# 403(b) vs. 457(b): Which is better for you?

Or choose both and possibly save twice as much a year – tax deferred



## What's the difference?

| 403(b) | 457(b) |
|---|---|
| **Key difference:** It's easier to access your funds while you are employed by the plan sponsor. | **Key difference:** You are not subject to the 10% federal early withdrawal tax penalty once you leave the plan sponsor. |

| Here's why: | |
|---|---|
| Less stringent withdrawal restrictions while you are employed, but a 10% federal early withdrawal tax penalty might apply. | More stringent withdrawal restrictions while you are employed, but no 10% federal early withdrawal tax penalty after severance from employment [except in the case of rollovers from non-457(b) plans, including IRAs]. |
| Generally withdrawals made prior to severance from employment or the year you reach age 59½ can only be made due to financial hardship. | Generally withdrawals made prior to severance from employment or the year in which you reach age 70½ can only be made for an unforeseeable emergency. |
| A financial hardship withdrawal is considered less restrictive — while you are employed — than a 457(b) unforeseeable emergency. Examples of financial hardship include:<br>• Unreimbursed medical expenses<br>• Payments to purchase a principal residence<br>• Higher education expenses<br>• Payments to prevent eviction or foreclosure of a mortgage | An unforeseeable emergency is more restrictive — while you are employed — than a 403(b) financial hardship. Some examples:<br>• A sudden and unexpected illness or accident for you or a dependent<br>• Loss of your property due to casualty<br>• Other similar extraordinary circumstances arising as a result of events beyond your control<br>Sending a child to college or purchasing a home, two common reasons for 403(b) hardship withdrawals, generally are not considered unforeseeable emergencies |
| Withdrawals can be subject to a 10% federal early withdrawal tax penalty prior to age 59½. | The 10% federal early withdrawal tax penalty, generally applicable to distributions prior to age 59½ from a 403(b) plan, does not apply to distributions from 457(b) plans except on amounts rolled into the plan from non-457(b) plans (including IRAs). |

**Visit aig.com/RetirementServices** or contact your financial advisor with any questions.



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# Important Information about the SECURE Act

The Setting Every Community Up for Retirement Enhancement Act, commonly referred to as the "SECURE Act," was signed into law in December 2019, as part of the Further Consolidated Appropriations Act, 2020 ("the Act").The SECURE Act portion of the Act may be relevant to you because it contains multiple provisions that impact employer retirement plan accounts and Individual Retirement Accounts (IRAs). Many of the provisions became effective as of January 1, 2020.

While **we cannot provide tax or legal advice**—and this communication is not intended to be either tax or legal advice—we want to inform you of some provisions in this recent legislation.

**The rules around taking Required Minimum Distributions (RMDs) from an employer's retirement plan or IRA changed on January 1, 2020.**

If a plan participant or IRA owner's birthday is on or after July 1, 1949, their age for starting RMDs will be age 72, not age 70½. If the IRA owner or participant was born before July 1, 1949, their age for starting RMDs remains at 70½.

It is important to remember that in the case of an IRA, this age, as applied to the individual, is the latest age at which minimum withdrawals must begin. Individuals may begin taking withdrawals prior to that age, subject to the terms of the IRA and the investment arrangement.

Also keep in mind that, for accounts inside an employer's retirement plan, unless an individual is a 5% owner of the employer, their RMDs are required to begin upon the later of:

- Attainment of the specified age (either 70½ or 72) or
- Retirement from the employer sponsoring the plan.

**The rules for distributions to a beneficiary following the plan participant or IRA owner's death have changed.**

Rather than allowing all individuals who are designated beneficiaries to take their payments over their life expectancy (sometimes referred to as a "stretch" payout), the period over which payments may be made to many of these beneficiaries will be limited to 10 years. This limit will not apply to post-death distributions to:

- A surviving spouse
- The account holder's minor child until age of majority
- A chronically ill or disabled beneficiary
- A beneficiary who is not more than 10 years younger than the account holder

The rule for a beneficiary who does not qualify as a "designated beneficiary" has not changed; if the account holder dies before RMDs have begun, those distributions will be required within five years following the plan participant or IRA owner's death.

