



## Introducing the Roth 403(b)


TIAA-CREF Administrator Workshop

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For Plan Administrator Use only, not for distribution to participants.


### Interest in Roth is growing

*Media attention has likely been a factor increasing employee and employer interest.*

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### An exciting savings option for your retirement plan


- Benefits for you and your employees
  - Offered in direct response to the retirement plan management needs of our clients
  - An innovative retirement planning solution for many individuals

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### Overview: Roth 403(b) & 401(k) basics


- Contributions made on an after-tax basis
- Allow higher contributions than the Roth IRA
- Provide additional flexibility in planning retirement income by protecting against higher future tax rates
- Qualified\* distributions are 100% tax-free


\*Qualified distributions are generally made after age 59 1/2, and at least five years after January 1 of the year in which the first Roth contribution was made to the current or a predecessor plan. Unlike the Roth IRA, first-time home purchase is not a qualified distribution. Earnings in nonqualified distributions are subject to tax and potentially a 10% penalty.

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### Today's discussion


- Overview of Roth-style savings
- Who might benefit?
- Legal status clarified
- Plan sponsor considerations
- Participant considerations
- Getting Started



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### Overview: expanding the role of Roth savings

- Since January 1, 2006, 403(b) or 401(k) retirement plans may allow a participant to designate some or all of their retirement plan elective deferrals as an after-tax Roth-style contribution rather than a pretax contribution
- Roth 403(b) and 401(k) plans may be established for employee elective deferrals only

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### Who might benefit?

- Highly paid employees
- Young employees in a low tax bracket
- Individuals who seek to maximize flexibility in drawing their retirement benefits
- Individuals who wish to diversify against potential tax risks associated with pretax savings

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### Who might benefit?

*Example: Same rates*

	Traditional 403(b)	Roth 403(b)
Gross accumulation in 20 years	\$49,711	\$49,711
Net accumulation (after taxes are paid)	\$32,312*	\$49,711

\*Investor saves an additional \$5,425 in taxes if they contribute \$15,500 before taxes to the Traditional 403(b)

**Savings available for after-tax spending:**  
 Traditional 403(b) = \$43,972\*\*  
 Roth 403(b) = \$49,711

\*\*Value of \$32,312 plus tax savings of \$5,425 invested at 6% for 20 years

Assumptions: Age 45; 35% marginal tax bracket before & after retirement, contribution rate: maximum (\$15,500 in 2007); rate of return: 6% for 20 years

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### Who might benefit?

The anticipated tax bracket a participant will be in during retirement is important in selecting their savings vehicle:

Higher rates → *Roth is generally superior*  
 Same rates → *Depends\**  
 Lower rates → *Traditional is generally superior*

\*If one can not afford to save the maximum allowable contribution, then the Traditional and Roth will end up with the same accumulation. However, if one can save the maximum allowable, the Roth will end up with a larger accumulation at retirement.

**Making the maximum Roth contribution and paying taxes now can result in the largest retirement savings available for after-tax spending**

The New Way To Save More: Roth 403(b) and 401(k) by Michael Heller and Benjamin Goodman from the Winter 2006 edition of Balance (2/22/06) provides information and scenarios on who might benefit.

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### Who might benefit?

- GENERAL RULE:** If you can afford to contribute the annual maximum on an after-tax basis and expect to be in the same or higher tax bracket in retirement, the Roth 403(b) is a better plan. It may be better even if you find yourself in a lower tax bracket.

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### Who might benefit?

	Traditional 403(b)*	Roth 403(b)
Gross accumulation in 20 years	\$21,381	\$16,036
Net accumulation (after taxes are paid)	\$16,036	\$16,036

\*Due to the tax deductibility of the Traditional 403(b), the amount saved in the Traditional 403(b) is \$6,666.67

**What if the tax bracket changes?**

Increases to 35%:  
 - Net accumulation in Traditional 403(b) = \$13,898

Declines to 15%:  
 - Net accumulation in Traditional 403(b) = \$18,174

Assumptions: Age 45; 25% tax bracket; contribution rate is \$5,000 in 2007; rate of return: 6% for 20 years

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### Legal status of Roth clarified

- Proposed regulations were issued in March 2005
- Final regulations were issued in December 2005, and additional proposed regulations covering taxation of Roth distributions were issued in January 2006
- Roth contributions, like many EGTRRA provisions, were subject to the sunset provisions in 2010. The Pension Protection Act of 2006 ended the sunset provision for Roth contributions

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## Contribution Rules: Plan Sponsor

