FRANKLIN TEMPLETON

Retirement Reimagined® | 2020

ADVANTAGES OF A 403(b)(7) ACCOUNT

Key benefits:

Effective way to reduce current taxes while saving for retirement

No special eligibility rules for participation

Full and immediate vesting of all contributions

Who can participate in 403(b)(7) account?

A 403(b)(7) account program is designed for employees of public schools and non-profit organizations exempt under Section 501(c)(3) of the Internal Revenue Code, such as universities, hospitals, churches and libraries.

How do 403(b)(7) accounts work?

Employees own and control their own 403(b)(7) accounts, and they enter into salary reduction agreements with their employer to make pre-tax payroll contributions to them. Contributions and account earnings are not taxed until withdrawal.

Are you a schoolteacher or are you employed by a non-profit organization? If so, ask your employer about 403(b)(7) accounts.

Funded by your own pre-tax contributions, a 403(b)(7) account can be an effective way to invest, save money and plan for your financial future.

Highlights

Eligibility requirements

All employees of an employer sponsoring a 403(b)(7) account program are eligible to contribute.

Investments

A 403(b)(7) account gives the account owner control over his or her investments. Under federal tax law, a 403(b)(7) account can only invest in mutual funds.

Contributions

Employees can make pre-tax voluntary payroll contributions to their own 403(b)(7) accounts:

- Annual pre-tax contributions of up to $19,000 for 2019 and $19,500 for 2020 are permitted.
- If age 50 or older, employees can make additional catch-up contributions of $6,000 for 2019 and $6,500 for 2020.
- Additional contributions may be permitted for employees with at least 15 years of service with certain qualified organizations.

Source: IRS Publication 571 (Rev. January 2019); IR-2018-211 (November 1, 2018); IR-2019-179; IR-Notice 2018-83; IR-2019-178; IR-Notice 2018-211.

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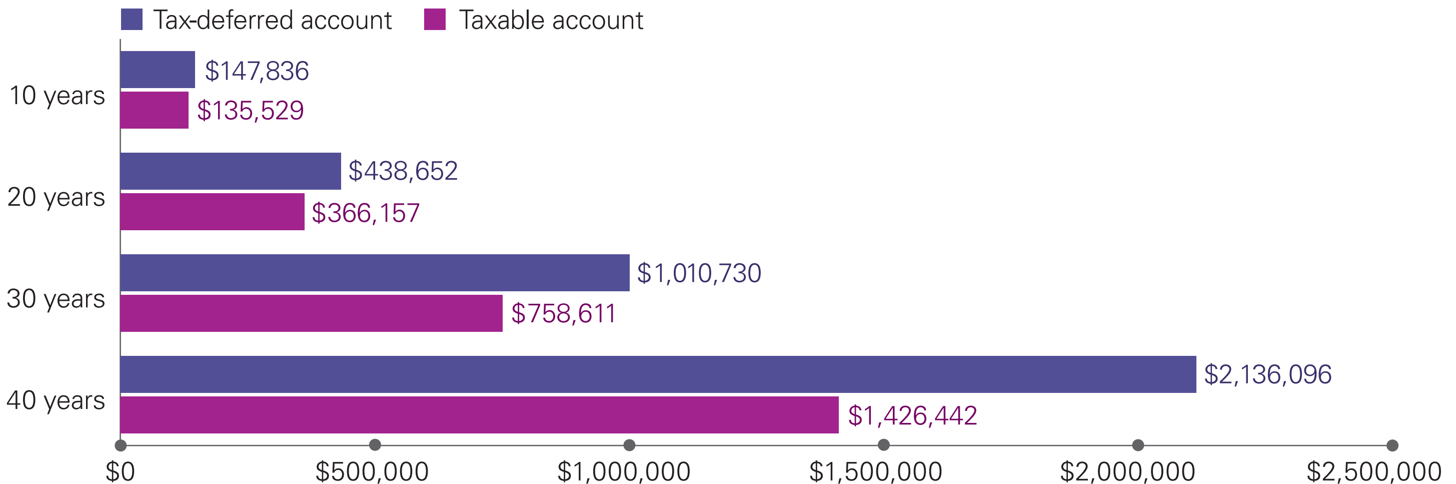
INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

The power of tax-deferred compounding

In a tax-deferred account, you will not pay taxes on your contributions or account earnings until you take withdrawals — which can make a significant difference over time. To understand how much of a difference, consider the following hypothetical illustration:



Source: Legg Mason, 2020. The above illustration assumes a $10,000 annual investment, and a hypothetical annual return rate of 7%, compounded annually over 10-, 20-, 30- and 40-year periods, and does not represent an actual investment. For purposes of the illustration, it has been assumed that the taxable account will generate a combination of long-term capital gains and qualified dividends taxable at a rate of 15% under current federal income tax law,[1] and short-term capital gains and interest taxable as ordinary income (taxable at a rate of 24%), resulting in an annual blended federal tax rate of 22%. This illustration assumes that no distributions are made from the tax-deferred account during or at the end of such period, and that taxes applicable to the taxable account are paid out of such account each year. Actual investments may include fees, charges and other expenses that would affect an investment's return. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. This illustration is not representative of any investment product. Actual returns will vary. The assumed rate of return is not guaranteed. Withdrawals from a tax-deferred account are taxable as ordinary income in the year made, and early withdrawals prior to age 59½ are generally subject to a 10% additional federal tax. The impact of taxes on tax-deferred withdrawals is not reflected in the above illustration. If reflected, such impact would make the accumulation of assets in the tax-deferred account relative to the accumulation of assets in the taxable account look less favorable.

Consider the following hypothetical example

- Annual $10,000 payroll contributions are made to a tax-deferred account. Assuming 40 years of contributions, and a 7% hypothetical return, the tax-deferred account will have a pre-tax value of about $2.1 million at retirement, representing approximately $1.7 million in growth ($2,136,096 pre-tax value minus $400,000 investment amount[2]).
- If the $10,000 is received as current taxable compensation and invested into a taxable account subject each year to a blended 22% federal tax rate, the account would accumulate about only $1.4 million over the same period, that is growth that just exceeds $1,000,000 ($1,426,442 taxable account value minus $400,000 investment amount[2]).
- The growth of the tax-deferred account beats the taxable account by over $700,000 due to the power of tax-deferred compounding. Please note that distributions from a tax-deferred account are taxed as ordinary income in the year made, and early withdrawal prior to age 59½ generally are also subject to a 10% additional federal tax. The impact of such taxes is not reflected in the above illustration.
- Your actual experience will vary depending on your actual investment returns and your specific tax rate (which may be more or less than the figures shown). Capital gains and qualified dividends may receive more favorable tax treatment within a taxable account relative to a tax-deferred account due to the lower rates currently applicable to long-term capital gains and qualified dividends and the fact that all distributions from a tax-deferred account are taxed as ordinary income. You should consider your investment time horizon and tax brackets, both current and anticipated. **All investments involve risk, including possible loss of principal.**

[1] The tax rate on long-term capital gains and qualified dividend income is 20% for high-income taxpayers. Capital gain and dividend income is subject to an additional 3.8% tax on "net investment income" for taxpayers with modified adjusted gross income over $200,000 (single person)/$250,000 (married persons filing jointly).

[2] The $400,000 investment amount was calculated by multiplying the annual $10,000 investment by 40 years. Please note that for the taxable account, in order to be able to invest $400,000 you will have had to earn a higher amount because your investment is made on an after-tax basis.

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