

Latest 403(b) & Tax Sheltering Regulations



Educators Financial Services, Inc.
Kent Schutte, President
CFP, CRS, CLU, LUTCF, ChFC

2010

MIN Version

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403(b) & Tax Sheltering Laws
are SO Much Fun...
You're going to LOVE it 😊

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Being Prepared for an IRS Audit

2 Items to consider:

- The IRS/Government wants people to save.
- They also need tax revenue so they must adhere to the maximum limits.

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Benefit/Limitation Issues – Posts Severance Contributions

- Audit steps
 - 5 year non-elective contribution
 - Does the written plan allow?
 - Review for elective deferral option
 - Review union contracts/bargaining agreements
 - Vendor must be listed in the Plan

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Rev. Proc. 2007-71

- Contracts where vendor received no contributions after 01-01-2005
 - Reduced Due Diligence
- Orphan Plans - current employees no longer contributing to vendor
 - Good Faith effort to obtain ISA
 - Audit step – Review documentation

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Issues/Movement of Funds

- Within Current Plan
 - Review written plan for what is allowed
 - Review account records for movement of funds
- Movement to non-payroll slot vendor
 - Audit step-Request Information Sharing Agreement
 - Potential problems-non-Grandfathered 90-24 transfers
- Transfer to or from another plan
 - Audit step
 - Does plan allow
 - Review documentation on the transfers
- Timely transfer to vendors

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Which Plan is Better?

403(b), 457 or 401(a)

- Think about what you want the plan to accomplish
- Keep it simple
- You must do whatever the plan says
- Plan for flexibility
- 403(b) plan can be paired with other plans to resolve specific problems
- There is no “one best plan” for all situations

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Where Does 457(b) Fit?

- Often used by public education employers to “double the deferral opportunity”
- Often aimed at “short-term” employees for pre-retirement use (no 10% IRS penalty tax when separate from service)
- Generally, not used by public education employers needing to make employer contributions

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Compliance Challenges with Multiple Plans

- Hardship withdrawals must be coordinated among plans
- Rules for hardship withdrawals are different
 - 457(b) requires “unforeseen” emergency; 403(b) & 401(k) do not
 - 403(b) more difficult to qualify
- The challenge: Not everyone understands those differences!
- Solution: Permit hardship withdrawals from only one of the plans (i.e. 457)

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Compliance Challenges with Multiple Plans

- Single loan limit for *all* plans of the employer; monitoring among plans is a challenge
- Issues with new loan & outstanding defaulted loan in any of the plans (for employers not permitting payroll deducted repayment of new loan)
- Solution: permit loans in only one of the plans (i.e. 403(b))

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Detail on Aggregation of 415(c) Limit Within Employer's Plans

- Employer sponsors 401(a) defined contribution plan and 403(b)
- Two \$49,000 limits (no aggregation)
- CAUTION: 401(a) should require substantial and recurring deposits

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Other Aggregation Concerns

- Must aggregate with other 403(b) employer plans
- IF 403(b) participant owns 50% or more of an "outside" business:
 - The outside business retirement plan limit (SEP, 401(k)) is coordinated with the 403(b) limit
- Examples: Private consulting practice, painting, construction, real estate self-employment income

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Optional Features

■ Catch Up Contributions

- Consider not allowing 15 years catch up provision
 - Simplifies administration/costs
 - No ordering rule (law requires use of Age 50 Catch-up first)
 - No record retention for contribution averaging purposes during employment (must average less than \$5,000/yr)
 - Minimal impact
 - Few employees utilize feature
 - Most employers do not have data to calculate properly
 - When all parties understand how the catch up really works, most are willing to drop from the plan

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Optional Features

■ In-service access to accounts

- Age 59 ½
- Mandatory distributions of accounts with small balances
- Unrestricted distributions from rollover accounts

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First thing to remember – The IRS Wants Participation

Audit Steps/Records

■ Universal Availability (“UA”)

- Review written plan provisions
- Detailed review of internal control to identify exclusions
 - work less than 20 hrs/wk & contribute less than \$200/year
- Review of payroll records and HR records

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Why are Universal Eligibility and Meaningful Notice so important?

Could it have something to do with Social Security Income and DB Plans?

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Why is Social Security Income a Big Deal?

- People expect it
- People need it

What could change this dependence?

