

403(b) Plans: Q & A

What is a 403(b) plan?

A 403(b) plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations and certain ministers. Both employers and employees can contribute to this plan. Individual accounts in a 403(b) plan can be any of the following types:

- An annuity contract, which is a contract provided through an insurance company;
- A custodial account, which is an account invested in mutual funds; or
- A retirement income account set up for church employees. Generally, retirement income accounts can invest in either annuities or mutual funds.

What are the benefits of contributing to a 403(b) plan?

There are three benefits to contributing to a 403(b) plan:

1. 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. Allowable contributions to a 403(b) plan are either excluded or deducted from your income. If an amount is excluded from your income, it is not included in your total wages on your Form W-2. This means that you do not report the excluded amount on your tax return. If an amount is deducted from your income, it is included with your other wages on your Form W-2. You report this amount on your tax return, but you are allowed to subtract it when figuring the amount of income on which you must pay tax. However, if your contributions are made to a Roth contribution program, this benefit does not apply. Instead, you pay tax on the contributions to the plan but distributions from the plan (if certain requirements are met) are tax-free.
2. The second benefit is that earnings and gains on amounts in your 403(b) account are not taxed until you withdraw them. Earnings and gains on amounts in a Roth contribution program are not taxed if your withdrawals are qualified distributions. Otherwise, they are taxed when you withdraw them.
3. The third benefit is that you may be eligible to take a credit for elective deferrals contributed to your 403(b) account.

Who can participate in a 403(b) plan?

Any eligible employee can participate in a 403(b) plan.

Eligible employees – The following employees are eligible to participate in a 403(b) plan:

- 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.
- Employees of public school systems who are involved in the day-to-day operations of a school
- Employees of cooperative hospital service organizations
- Civilian faculty and staff of the Uniformed Services University of the Health Sciences (USUHS)
- Employees of public school systems organized by Indian tribal governments
- Certain ministers (explained next)

Ministers – The following ministers are eligible employees for whom a 403(b) account can be established:

1. Ministers employed by section 501(c)(3) organizations
2. Self-employed ministers. A self-employed minister is treated as employed by a tax-exempt organization that is a qualified employer.
3. Ministers (chaplains) who meet both of the following requirements:
 1. They are employed by organizations that are not section 501(c)(3) organizations.
 2. They function as ministers in their day-to-day professional responsibilities with their employers.

Example: A minister employed as a chaplain by a state-run prison and a chaplain in the U.S. Armed Forces are eligible employees because their employers are not section 501(c)(3) organizations and they are employed as ministers.

Who can set up a 403(b) account?

You cannot set up your own 403(b) account. Only employers can set up 403(b) accounts. A self-employed minister cannot set up a 403(b) account for his or her benefit. If you are a self-employed minister, only the organization (denomination) with which you are associated can set up an account for your benefit.

How can contributions be made to my 403(b) account?

Generally, only your employer can make contributions to your 403(b) account. However, some plans will allow you to make after-tax contributions (defined later).

The following types of contributions can be made to 403(b) accounts:

1. **Elective deferrals** – These are contributions made under a salary reduction agreement. This agreement allows your employer to withhold money from your paycheck to be contributed directly into a 403(b) account for your benefit. Except for Roth contributions, you do not pay tax on these contributions until you withdraw them from the account. If your contributions are Roth contributions, you pay taxes on your contributions but any qualified distributions from your Roth account are tax-free.
2. **Nonelective contributions** – These are employer contributions that are not made under a salary reduction agreement. Nonelective contributions include matching contributions, discretionary contributions and mandatory contributions from your employer. You do not pay tax on these contributions until you withdraw them from the account.
3. **After-tax contributions** – These are contributions (that are not Roth contributions) you make with funds that you must include as income on your tax return. A salary payment on which income tax has been withheld is a source of these contributions. If your plan allows you to make after-tax contributions, they are not excluded from income and you cannot deduct them on your tax return.
4. **A combination** – A combination of any of the three contribution types listed above.

Self-employed minister – If you are a self-employed minister, you are considered both an employee and an employer, and you can contribute to a retirement income account for your own benefit.

Do I report contributions on my tax return?

Generally, you do not report contributions to your 403(b) account (except Roth contributions) on your tax return. Your employer will report contributions on your Form W-2. Elective deferrals will be shown in box 12 and the Retirement plan box will be checked.

Self-employed ministers – If you are a self-employed minister, you must report the total contributions as a deduction on your tax return. Deduct your contributions on line 28 of Form 1040.

Chaplains – If you are a chaplain and your employer does not exclude contributions made to your 403(b) account from your earned income, you may be able to take a deduction for those contributions on your tax return. However, if your employer has agreed to exclude the contributions from your earned income, you will not be allowed a deduction on your tax return. If you can take a deduction, include your contributions on line 36 of Form 1040. Enter the amount of your deduction and write “403(b)” on the dotted line next to line 36.

How much can be contributed to my 403(b) account?

There are limits on the amount of contributions that can be made to your 403(b) account each year. If contributions made to your 403(b) account are more than these contribution limits, penalties may apply. To determine the maximum amount you may contribute to your 403(b) account see: www.irs.gov/publications/p571/ch02.html.

For more information: www.irs.gov

We're here to help! [Contact Sentinel Benefits & Financial Group](#) for the guidance you need.

This article is not intended to be exhaustive nor should any discussion be construed as legal or financial advice.

