

Your Guide to Tax Deferred Investing

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What is a tax-deferred investment program?

Sections 403(b) and 457 of the Federal Internal Revenue Code authorize tax-deferred investment programs for non-profit organizations. The purposes of a tax-deferred investment program include reducing taxes on current earnings while helping you with a long-range savings plan. It provides an opportunity to supplement other retirement plans while enjoy tax advantages at the same time. Contributions and earnings are not subject to federal or state taxes until you receive your annuity payments or lump sum settlement - usually at retirement, when your income will probably be smaller and taxed at a lower rate.

The pre-tax dollars you invest are totally controlled by you. You determine the amount to invest, up to the maximum limit, and how to invest these dollars among the various investment choices. The amount of retirement income you will receive depends on the amount you invest, the type of investments you select, and the length of time your money is invested.

Consider a theoretical employee earning \$500.00 each pay period. Below is an example of how a \$50.00 tax deferred investment affects this employee's take home pay:

| | ENROLLED | NOT ENROLLED |
|--------------------------------|-----------------|---------------------|
| GROSS PAY | \$500.00 | \$500.00 |
| Local Tax | 13.75 | 13.75 |
| State Tax (5.4% rate assumed) | 24.30 | 27.00 |
| Federal Tax (15% rate assumed) | 67.50 | 75.00 |
| Retirement * | 49.28 | 49.28 |
| Tax Deferred Investment | 50.00 | 0.00 |
| NET PAY | \$295.17 | \$334.97 |

By investing in the TDIP, the take home pay drops by only \$39.80. Therefore, \$10.20 of the investment was funded by decreased taxes.

*9.855% for certified personnel hired prior to July 1, 2008. 10.855 for those hired after July 1, 2008. The rate is 5% for classified personnel.

What kinds of investments are offered?

- ◆ **Fixed Interest Rate** - This type of an account earns interest at a rate that does not change. These annuities are backed by the general assets of the company and are subject to the claims of other creditors.
- ◆ **Variable Rate Account** - May have a different name depending on the company. These accounts are backed by assets set apart from the company's general assets, meaning they are not subject to general creditors if the company goes out of business. These accounts' values change daily with the fluctuations in the value of the stocks, bonds, or other investments in the fund. Variable return accounts may include the following:
 - ◆ **Aggressive Stock Funds:** These funds invest in stocks of new or young companies. Because these companies are typically smaller, these funds will be more volatile, offering greater potential returns with greater risks.
 - ◆ **Stock Growth Funds:** These funds invest in stocks of established companies as well as newer companies, which are expected to increase in value. The goal for these funds is long-term growth of capital.
 - ◆ **Growth and Income Funds:** These are conservative stock funds invested in stocks of companies with an established track record and are still expected to produce a higher stock value and pay regular dividends.
 - ◆ **Combination Funds:** These funds invest in both stocks and bonds as a way to hedge against swings in the investment markets. The goal is to seek high returns through a combination of dividends and interest.
 - ◆ **Bond Funds:** The goal of these funds is to produce a steady level of income. A bond fund could be invested in different types of bonds, i.e., corporate or government. The value of bonds is based on changes in interest rates. Bond values go up as interest rates go down, and vice versa.
 - ◆ **Money Market Funds:** These funds invest in short-term securities such as Treasury Bills, certificates of deposit, and commercial paper issued by corporations. The rates earned are similar to those received on certificates of deposit.

Investment Choices:

Fayette County Public Schools offers its employees investment opportunities with four entities. They were reviewed by the Fayette County Public Schools' benefits committee and William M. Mercer, Inc., with competitive negotiation practices, through a uniform objective criteria evaluation.

They offer a variety of products with different investment objectives designed to meet individual needs.

- ◆ ING Aetna Life Insurance Annuity Company (403b, 457) (800) 451-4702
- ◆ Van Kampen Mutual Funds (403b7) (800) 417-9099
- ◆ AIG (VALIC) (403b, 457) (800) 892-5558

State Agency Benefit:

- ◆ Kentucky Public Employees Deferred Compensation (401k, 457) (800) 542-2667

If you are saving in a conventional savings plan, compare the results of your plan with that of a tax-deferred investment:

The examples contained in this publication are for instructional purposes, only. You should consult your tax advisor concerning your individual situation before embarking on any course of action.

