

403(b) Plans: Beneficial Tax Law Changes

In 1958, the Internal Revenue Service (IRS) created **403(b) plans** to encourage employees of certain organizations to begin saving for retirement. Organizations eligible for participation in these plans include those “organized and operated exclusively for religious, charitable, scientific, public-safety testing, literary, or educational purposes.” Paragraph (7) was added in 1974 by Congress, which gave participants the right to invest in mutual funds as opposed to only insurance company investments. In 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) offered the most recent update on 403(b) plans, and provided several favorable changes to the rules and regulations.

A Closer Look

First, EGTRRA made the maximum amount contributable (MAC) calculation much simpler by negating the maximum exclusion allowance (MEA) calculation. Previously, this calculation was necessary to determine the annual contribution limit to a 403(b) plan. The MEA calculation required the computation of previous years’ contributions, which was often considered a burdensome task, especially for those who had changed jobs. With EGTRRA, these rules have changed, and now rules governing the maximum amount contributable allow contributions of:

- An elective deferral limit of \$16,500 in 2009; or
- As much as 100% of compensation, as long as that amount is less than the elective deferral limit; or
- Employer-sponsored contribution limits of the lesser of \$49,000 (in 2009: \$16,500 from the employee and \$32,500 from the employer) or 100% of compensation.
- Those above age 50 may contribute an extra \$5,500 in 2009.

It is also important to note that 403(b) plans are now eligible for **rollover** into a **401(k) plan** as long as the following apply:

- The individual must be a 401(k) participant.
- Rollovers must be allowed in the 401(k) plan’s rules.
- Distributions from a 403(b) plan must be qualifiable, such as: death; disability; employment severance; or reaching [attainment of] age 59½.

EGTRRA made several positive legal changes in 403(b) plans, which are now more accessible than ever. However, there are also a few good personal reasons to contribute to a 403(b). Although employees of qualifying organizations may be entitled to receive a pension at retirement, many find that pension proceeds are not as high as pre-retirement income. Contributions to a 403(b) plan can be a significant supplement to pension proceeds. Furthermore, 403(b) contributions are taken from gross pay and are made with pre-tax dollars, which means that all funds in a 403(b) plan grow tax deferred, and earnings accumulate without taxation until withdrawal. Withdrawals made before the age of 59½ may be subject to a 10% federal income tax penalty.

The combination of legal changes brought into effect by EGTRRA and the personal advantages of 403(b) plans make participation more appealing than ever. Don’t wait: Start participating in your plan today. After all, it’s your retirement.