reduction 403(b) are restricted by section 403(b)(11) of the Internal Revenue Code. In order for a distribution to take place, a qualifying event must occur. These events include death, disability, severance of employment or attainment of age 59 1/2. However, a distribution to an "alternate payee" will be permitted if pursuant to a qualified domestic relations order (QDRO).

A QDRO is a decree, judgment or order that meets the qualification requirements of the Internal Revenue Code. Those requirements include:

- The order must have been issued under a state's community property or other domestic relations law,
- It must relate to the provision of alimony, child support or the property rights of a spouse, former spouse, child or other dependent (alternate payee),
- It must assign to the alternate payee the right to receive all or a portion of the participant's plan

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benefits, and

- It must clearly specify (1) the names and addresses of each alternate payee, (2) the amount or percentage of the participant's benefit to be paid to each alternate payee, (3) the period of time over which the order applies and (4) each plan to which the order applies.

If a distribution is made to a spouse or former spouse under a QDRO, the distribution may be rolled into a qualified plan or IRA that the spouse or former spouse has. Distribution to any other alternate payee is not eligible for rollover.

What happens to 403(b) money in the event of death?

Death benefits to be paid under a 403(b) plan depend on when death occurs and who is the designated beneficiary on the plan.

The Internal Revenue Code states that distributions generally must be made from a 403(b) plan by the participants required beginning date, which is April 1 of the year following the year in which the participant attains age 70 1/2. Different rules apply to death benefits depending on whether or not death occurs before the required beginning date. The following table briefly summarizes the death benefit requirements of a 403(b):

| Designated Beneficiary | Employee's Death Occurring | |
|---------------------------|---|--|
| | Before Required Beginning Date | On or After Required Beginning Date |
| None | Entire account must be distributed by December 31 of the year containing the fifth anniversary of the employee's death. | The remaining account must be distributed over the employee's remaining life expectancy, determined using the single life expectancy table published by the IRS and the employee's age on their birthday in the year of death. In subsequent calendar years, the distribution period is reduced by one for each year that has elapsed since death. |
| Spouse (sole beneficiary) | Distributions are to begin on or before the later of (a) the end of the year in which the employee would have attained age 70 1/2 or (b) the end of the year following the employee's death. The account is to be distributed over the surviving spouse's life expectancy, determined using the single life expectancy table published by the IRS and the surviving spouse's age on their birthday during the applicable year. | The remaining account must be distributed over the surviving spouse's life expectancy, determined using the single life expectancy table published by the IRS and the surviving spouse's age on their birthday the applicable year. |
| Non-spouse | Distributions are to begin by the end of the year following the year of the employee's death. Distributions are to be made over the beneficiary's life expectancy, using the single life expectancy table published by the IRS and the beneficiary's age on their birthday in the year after the employee's death. In subsequent calendar years, the distribution period | The remaining account must be distributed over the beneficiary's life expectancy, using the single life expectancy table published by the IRS and the beneficiary's age on their birthday in the year following the employee's death. In subsequent calendar years, the distribution period is reduced by one for each year that has elapsed since |

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is reduced by one for each year that death.
has elapsed since death.

The surviving spouse may elect to roll death benefits into his or her own IRA, after any required distributions are made for the year of the decedent participant's death. In order to make this election, the surviving spouse must be the sole beneficiary of the 403(b) account and have an unlimited right to withdraw amounts from the 403(b).

How will distributions from my 403(b) be taxed?

In most cases, the payments you receive, or that are made available to you from a 403(b) are taxable in full as ordinary income. In general, the same tax rules apply to distribution from a 403(b) that apply to distributions from other retirement plans. For more detailed information refer to [IRS Publication 571](#). For your specific situation it's recommended that you consult a professional tax advisor.

Can I leave my money in the plan indefinitely?

No. The federal government will allow you to put off paying taxes on the money for only so long. Generally, you must begin to take withdrawals no later than April 1 of the year following the year in which you turn age 70 1/2.

What about distribution requirements for 403(b) money contributed prior to December 31, 1986?

403(b) account balances that existed on December 31, 1986 are not subject to the age 70 1/2 distribution requirement. However, any earnings on that balance are. Distribution from the 12/31/86 balance needs to start at age 75. This requirement is not found in the Internal Revenue Code, but rather in a letter ruling. Also, any distributions in excess of required distributions are deemed to reduce the 12/31/86 balance. So, if any money has been taken out of the 403(b) account other than those that are required (such as a partial withdrawal or a deemed distribution), the 12/31/86 balance may be less than anticipated. For your specific situation it's recommended that you consult a professional tax advisor.

Can I contribute to a 403(b) and a 401(k)?

Yes. If your employer(s) offer both a 403(b) and a 401(k), you may contribute to both. However, your aggregate contributions may not exceed the elective deferral limit. In 2005, this limits your total contribution to \$14,000. If you are age 50 or older at any time during the year, your contribution limit increases to \$18,000.

Can I contribute to a 403(b) and a Roth IRA?

Yes. The Roth IRA has Adjusted Gross Income (AGI) limitations. Singles earning up to \$95,000 may contribute fully; ability to participate phases out at \$110,000. Those filing jointly earning up to \$150,000 may contribute fully; ability to participate for joint filers phases out at \$160,000.

What is a Roth 403(b)?

Similar to the Roth IRA, the Roth 403(b) allows individuals to contribute after-tax dollars to an account that will grow tax-deferred. Withdrawal of contributions will not be taxed. Employees have the option of directing 403(b) contributions to either a regular 403(b) or a Roth 403(b), or some combination of the two plans that does not exceed that year's contribution limits. The Roth 403(b) was created as part of the Economic Growth and Tax Reconciliation Act (EGTRRA) of 2001 and became available in January 2006. It is expected to take time before the Roth 403(b) is widely offered by employers.

Can I contribute to a 403(b) and a SEP IRA?

Yes. You may make salary reduction contributions to your 403(b), and make contributions to a SEP-IRA. However, SEP IRA contributions are generally made by an employer. Therefore, you will need to have income from self-employment or from another employer in order to have contributions made to a SEP IRA on your behalf.

Can I contribute to a 403(b), Roth IRA and SEP IRA?

Yes. As long as the above-mentioned provisions are met.

To the best of our knowledge, we believe all of the information contained on this page to be accurate. Always get a second opinion and check other sources before taking any action.