25-Year Illustration of an Annual Savings of \$1,000

| | Conventional Savings | Tax Deferred Investment |
|----------------------------------|-------------------------|----------------------------|
| Investment | \$1,000.00 | \$1,000.00 |
| Taxes (estimated) | 250.00 | 0.00 |
| Net After Taxes | 750.00 | 1,000.00 |
| Total Deposit (over 25 years) | 18,750.00 | 25,000.00 |
| 8% Interest Rate (comp. annual.) | 40,466.00 | 53,954.00 |
| NET RESULT | \$59,216.00 | \$78,954.00 |

Additional amount accumulated by using tax deferred investment plan.

Some Questions and Answers:

◆ **Am I able to participate in this program?**

All regular full and part-time employees of the FCPS System are eligible. You can participate by signing a salary reduction agreement, which allows the school system to place your pre-tax dollars into an investment program with one of the companies on the vendor list.

◆ **How much can I contribute to a tax deferred investment program (TDIP)?**

The law limits the amount you can invest in a TDIP based on a variety of factors, including your employment history and your use of other retirement plans. Most employees are eligible to contribute \$16,500 per plan per year. In order to ensure that you are within the limits, you should meet with your representative for each salary reduction agreement. Fayette County Public Schools requires a minimum amount of \$10 per pay-check.

◆ **Can I stop my contribution or change the amount I contribute?**

Yes. You can stop contributions at any time. Funds continue to accumulate earnings tax-deferred until you withdraw the money. You may resume contributions at any time. You are limited to agreements with two companies from the vendor list. You are no longer limited to one change per year. There is no limit on the number of salary amendment agreements that can be done.

◆ **Can I transfer funds from one account to another?**

Transferring money from one investment fund to another within the company is generally allowable and tax free, but could result in a penalty. Likewise, transferring between companies could result in a penalty and some time delay. Transfer regulations and penalties vary from company to company and fund to fund.

◆ **Is it possible to take out a loan against the balance of my account?**

Loans are permitted by law. Regulations and procedures vary from company to company.

◆ **Can I withdraw money from my account before I retire?**

Withdrawal of 403(b) funds is prohibited except in the case of death, disability, separation from service, attainment of age 59 ½, or financial hardship. If money is withdrawn for one of these reasons it is subject to normal income tax rates. Also, a 10% tax penalty may be imposed by the IRS. Hardship cases are handled differently by each company.

◆ **How will the distributions from my TDIP be taxed?**

You will pay ordinary income taxes on your money in the year in which you receive the money. If this is at retirement, you may be in a lower tax bracket. You have the option of receiving the money in a lump sum or as periodic payments in the form of an annuity.

◆ **May I make additional contributions to "catch up" for the years in which I didn't participate?**

Yes. Current law permits most employees to make additional contributions, in excess of the general limit, as long as your total voluntary contributions for the year do not exceed \$16,500 (if you turn age 50 or older you may contribute up to an additional \$5,500). There are two different catch-up provisions for employees, which may apply and could allow higher contributions.

◆ **What types of fees can I expect to encounter?**

There are several types of fees: Annual fees, management fees, surrender charges, penalties, and commissions. It is very important to understand and consider all fees involved before you invest in a plan. (Maintenance fees are the only fees incurred with the state's Kentucky Public Employees Deferred Compensation.)

◆ **How do I know these companies are reliable and a solid place for my investment funds?**

Four independent rating agencies are recognized as experts in evaluating the strength and stability of investment companies: A.M. Best, Standard & Poor's, Duff & Phelps and Moody's. The financial ratings from these independent agencies for the companies on our list are published and should be available upon request from the agent or at the public library. Also, it's important to look at the performance history of the different funds within a company. This history is available in a company's prospectus.

◆ **When must I begin withdrawing money from my account?**

Distributions from your account must begin no later than April 1 following the calendar year that you reach age 70 1/2.

What do I do now?

This tax-deferred investment program summary plan description is not intended to be a comprehensive guide. You are encouraged to gather as much information as possible so that you can make informed decisions. Ask agents for information on various options, request a prospectus on the different funds, and compare data. Examine the materials closely and ask questions about anything you do not understand. Your Fayette County Public Schools point of contact concerning the tax-deferred investment program is the Office for Employee Services at 381-4118.

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