loans before borrowing from your retirement savings, you might find you need assistance with paying for your children's college educations, etc.

How salary deferrals affect your paycheck

To compute how much your paycheck will be reduced by a salary deferral, you need to know your "marginal tax rate." Your marginal tax rate is the highest percentage of your income that goes to taxes. For example, in 2005, if you are married and filing jointly and your AGI falls between $59,401 and $119,950, your marginal tax rate is 25%. Ask your Legend Advisor for a copy of Legend's *Taxpayer's Guide* to determine your Federal marginal tax rate. In most cases, your salary deferrals will not be subject to your state or local income taxes either.

Lower Your Current Taxes

Federal and most state income taxes are not withheld from the amount you defer.

Paycheck analysis	***No*** **§403(b)plan (after tax)**	**§403(b) plan (pre-tax)**
Gross earnings	$2,000	$2,000
Savings	200	200
Federal withholding	**500**	**450**
State withholding	**100**	**90**
FICA	153	153
Net Pay	**$1047**	**$1107**

Assumes a 5% state and 25% federal tax rate.

This illustration is hypothetical only and does not represent any particular situation.

Once you have determined your marginal tax rate (Federal plus state and local taxes, if applicable), take any proposed contribution dollar amount and multiply it by your marginal tax rate. Subtract this amount from your proposed contribution to determine the actual amount that your paycheck would be reduced. See the chart ***Lower Your Current Taxes*** to compare the effects of saving with pre-tax contributions versus after-tax savings accounts.

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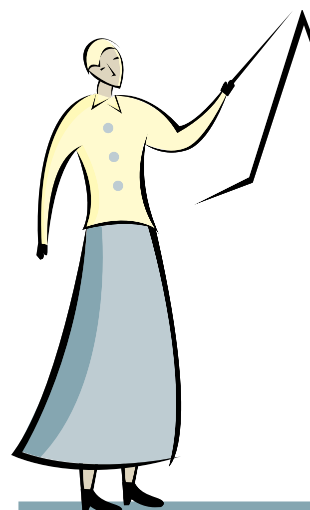
2005 Tax Strategies for Educators



The typical educator may have access to three different types of salary deferral plans: §403(b), §403(b)(7) and §457(b). These plans were designed to give professionals in certain non-profit sectors preferential tax treatment to encourage saving for retirement.

The most popular employer retirement plans are the §403(b) (annuities) and §403(b)(7) (custodial mutual fund accounts). §457(b) Deferred Compensation Plans have recently been gaining in popularity since Congress made it possible for educators to make deferrals to both §403(b) and §457 plans with no coordination of the deferral limits.

Grandfathered §401(k) plans might also be available to some educators. If you are in a public school system where a §401(k) plan was adopted before governmental agencies were precluded from doing so, your school may maintain the plan and new employees may be added.

Educators may also make contributions to a traditional IRA. However, it is possible that you will not qualify to make a tax-deductible contribution if you are an active participant in employer's retirement plan(s).

Most educators can qualify to make Roth IRA contributions. While Roth contributions are not tax deductible, qualified distributions taken from the account (i.e., after age 59½ *and* after holding the Roth IRA for at least 5 years) are tax-free. A single educator must make less than $95,000 to make a full Roth IRA contribution while a married educator's adjusted gross income (AGI) must be less than $150,000. Individuals may also convert traditional IRAs to Roth IRAs if their AGI (not counting the amount being converted) is less than $100,000.

Maximum Allowable Contributions

You can defer up to 100% of your compensation, or the maximum annual contribution amount, whichever is less, to any of these plans. See the contribution limits below.

Contribution Limits

Year	Basic Limit	Over-50 Catch-up*	§403(b) Over-15-Yr Catch-up**	§457(b) Retirement Catch-up***	Max §403(b) Deferral	Max §457(b) Deferral	Max §401(k) Deferral
2003	$12,000	$2,000	$3,000	$12,000	$17,000	$24,000	$14,000
2004	$13,000	$3,000	$3,000	$13,000	$19,000	$26,000	$16,000
2005	$14,000	$4,000	$3,000	$14,000	$21,000	$28,000	$18,000
2006	$15,000	$5,000	$3,000	$15,000	$23,000	$30,000	$20,000

* The Over-50 Catch-up is available to anyone who will attain age 50 in the calendar year the deferrals are being made.

