

Final Pay Plan

Retirement Program For K-12 Public School Districts



MetLife®

Helps Reduce Employer and Retiree Tax Burden

As a public school employer, you may be compensating retirees for some of the vacation, personal-leave, and sick days that they had earned but did not use before severance of employment. We'll call the payment of these funds "final pay."

If an employer pays the final pay as a non-elective contribution to a 403(b) contract or other qualified retirement plan instead of as "cash" wages, the contribution is not considered wages for FICA and Federal income tax purposes. In most states, it also is not considered wages for state income tax purposes.

Employer's Tax Savings

Because an employer pays half of FICA taxes, its tax savings in changing final pay from "cash" wages into a retirement contribution can be up to 7.65% of the final pay involved.

For example, if an employer that would have paid \$1 million directly to retirees instead paid the same \$1 million as retirement contributions, it would save \$76,500 just in the employer's portion of FICA tax withholdings. Could your school budget use that money?

These FICA tax savings are permanent because the non-elective contribution is not and does not become FICA wages.

Retiree's Tax Savings and Deferrals

If a public school retiree's final pay amount were \$25,000, his or her tax-withholding savings could be almost \$9,000. Here's a hypothetical example:

Ruth Smith, who began work in public schools in September 1971, retires at the end of June 2009. The annual-additions limit (combination of employer and employee contributions) on 2009 contributions to a § 403(b) contract is \$49,000. From January 1 to June 30, 2009, Ruth, who is over age 50, made salary-reduction contributions of \$18,000 to her § 403(b) contract. Ruth's final pay is \$25,000. Because \$49,000 minus \$16,500 (the elective-deferral limit) is \$32,500, all of Ruth's final pay will be the employer's non-elective contribution to her § 403(b) contract in 2009. Ruth's tax-withholding savings could be about \$8,930, as shown in the following table:

Tax ^{1,2}	Tax Rate ^{1,2} Final Pay Contribution	Tax-withholding Savings from 403(b) Distribution	Tax on
FICA tax	7.65%	\$1,912.50	zero
Federal income tax	25.00%	\$6,250.00	in the year paid
State tax	3.07%	\$767.50	taxed, partially taxed, or not taxed (see above)
Taxes (total)	35.72%	\$ 8,930.00	

¹ State income tax laws may vary. For example, NJ requires that employer contributions to a post-severance 403(b) arrangement be included in wages for Form W-2. In contrast, PA does not uniformly mandate such inclusion but requires certain conditions in order for the employer contribution to be excluded from Form W-2 wages. Employers, employees and other interested parties should consult with their own tax advisors as to how the various state tax laws apply to their own situations.

² For this example, it is assumed the employee's includible compensation was greater than \$49,000 for the last full year of employment. Hypothetical tax rates are reflected above and may not represent the actual tax rates (or their actual impact, e.g., the beneficial effect of the deduction for state tax on the Federal tax rate) in your particular situation.

The FICA tax savings is permanent because the non-elective contribution is not and does not become FICA wages. Later, a retiree would owe Federal and may owe state income taxes when he or she took distributions from the retirement plan. After severance, an employee may claim a distribution from their § 403(b) contract.

If the funding vehicle were a custodial account investing in shares of regulated investment company stock, distributions before age 59½ are not permitted. Certain fees and withdrawal charges may apply with respect to contributions and/or withdrawals made under the 403(b) funding vehicle. Additionally, unless the employee separated from service after age 55, a 10% penalty tax (in addition to ordinary income tax) would generally apply if the distribution were taken prior to age 59½. Each employee should consult his or her own tax advisor.

Necessary Documents?

The "Final Pay Plan" must be described in a written plan. However, an employer may postpone adopting a written plan until as late as December 31, 2009 if:

- The final pay arrangement is described in a writing such as a Board of Education resolution, a collective bargaining agreement, or individual employee letters;
- During 2009, the employer administers the plan in accordance with a reasonable interpretation of § 403(b); and
- Before the end of 2009, the employer makes its best efforts to retroactively correct any administrative errors occurring during 2009 to conform to the terms of the written plan.

Both elective and non-elective contributions can go into the same 403(b) contract, provided the contract will accept both employer contributions and employee salary reduction contributions.

Advantages of Using a Section 403(b) Plan

The use of a 403(b) plan provides more advantages than the use of other types of retirement plans because §403(b) provides greater flexibility to receive non-elective contributions after an employer severance.

Other defined contribution plans such as a 401(a) or a 457(b) plan may permit final pay non-elective contributions to be made up to 2½ months after severance or, if later, the end of the calendar year of severance; but a 403(b) plan may permit non-elective contributions to be made as late as the end of the calendar year that includes the 5th anniversary of the employee's severance. This is important because the employer is only allowed to contribute a set amount for the employee each year.

The total of all contributions from the employer and the employee combined generally may not annually exceed the lesser of the employee's compensation or \$49,000 for 2009. An employer that wishes to provide a non-elective contribution in excess of the annual limitation would not be able to contribute such excess with respect to a 401(a) or 457(b) plan; but a 403(b) plan may be able to accept such excess because a 403(b) plan may permit non-election contributions for the year of severance and each of the five subsequent years.

Therefore, the employer may make in aggregate a larger amount of non-elective contributions to a 403(b) plan on behalf of a severed employee when compared to other types of defined contribution plans because the portion of an employer's non-elective contribution in excess of the annual contribution limit for the year of the employee's severance may be contributed to a 403(b) plan over the succeeding five-year period.

Circular 230 Disclaimer - The information contained in this communication (including attachments) concerning Federal tax issues is not intended to (and cannot) be used by anyone to avoid IRS penalties. This communication is intended to support the sale of MetLife insurance, annuity products and financial services. You should seek advice based on your particular circumstances from an independent tax advisor.

MetLife and its agents and representatives may not give legal or tax advice. Any discussion of taxes in this communication or related to this communication is for general information purposes only and does not purport to be complete or to cover every situation. Tax law is subject to interpretation and legislative change. Tax results and the appropriateness of any product for any specific taxpayer may vary depending on the facts and circumstances. You should consult with and rely on your own independent legal and tax advisers regarding your particular set of facts and circumstances.

MetLife Resources is a division of Metropolitan Life Insurance Company (MLIC). Securities products are offered through MetLife Securities Inc. (MSI), (FINRA/SIPC). MLIC and MSI are MetLife companies, both of 200 Park Avenue, New York, NY 10166.