What Is a 403(b) Plan?

A 403(b) plan is a special tax-deferred retirement savings plan that is often referred to as a tax-sheltered annuity, a tax-deferred annuity, or a 403(b) annuity. It is similar to a 401(k), but only the employees of public school systems and 501(c)(3) organizations are eligible to participate in 403(b) plans.

Employees can fund their accounts with pre-tax contributions, and employers can also make contributions to employee accounts. Employer contributions can be fixed or discretionary. Eligible employees may elect to defer up to 100% of their salaries, as long as the amount does not exceed $18,000 (in 2016, unchanged from 2015). A special “catch-up” contribution provision enables those who are 50 and older to save an additional $6,000. Total combined employer and employee contributions cannot exceed $53,000 (in 2016, unchanged from 2015). Contribution limits are indexed annually for inflation.

Employees have the option of choosing the types of investments utilized in their funds. A 403(b) can be an annuity contract, a custodial account, or a retirement income account. It is a good idea to do a little research before selecting how you would like to invest your funds. Your employer can provide you with a list of the investments that are available.

Distributions from 403(b) plans are taxed as ordinary income. Withdrawals made before age 59½ may be subject to a 10% federal income tax penalty unless a qualifying event occurs, such as death or disability.

Generally, once you reach age 70½, you must begin taking annual required minimum distributions. You can receive regular periodic distributions on a schedule that is calculated based on your life expectancy, or you can collect your entire investment as a lump sum.

Participating in a 403(b) plan may be a good way to save for retirement. Contact your employer to find out what type of plan is offered and how you can take advantage of this retirement funding vehicle.