- Induce saving on their own
- Awareness of what is available and how to save

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Employee's Perspective

- Employees don't have the time or inclination to become investment educated
- Surveys continually reinforce employee's desire for effective investment advice
- Leading employees to plan and investment information online has not been successful
- Employees respond when information is proactively delivered to them
- The majority of employees want it done for them

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Annual Meaningful Notice Alternative

Provide a more effective
Meaningful Notice

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Net Effect of 403(b) Pre-tax contribution

Jane /John Educator
\$36,000 Annual Salary
Monthly Net Effect of investing 10%

	Pre-tax Contribution	No Contribution
Gross Income	3,000	3,000
403(b) / 401(k)	-300	-0
Taxable Income	2,700	3,000
Social Security	229	229
Employer Pension	165	165
Federal Tax	311	359
State Tax	143	160
Net Take Home Pay	1,852	2,087

Net Difference \$235.00/Month

Reward: A \$300.00/Month investment costs you \$235.00/Month

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YEAR	SALARY	AMOUNT	ANNUAL	TOTAL	VALUE @	WITH	VALUE @	WITH
NUM	3%	PER MO	CONT	CONT	6%	MATCH	9%	MATCH
1	\$ 38,000.00	\$ 3,000.00	\$ 3,600.00	\$ 3,600.00	\$ 3,719.17	\$ 7,438.34	\$ 3,780.42	\$ 7,560.84
2	\$ 37,080.00	\$ 3,000.00	\$ 3,600.00	\$ 7,200.00	\$ 7,661.49	\$ 15,322.99	\$ 7,601.07	\$ 15,202.15
3	\$ 36,160.00	\$ 3,000.00	\$ 3,600.00	\$ 10,800.00	\$ 11,040.35	\$ 22,080.71	\$ 11,392.59	\$ 22,785.18
4	\$ 35,240.00	\$ 3,000.00	\$ 3,600.00	\$ 14,400.00	\$ 16,269.95	\$ 32,539.90	\$ 17,288.34	\$ 34,576.68
5	\$ 34,320.00	\$ 3,000.00	\$ 3,600.00	\$ 18,000.00	\$ 20,965.32	\$ 41,930.64	\$ 22,624.71	\$ 45,249.42
6	\$ 41,733.87	\$ 3,000.00	\$ 3,600.00	\$ 21,600.00	\$ 25,942.41	\$ 51,884.82	\$ 28,441.35	\$ 56,887.70
7	\$ 42,855.88	\$ 3,000.00	\$ 3,600.00	\$ 25,200.00	\$ 31,218.13	\$ 62,436.25	\$ 34,781.49	\$ 69,567.98
8	\$ 44,275.46	\$ 3,000.00	\$ 3,600.00	\$ 28,800.00	\$ 36,810.39	\$ 73,620.77	\$ 41,692.24	\$ 83,384.48
9	\$ 45,603.72	\$ 3,000.00	\$ 3,600.00	\$ 32,400.00	\$ 42,738.18	\$ 85,476.36	\$ 49,224.98	\$ 98,449.92
10	\$ 46,971.83	\$ 3,000.00	\$ 3,600.00	\$ 36,000.00	\$ 49,021.64	\$ 98,043.29	\$ 57,435.62	\$ 114,871.25
11	\$ 48,380.88	\$ 3,000.00	\$ 3,600.00	\$ 39,600.00	\$ 55,682.11	\$ 111,364.23	\$ 66,385.25	\$ 132,770.50