These changes generally went into effect January 1, 2020, for most plans and IRAs that were already subject to the existing distribution requirements. However, a later effective date of January 1, 2022 applies to certain collectively bargained and/or governmental plans. Additionally, certain existing beneficiary arrangements are excluded from the changes. Those generally include annuitized contracts and other annuity contracts under which the account holder has made an irrevocable election with respect to the form of beneficiary payout, prior to the date of enactment.

Also, there are special rules for applying these changes if the plan participant or IRA owner died in 2019 or earlier. Finally, it is not clear whether the changes were intended to be applicable to eligible 457(b) deferred compensation plans of private not-for-profit employers.

**There is no longer a maximum age for making an IRA contribution. However, IRA contribution eligibility still requires that the individual have compensation.**

Related to this change, an additional change was made to the rules governing nontaxable direct rollovers to qualified charities, referred to as Qualified Charitable Distributions, or QCDs. The amount of allowable QCDs will be reduced by the amount of any post-70½ pretax IRA contributions.

Under the SECURE Act, certain nontaxable fellowships and stipends provided to graduate students can now be treated as compensation for making IRA contributions. Also, certain healthcare workers will be able to count excludable foster care "difficulty of care" payments as compensation for purposes of making after-tax IRA or retirement plan contributions.

**A provision in the legislation allows penalty-free distributions upon the birth or adoption of a child, referred to as a "qualified birth or adoption distribution," of up to $5,000 from an applicable eligible defined contribution plan or IRA.**

This distribution is not subject to the 10% early withdrawal penalty. In addition, *if the plan permits*, the distribution can be taken even if the individual is not otherwise eligible to receive a distribution from the plan. The legislation also includes provisions to permit a repayment of such a distribution to a plan or IRA. Although this provision went into effect on January 1, 2020, there are still many details to be determined, including:

- What specific actions a plan should take if it decides to allow the distributions, in anticipation of a formal plan amendment
- Whether documentation will be required, or whether the plan or IRA can rely upon the individual's representations
- How the distribution should be tax reported, especially with respect to the exception to the 10% early withdrawal penalty

**The legislation also reduced the earliest permitted distribution age, for in-service distributions, to 59½**, for:

- Eligible governmental 457(b) plans (from age 70½);
- Defined benefit plans (from age 62)
- Money purchase pension plans (from age 62)

The changes are effective for plan years beginning on or after January 1, 2020. However, it is important to note that this is the *earliest* age at which in-service distributions *could be* permitted under the above plans. Plan sponsors will need to determine whether to change the age for in-service distributions (if they are allowed) under their plans.

**For college savings 529 plans,** the legislation also includes a provision that is retroactive to the beginning of 2019 which allows the treatment of certain apprenticeship program expenses and qualified student loan repayments, up to a lifetime limit of $10,000 per individual, as nontaxable distributions.

**For 401(k) plans**, the SECURE Act made the following changes:

- Starting with plan years that begin after December 31, 2020, a 401(k) plan will be required to allow part-time employees with at least 500 hours of service in at least three consecutive 12-month periods (and have reached age 21) to make elective deferrals to the plan. The new requirement generally will not require employer contributions (matching or non-matching) to those individuals, if they did not meet the otherwise applicable eligibility limitations. The provision also provides nondiscrimination, coverage and top-heavy testing relief.
- The automatic enrollment and automatic escalation safe harbor contribution cap is increased from 10% to 15% (except in the first plan year of an employee's automatic enrollment when it still cannot exceed 10%), effective for plan years beginning after December 31, 2019.
- The safe harbor 401(k) plan notice requirement is eliminated if the plan is using nonelective contributions and relaxed the timing and other requirements in certain cases for adopting a nonelective safe harbor plan, effective for plan years beginning after December 31, 2019.

**For small employers,** the legislation raised the annual cap on the available tax credit for small employer plan startup costs and added a new tax credit for small employers adopting auto enrollment, both of which are effective for tax years beginning after December 31, 2019.

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