- Plan must be amended to specifically allow Roth contributions
- Roth only plans not permitted
- Employer may continue to offer pretax deferrals, only, or can add Roth as an option
- Contributions are subject to regular withholding requirements – *"included in gross income at the time the employee would have received the contribution"*



13

## Contribution Rules: Employee

- Designation of employee contributions as Roth, must be irrevocable with regard to any contributions already made
  - ♦ Subject to 402(g) limit — \$15,500 in 2007
  - ♦ Allowed for the 414(v) age 50 catch-up — \$5,000 in 2007
  - ♦ Contribution amounts must be combined with all pretax elective deferrals for purposes of 402(g)



16

## Contribution Rules: Plan Sponsor

- Roth contributions treated similarly to pretax contributions for nondiscrimination testing purposes
- Safe harbor plans can allow Roth contributions
- Must be offered to all participants
- Loans and hardship withdrawals may be permitted
  - ♦ Pretax and Roth accumulations are generally aggregated with regard to loans
- Separate accounting



14

## Treatment of excess deferrals

- Before April 15<sup>th</sup>:
  - ♦ Only earnings are taxable
- After April 15<sup>th</sup>:
  - ♦ Earnings and contributions are taxable
  - ♦ Results in double taxation on Roth contributions
  - ♦ Participant who makes both pretax and Roth contributions can decide which to have refunded



17

## Contributions Rules: Plan Sponsor

- \$15,500 with a \$5,000 catch-up for individuals age 50 or older in 2007
- 100% vested
- Employer can match voluntary employee contributions
  - ♦ Must be accounted for separately from pretax amounts
- Only voluntary contributions made by the participant can be Roth contributions
- Employer matching and mandatory contributions cannot be Roth contributions



15

## Roth distributions

- Distributions are available for the following events:
  - ♦ Termination of employment
  - ♦ Death
  - ♦ Disability
  - ♦ Attaining age 59½ (if plan allows)
  - ♦ Hardship (if plan allows)
- Distributions of Roth contributions are always tax free except, in the case of a post April 15 distribution of an excess deferral
- Distributions of Roth earnings are taxable and potentially subject to penalty unless, they meet "qualified distribution" requirements




18

### Qualified distributions

- Distributions from Roth 401(k) or 403(b) plans are completely nontaxable to participants if they are made after both:
  - The "nonexclusion period"
    - at least five years after January 1 of the year in which the first Roth contribution was made to the plan (or to a prior plan in case of a roll over)
  - And one of the following three events:
    - age 59½, or
    - the participant's death; or
    - pursuant to the participant's disability

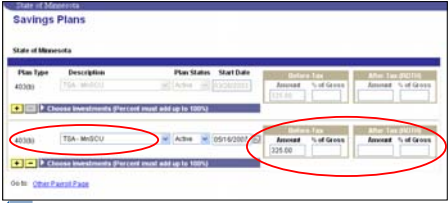

*Unlike the Roth IRA, first-time home purchase is not a "qualified distribution."*



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### MnSCU TSA Plan: How to Enroll


- Participants already enrolled in the Tax Sheltered Annuity (TSA) need only to elect the contribution amount on the MnSCU Employee Self Service website.
- Participants enrolling in the plan for the first time need to complete a TIAA-CREF enrollment via [www.tiaa-cref.org/mnscu](http://www.tiaa-cref.org/mnscu) AND elect the contribution amount on the MnSCU Employee Self Service website.

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### Nonqualified distributions


- If earnings are withdrawn and they do not meet "qualified distribution" requirements, they will generally be subject to federal and state tax, and potentially, a 10% penalty
- Amounts distributed prior to age 59½ due to termination of employment, hardship, or plan termination, would not be considered qualified distributions unless the participant was disabled



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### TIAA-CREF Communication Plan: Plan Participants


- TIAA-CREF will provide information to educate participants through:
  - One Page Announcement Flyer distributed via MnSCU Retirement List Service
  - FES Seminars and one-on-one counseling
  - MnSCU and TIAA-CREF web portals
  - Telephone Counseling Center at 800 682-8969, Monday through Friday from 8 a.m. to 5 p.m. (CT)



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### Rollover options with Roth

- Roth accumulations can be rolled over to or from another plan that allows Roth savings, or to, *but not from*, a Roth IRA
- Separate accounting and tax cost basis tracking and reporting must be established for the Roth contributions
- Like traditional, pretax contributions, Roth contributions are subject to the required minimum distribution (MDO) rules
- Participants can roll over their Roth 403(b)/401(k) into a Roth IRA, which does not have a minimum distribution requirement
- Avoiding MDO can be a valuable estate planning tool for highly paid employees



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