12	\$ 49,832.40	\$ 3,000.00	\$ 3,600.00	\$ 43,200.00	\$ 62,742.21	\$ 125,494.43	\$ 75,140.34	\$ 152,290.68
13	\$ 51,327.39	\$ 3,000.00	\$ 3,600.00	\$ 46,800.00	\$ 70,225.92	\$ 140,451.84	\$ 84,773.39	\$ 173,546.78
14	\$ 52,867.21	\$ 3,000.00	\$ 3,600.00	\$ 50,400.00	\$ 78,138.65	\$ 156,277.29	\$ 95,393.41	\$ 196,728.82
15	\$ 54,453.03	\$ 3,000.00	\$ 3,600.00	\$ 54,000.00	\$ 86,597.34	\$ 173,134.67	\$ 107,099.34	\$ 222,195.07
16	\$ 56,088.83	\$ 3,000.00	\$ 3,600.00	\$ 57,600.00	\$ 95,480.55	\$ 190,961.10	\$ 120,768.64	\$ 249,533.28
17	\$ 57,769.43	\$ 3,000.00	\$ 3,600.00	\$ 61,200.00	\$ 104,828.55	\$ 209,657.11	\$ 135,776.06	\$ 279,582.17
18	\$ 59,502.51	\$ 3,000.00	\$ 3,600.00	\$ 64,800.00	\$ 114,683.44	\$ 229,369.88	\$ 151,136.32	\$ 312,772.64
19	\$ 61,287.59	\$ 3,000.00	\$ 3,600.00	\$ 68,400.00	\$ 125,059.22	\$ 251,118.44	\$ 173,969.01	\$ 347,938.01
20	\$ 63,126.22	\$ 3,000.00	\$ 3,600.00	\$ 72,000.00	\$ 136,811.04	\$ 273,623.89	\$ 193,406.64	\$ 396,813.27
21	\$ 65,020.00	\$ 3,000.00	\$ 3,600.00	\$ 75,600.00	\$ 148,739.83	\$ 297,479.66	\$ 214,560.65	\$ 449,181.20
22	\$ 66,970.60	\$ 3,000.00	\$ 3,600.00	\$ 79,200.00	\$ 161,383.39	\$ 322,766.79	\$ 237,687.50	\$ 475,375.00
23	\$ 68,979.72	\$ 3,000.00	\$ 3,600.00	\$ 82,800.00	\$ 174,783.57	\$ 349,571.14	\$ 262,859.19	\$ 525,718.58
24	\$ 71,049.11	\$ 3,000.00	\$ 3,600.00	\$ 86,400.00	\$ 188,991.88	\$ 377,983.75	\$ 290,297.58	\$ 580,585.15
25	\$ 73,180.59	\$ 3,000.00	\$ 3,600.00	\$ 90,000.00	\$ 204,050.56	\$ 408,101.12	\$ 320,204.79	\$ 640,469.58
26	\$ 75,376.01	\$ 3,000.00	\$ 3,600.00	\$ 93,600.00	\$ 220,012.77	\$ 440,025.53	\$ 352,803.64	\$ 705,607.29
27	\$ 77,637.59	\$ 3,000.00	\$ 3,600.00	\$ 97,200.00	\$ 236,832.70	\$ 473,855.41	\$ 388,336.38	\$ 775,872.77
28	\$ 79,966.40	\$ 3,000.00	\$ 3,600.00	\$ 100,800.00	\$ 254,467.84	\$ 509,735.68	\$ 427,067.08	\$ 854,134.16
29	\$ 82,365.40	\$ 3,000.00	\$ 3,600.00	\$ 104,400.00	\$ 272,879.08	\$ 547,756.16	\$ 469,283.53	\$ 936,597.07
30	\$ 84,836.59	\$ 3,000.00	\$ 3,600.00	\$ 108,000.00	\$ 293,031.00	\$ 589,051.89	\$ 515,295.47	\$ 1,024,888.94
31	\$ 87,381.45	\$ 3,000.00	\$ 3,600.00	\$ 111,600.00	\$ 315,352.03	\$ 633,784.06	\$ 565,458.84	\$ 1,120,913.69
32	\$ 90,002.08	\$ 3,000.00	\$ 3,600.00	\$ 115,200.00	\$ 338,024.72	\$ 679,059.45	\$ 620,126.57	\$ 1,240,236.75
33	\$ 92,702.93	\$ 3,000.00	\$ 3,600.00	\$ 118,800.00	\$ 362,035.98	\$ 724,071.96	\$ 677,720.34	\$ 1,379,443.69

