



RETIREMENT PLANNING

Section 403(b)

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RETIREMENT PLANNING

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PLEASE NOTE

The Consolidated Appropriations Act, 2021 continues many temporary CARES Act provisions through 2021 to ease access to retirement funds, including:

- ◆ The exception to the 10% early withdrawal penalty for distributions prior to age 59½
- ◆ The elimination of the mandatory 20% withholding requirement on distributions
- ◆ The option to take out up to \$100,000 in a loan or withdrawal (if otherwise allowed under plan provisions)



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SUMMARY

WHAT IS A 403(B)?

A 403(b) is a tax-deferred retirement plan that can be established by two general categories of employers: schools (public school systems, state colleges and universities) and tax-exempt 501(c)(3) organizations (charities, hospitals and religious organizations).

In a typical 403(b) plan, employees in a qualifying organization defer a portion of their salaries into individual accounts according to a salary reduction agreement with the employer.

The salary reduction agreement applies to the employee's future earnings. If the agreement is ever modified, the modification will only affect the employee's subsequent earnings.

Salary deferrals, while exempt from current federal income tax up to certain limits, are still subject to Social Security and Medicare withholding taxes.

The employer may also make contributions up to certain limits.

ARE THERE CONTRIBUTION LIMITATIONS?

There are limits to how much an employee can defer into the account each year depending, among other things, on the person's age. The 2021 limit is \$19,500 (\$26,000 for people age 50 and over). However, for participants with 15 years of service or more with the employer, the annual limit is increased by an additional \$3,000.

There's also an overall limit on annual additions to the account from all sources—including any employer contributions. In 2021, the limit is 100% of the employee's compensation or \$58,000, whichever is lower.



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WHAT'S THE TAX TREATMENT?

Amounts deferred into the 403(b) plan are not currently taxed to the employee unless made on an after-tax basis, including those designated as Roth deferrals. Earnings inside the account accrue on a tax-deferred basis until they're withdrawn.

Employer contributions are deductible by the employer in the year they're made.

Employee withdrawals from the 403(b) account—except amounts representing a return of the employee's nondeductible contributions—are taxed as ordinary income. Roth deferrals are the exception, as they may be withdrawn tax free when certain requirements are met.

The special tax treatment available for lump-sum distributions to certain grandfathered participants in other qualified retirement plans is not available to 403(b) participants.

WHAT ABOUT DISTRIBUTIONS?

Withdrawals from a 403(b) plan prior to the employee's age 59½ may incur a 10% penalty tax unless certain exceptions apply.

Distributions generally must begin no later than April 1 of the year following the year the participant reaches age 72. Distributions may, however, be deferred until the participant's actual retirement if that is later than age 72.

Participants who fail to comply with the RMD rules face a 50% penalty tax on the amount that should have been distributed but was not.



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- 1. An employee of a public education organization or tax-exempt organization elects to defer a portion of salary into a 403(b) plan subject to annual contribution limits (which increase at age 50).
- 2. Deferrals within these limits are not taxed. (Any Roth deferrals are currently taxed but may then be distributed tax-free when certain requirements are met.) Earnings inside the plan grow tax deferred, allowing for greater accumulation.



- 3. The employee may begin taking distributions from the plan at age 59½, and must begin taking distributions by age 72 or actual retirement, if later. Early distributions face a 10% penalty (with some exceptions). Distributions after age 72 face a 50% penalty on the amount that should have been distributed but was not.
- 4. At the employee's death, the plan (if so arranged) provides survivor benefits to the employee's beneficiary.

- 5. Distributions are taxed as ordinary income. Survivor benefits are also taxed as ordinary income.