** To qualify for the Over-15-Year Catch-up, the employee must have worked for the same employer (e.g., school district) for 15 years or more and have averaged less than $5,000 in §403(b) plan deferrals over those years of employment.

*** The §457(b) Retirement Catch-up is available in the three (3) years prior to the year the employee attains normal retirement age under the plan and only if the individual has been eligible to defer such amounts in previous years and which s/he has not deferred.

Why should you have a salary deferral account?

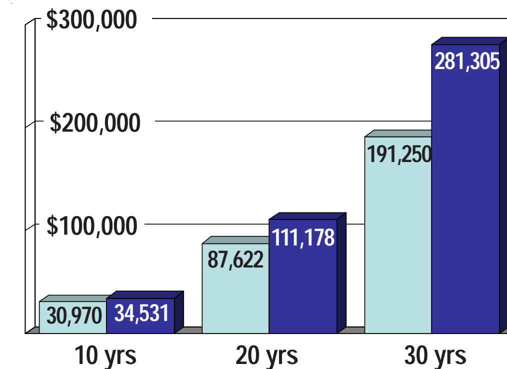
First of all, taxes are deferred from the present to the future when you may be in a lower tax bracket, or, as a retiree, some of your income may be exempt from taxes.

Secondly, your current adjusted gross income (AGI) is lowered. This can be meaningful when you have medical and dental expenses you wish to deduct, or if you have miscellaneous deductions. Your deferrals lower your AGI and therefore help you qualify for greater tax deductions based on percentages of AGI (i.e., medical and dental expenses are not deductible until they exceed 7.5% of AGI and miscellaneous deductions must exceed 2%).

Furthermore, money invested in a tax-deferred account can increase your net worth more rapidly than a traditional savings account. Not only does the deferred salary go into the account before taxes are paid, any growth experienced within the account is also tax-deferred, and those monies remain invested to work for you as well.

Let's examine a monthly contribution of $250 into a tax-deferred §403(b) plan earning 8%, as compared to a taxable investment using a 25% tax rate.

Tax-Deferred Compounding

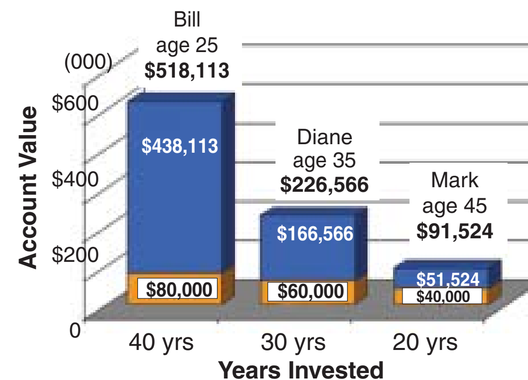


Assumes a $250 monthly contribution earning 8% APR. Illustration is hypothetical only and does not represent any particular investment.

A taxpayer saving in a taxable investment would first have to pay tax on the $250 earmarked for saving, netting only $187.50 for deposit each month. After 10 years, the taxable investment would have grown to $30,970 and the tax-deferred investment earning the same rate of interest would have grown to $34,531 net after taxes. The difference is that in the taxable investment, taxes were paid on **all** of the gains, reducing the end result, whereas in the §403(b) plan program, the funds grew tax-deferred. The ***Tax-Deferred Compounding*** chart illustrates this scenario.

Time Makes a Difference

Three educators each contributed $2,000 a year to the same hypothetical investment earning 8% APR annually until retirement.



Illustrations are hypothetical and do not represent the performance of any specific investment. For illustrative purposes, tax implications have been removed from this scenario.

In the same vein, the amount of time your tax-deferred investment has to grow and compound may make a significant difference in your retirement years. Consider the three educators illustrated in the ***Time Makes a Difference*** chart who began their salary deferrals at different points in their careers. As you can see, Bill should have a much more comfortable retirement.

Lastly, most §403(b) and §403(b)(7) plans offer loan provisions at competitive interest rates. Although you should seek conventional