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It Was the Best of Times, It Was the Worst of Times

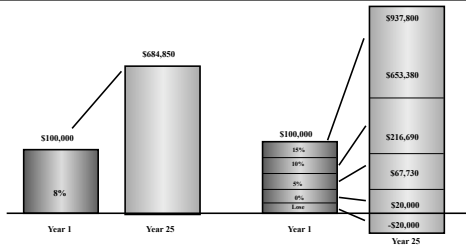
The chart below shows the importance of keeping your portfolio investments in many different asset classes. This diversification may help you reduce the volatility that is associated with investments in individual investment categories.

1986 - 2009	Cash	Bonds	Large Stocks	Mid Stocks	Small Stocks	Int'l Stocks	Annual Inflation
Dec86	7.4%	22.1	32.2	32.0	31.1	36.4	3.8
Dec86	6.3%	15.3	18.2	18.2	5.4	62.9	1.1
Dec87	5.5%	2.8	8.2	0.2	(8.8)	24.9	4.4
Dec88	6.3%	7.9	18.8	19.8	24.9	28.6	4.4
Dec89	8.4%	14.5	31.5	26.3	16.2	10.8	4.6
Dec90	7.8%	9.0	(3.2)	(11.5)	(19.5)	(22.2)	6.1
Dec91	5.6%	19.4	30.5	41.5	46.1	14.9	3.1
Dec92	3.5%	7.4	7.7	16.3	18.4	(11.9)	2.9
Dec93	2.4%	9.8	10.0	14.3	18.9	24.2	2.7
Dec94	3.5%	(2.9)	1.3	(2.1)	(1.8)	8.1	2.7
Dec95	5.6%	15.5	37.4	34.5	28.4	11.6	2.5
Dec96	5.3%	3.8	24.1	19.0	18.5	5.4	3.3
Dec97	5.5%	9.7	33.4	29.0	22.4	6.1	1.7
Dec98	5.4%	10.7	29.6	10.1	(2.4)	20.3	1.8
Dec99	5.3%	10.1	21.0	15.6	12.4	26.2	2.6
Dec00	6.3%	11.6	(8.1)	8.2	(3.8)	(6.4)	3.4
Dec01	3.8%	8.4	(11.8)	(6.6)	2.8	(17.5)	1.6
Dec02	1.7%	10.2	(16.8)	(12.8)	(20.6)	(25.1)	2.6
Dec03	1.4%	4.10	28.68	34.59	37.26	38.6	1.0
Dec04	3.4%	4.94	11.87	16.41	19.29	20.25	2.66
Dec05	3.3%	7.43	4.91	12.65	4.56	13.53	3.4
Dec06	5.0%	4.23	15.79	19.26	18.37	26.34	2.6
Dec07	6.7%	6.97	5.49	5.60	(1.57)	11.17	4.08
Dec08	2.4%	5.24	(37.00)	(41.46)	(33.79)	(41.38)	0.09
Dec09	0.1%	5.31	18.47	16.48	14.47	11.78	-0.4
Avg. Return	4.8%	8.68	12.5	13.5	11.1	12.9	2.7

Indices are the returns of market performance. Indices are the returns of the market. Indices are the returns of the market.

Indices used to represent these markets are as follows: Short-Term Rates - 30-Day US Govt. T-Bill Average (Federal Reserve Statistical Release); for Bonds, the Barclays US Aggregate Bond Index; for Large Cap Stocks, the S&P 500 Index; for Mid Cap Stocks, the Russell Mid Cap Index; for Small Cap Stocks, the Russell 2000 Index; and for International Stocks, the Morgan Stanley EAFE Index (EAFE from the Citicorp Chart)

The Power Of Diversification As An Investment Strategy



Q: With \$ 100,000 to invest for 25 years -- Are you better off with an account with a fixed 8% return than if you split it into 5 pools of \$ 20,000 each and diversify?

A: Diversify -- Even if you lose one of the \$ 20,000 pools entirely, make nothing on another, make only 5% on the third, make 10% on the fourth and 15% on the fifth.

Even in this example, where 40% of the overall portfolio is earning less than 5%, you are 37% better off after 25 years.
Diversification does not guarantee a profit or protect against loss.

Rule of 90 Benefit (Member's Age 57 Years - 0 Months)

Final Salary \$3,000 Monthly
High-5 Average \$3,000 Monthly
Service 33 Years

Regular Monthly Schedule

- Single Life = \$1,533
- 25% Survivorship = \$1,494*
- 50% Survivorship = \$1,410*
- 75% Survivorship = \$1,349*
- 100% Survivorship = \$1,303*

*Member & Beneficiary Both Age 57

**These amounts do not include any past retirement benefit increases.

* Please see Disclosures

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Rule of 90 Benefit	
<i>(Comparison to Final Salary prior to age 62)</i>	
INCOME REPLACEMENT SUMMARY	
<i>(With Employer Paid Retiree Medical Insurance)</i>	
▪ PERA 100% Survivorship	\$ 1,303
▪ Married "0" Federal Tax @ 12.2%	-133
▪ Married "0" State Tax @ 5.6%	-58
▪ Net	\$ 1,113
PERA BENEFIT COMPARED TO FINAL SALARY	
▪ Net Pay	\$ 1,113
▪ Net Final Salary	\$ 1,852 =64%
INCOME REPLACEMENT SUMMARY	
<i>(Without Employer Paid Retiree Medical Insurance)</i>	
▪ Net	\$ 1,113
▪ Assumed Medical Insurance Monthly Premium	-600
▪ Net Spendable	\$ 513
PERA BENEFIT COMPARED TO FINAL SALARY	
▪ Net Pay	\$ 513
▪ Net Final Salary	\$ 1,852 =28%
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<small>* Please see Disclosures</small>	

