

Salary Reduction Plans

If you want to diversify your retirement fund investments, 401(k)s, 403(b)s, and 457 plans are the right vehicles.

Salary reduction plans are the best-known type of defined contribution plan. And they continue to grow in popularity as more employers offer them and more workers recognize the advantages of making tax-deferred investments when they have the chance.

The 401(k)s, 403(b)s, and 457s—their catchy names are the sections of the tax code that describe them—are also increasingly popular because they are sometimes the only game in town—or at least the only way many employees can participate in a retirement plan.

HOW SALARY REDUCTION WORKS

You invest in a salary reduction plan by having a percentage of your salary deposited in your plan account. The amount you deposit is deferred—it does not count as part of your taxable income for that year.

Employers who offer salary reduction (or salary deferral) plans arrange for you to invest your money in different fixed income, equity, or money market accounts. You choose among the options, and you may pay the costs of investing,

WHEN A 403(b) IS NOT A 403(b)

If you work for a nonprofit organization, you may not recognize the name 403(b), even if you're participating in one. Salary reduction plans are frequently known by other names, including TDAs, tax shelters, and savings plans, especially when they're offered as supplements to defined benefit plans.

such as administrative fees. But you do not have to pay any tax on your contributions to these funds or their earnings until you withdraw from the account.

A Double Plus

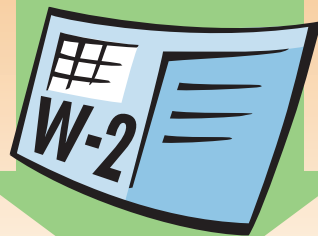
The double advantage of tax-deferred plans is saving on your tax bill and investing for retirement

The more money you put in a 401(k) plan...



WITH A 401(k) PLAN you save on taxes while you invest for retirement

the lower your taxable salary...



\$ 75,000	Salary
- 6,000	401(k) investment
= \$ 69,000	Reported income*

WITHOUT A 401(k) PLAN you pay more in tax and you must set aside savings from after-tax income

\$ 75,000	Salary
- 0	401(k) investment
= \$ 75,000	Reported income*

* Before deductions and exemptions

at the same time. For example, if you're single, make \$75,000, and put 8% of your salary in a salary reduction plan, you'll pay less in federal income taxes, and you'll have \$6,000 growing tax-deferred.

the less tax you pay...



\$11,756 Taxes on \$60,800**

\$13,258 Taxes on \$66,800**

** Tax at 2006 rates, single taxpayer, including personal exemption and the standard deduction.

and the greater your earnings potential



\$6,000 earning 8% tax deferred will grow to about \$7,560 after 3 years, and about \$12,960 after 10 years

No tax-deferred investment and more tax due

WHAT YOU CAN CONTRIBUTE

The maximum amount you can contribute to a salary reduction plan is set each year by Congress and your employer. The IRS caps the dollar amount, while your employer may impose a restriction based on a percentage of your salary.

For 2006, the government allows you to defer up to \$15,000 in a 401(k), 403(b), or 457 plan, and up to \$10,000 in a SIMPLE plan. Since 2002, people 50 and over can also make catch-up contributions designed to boost their account values and provide the potential for greater retirement income. In 2006, you can put an additional \$5,000 in a 401(k), 403(b), or 457, and \$2,500 in a SIMPLE.

A TAX-FREE 401(K)

Employers may offer a Roth 401(k) as part of their retirement savings plan. If you choose to defer salary into the Roth 401(k), your contribution is taxable. But your earnings and eventual withdrawals are tax exempt, provided you're at least 59½ and your account has been open at least five years when you take the money out.

That's the trade-off: You'll pay more income tax now in order to pay none later. On the other hand, the potential for tax-free income combined with the flexibility of being able to roll over your Roth 401(k) to a Roth IRA when you retire or change jobs is very attractive. Plus, there's no income ceiling limiting an employee's ability to choose this option as there is with a Roth IRA.