403(B) PLANS - WAVE OF FUTURE FOR MANY WORKERS

Millions of new teachers and health-care workers expected to be hired in the coming decade will need to become familiar with a retirement plan they may know little about: the 403(b), commonly called a tax-sheltered annuity.

403(b) plans are salary-deferral plans designed for teachers, college professors, health workers at nonprofit facilities, and employees working for churches and charitable groups. As with 401(k) and similar defined-contribution plans for the private sector, contributions and earnings in a 403(b) are tax deferred.

For 2005, the maximum an employee generally can defer out of pay into the 403(b) is $14,000 ($15,000 in 2006), or up to 100 percent of the employee's compensation for that year, whichever is less. (Some plans may limit contributions to less than these maximum amounts.) Employers can kick in up to another $28,000 as long as the employer and the employee's combined contributions don't exceed 100 percent of the employee's compensation. In 2005, employees 50 and older can make an additional "catch up" contribution of up to $4,000 (indexed annually).

403(b) rules do allow a special additional deferral contribution for workers who have underfunded their plan. If you've worked for the same 403(b) employer for 15 years or more (not necessarily consecutively) and your plan contributions have averaged $5,000 or less annually, you can boost contributions as much as another $3,000 a year. But these special additional contributions cannot exceed a lifetime total of $15,000. Got all that? You may want to see your financial planner or other tax expert to make sure you do it right.

As is the case with individual retirement accounts, and usually with 401(k) plans, the worker typically must begin making minimum taxable withdrawals from the 403(b) account when the worker turns 70 1/2. But from there, 403(b) plans tend to differ from similar private-sector plans.

For one thing, 403(b) plans typically supplement the pension plans that government and nonprofit organizations use, unlike the private sector, where employers rely more on employee-funded plans such as 401(k)s. While it's still important to fund your 403(b) plan as much as possible, because it probably won't be your main source of retirement income, you may want to handle your investment allocations differently than you might a 401(k) plan that is your primary retirement account.

Historically, 403(b) plans have been more restricted in their investment options than 401(k) plans, though that has improved over the years. While still referred to as tax-sheltered annuities, and although annuities still serve as the predominate investment vehicles, many of the 403(b) plans, especially larger ones, now offer mutual funds.

Still, overall, choices can remain limited and 403(b) participants commonly complain about high fees. But some participants have an alternative. Federal law allows participants in 403(b) plans that are not subject to a federal law known as ERISA to shift money out of the plan and into a custodial account at a financial institution of their choice where ideally they'll have lower fees and more investment choices (not individual stocks, however).

But before making such a move, consider several factors.

- Because a custodial alternative is cheaper doesn't mean it's better. Evaluate performance and other services.
- Your plan may not allow a switch even though the law does.
- You may have to pay a surrender fee or exit fee to annuities or mutual funds you're leaving. You and your advisor will have to determine whether it's worth paying the fee to switch.
- You can only move to the custodial account money you've already accumulated in the 403(b); you can't contribute new money to the custodial account. Thus, you may have to leave new contributions in for a while in order to allow time for any surrender fees to shrink.
- Ask your employer to add more or better investment choices with lower fees, so you don't need to switch.

The IRS recently proposed new rules for 403(b) plans. The rules (or modifications of the rules) won't become final until 2006, but in the meantime you can operate as if they're adopted. Several of the rules primarily affect plan administrators, but some will have a direct impact on participants, such as the ability to take loans, the application of certain divorce rules to 403(b) plans, and the transfer of funds to or from 403(b) plans from 401(k)-type plans.

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