Rule of 90 Benefit	
<i>(Comparison to Final Salary after age 62)</i>	
INCOME REPLACEMENT SUMMARY	
▪ Social Security Benefit	\$ 928
▪ Taxable Amount Including PERA	\$ 2,231
▪ Married "0" Federal Tax @ 12.2%	-228
▪ Married "0" State Tax @ 5.6%	-98
▪ Net	\$ 1,905
INCOME REPLACEMENT SUMMARY	
<i>(Without Employer Paid Retiree Medical Insurance)</i>	
▪ Net	\$ 1,905
▪ Medical Expense	\$ 600
▪ Net Spendable	\$ 1,305
PERA BENEFIT COMPARED TO FINAL SALARY	
▪ Net Pay	\$ 1,305 =71%
▪ Net Final Salary	\$ 1,852
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<small>* Please see Disclosures</small>	

How Much Do You Need to Maintain Your Standard of Living?	
Assumption:	
\$200,000 will generate \$1,000 of monthly income	
Net Final Salary	\$1,852
Net PERA Prior 62	\$ 513
Difference Needed to Maintain Standard of Living	\$1,339
To generate \$1,339/month you would need an approximate minimum of \$267,800	
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PERA'S FIVE PAYOUT OPTIONS

Option	Feature	Monthly Amount		
Single Life	with Guaranteed Refund	\$2,000		
Life and 25%	25% to Survivor	⁽¹⁾ 1900	⁽²⁾ 1880	⁽³⁾ 1920
		475*	470*	480*
Life and 50%	50% to Survivor	1820	1780	1860
		910*	890*	930*
Life and 75%	75% to Survivor	1740	1680	1780
		1305*	1260*	1335*
Life and 100%	100% to Survivor	1660	1580	1720
		1660*	1580*	1720*

Guaranteed refund means that if you die before receiving benefits in an amount equal to your contributions, the balance will be paid to your beneficiary(ies).

- (1) Member & beneficiary both age 60
- (2) Member age 60 – Beneficiary age 55
- (3) Member age 60 – Beneficiary age 65

*Benefit to survivor

Note: If you choose 25%, 50%, 75% or 100% options and your beneficiary dies before you, your remaining life time payments revert to the amount payable for your single life benefit. Also, the guaranteed refund clause applies if both you and your beneficiary die before your contributions are paid out in full.

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MN Match Rules

■ Previous Law

- Dollar for dollar, Employer Contribution, not to exceed \$2,000

■ Effective August 1st, 2008 New Law Increases Employer Contribution Limit

- Dollar for dollar not to exceed 50% of elective deferral limits

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MN Match 2010 Limits

Example:

	Elective Deferral (Employee Max Amounts)	Employer Match
Basic	\$16,500	\$8,250
Age 50 Catch-Up	\$5,500	\$2,750
Total	\$22,000	\$11,000

If qualifications are met, 15-Year Catch-up may apply for an additional \$3,000 elective deferral, \$1,500 employer match

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“Right to Bargain Vendors”

The identity and number of the available vendors under federal Internal Revenue Code section 403(b) is a term and condition of employment under section 179A.03.

When considering vendors, the school district and the exclusive Representative of the employees shall consider the following:

- Vendor's ability to comply with all employer requirements
- Vendor's experience
- Vendor's potential effectiveness in providing client services
- Nature and extent, suitability and vendor's ability to provide the rights and benefits
- Vendor's financial stability

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Frequently Asked 403(b) Questions & Answers

- Are there any legal requirements such as a required employee contribution?
 - Yes, must be dollar for dollar up to specified limit. (MN 356.24)
- Are there lifetime maximums?
 - No for IRS or State; however, common in some bargaining agreements.
- Are there special considerations at termination?
 - \$49,000 limit & available for 5 post-retirement years.
- How does this differ from a severance payment made to an EE & a corresponding TSA?
 - FICA Tax would apply if paid to EE as compensation; FICA Tax does not apply if payment goes direct to TSA Company.
- When are payments subject or not subject to FICA?
 - If choice of type of payment, FICA is applicable. If no choice, considered benefit and FICA does not apply.
- Must the Match go to the same company as EE contribution?
 - No.

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Thank You

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763-689-9023.

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