



Roth 403(b):

Is it right for you?

We recommend that you consult a tax or financial advisor about your individual situation.

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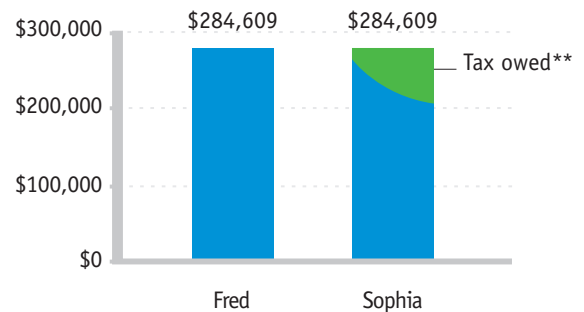
There's a new way of saving in your retirement plan called the Roth 403(b).

It's getting some attention, and it's easy to see why. If you meet certain requirements, you could withdraw Roth 403(b) contributions plus any earnings tax-free during your retirement.

If you have the account for at least five years and have turned age 59½, every cent in a Roth 403(b) could be withdrawn tax-free. That can be a significant advantage over the traditional 403(b), where withdrawals are currently taxed 10% to 35%, depending upon your federal income tax bracket.

Maybe you're wondering "What's the catch?" Well, unlike traditional pre-tax contributions, Roth 403(b) contributions are made with after-tax dollars. So you'd pay more in taxes today with the Roth. But that could be a price worth paying if it means more money in retirement.

Example: Sophia and Fred each contribute \$3,600 a year to a retirement plan, and each earns 6% annually on their investments. But Sophia makes pre-tax contributions while Fred makes after-tax Roth contributions. (That means Fred's contributions are taxed as regular income before being added to his account.) After 30 years each has \$284,609 for retirement. However, Sophia will owe taxes on her withdrawals. Fred's withdrawals will be tax-free.*



This hypothetical illustration does not represent any particular investment.

*Fred paid \$16,200 in taxes on contributions over 30 years, assuming 15% tax bracket. All references to taxes are federal taxes only. Individual state tax law may vary.

**Taxes owed will depend on tax rate at time of distribution and amount withdrawn.

Pay taxes today? Or later?

So should you pay taxes today when making Roth contributions to your plan or stick with pre-tax contributions, where you postpone paying taxes today but owe them in retirement? As always, it depends.

- If you think your tax rate will be lower in retirement, it's better to stick with traditional pre-tax contributions. That way you'll postpone paying taxes until retirement, when you expect to be in a lower bracket.
- If you think your tax rate will be the same or higher in retirement, it's better to go with the Roth. That way you'll be paying taxes at a lower rate today.

Of course, no one has a crystal ball to tell you exactly what your tax rate will be in retirement. It depends on so many things—your income, family status, retirement benefits, and even government tax policy.

The answer: tax diversification

What can you do in the face of this uncertainty? Do what you already do when dealing with investment uncertainty: Diversify. Consider holding both pre-tax and after-tax tax savings in your retirement account. That's known as tax diversification.

Pursuing a policy of tax diversification could be wise for many participants. That said, there are certain situations where it's an especially good idea and some cases where it makes less sense.

If you are financially well-prepared for retirement, the Roth makes sense.

Strong savers and those with generous retirement benefits may have a sizable retirement income—and be subject to sizable taxes. Having Roth savings exempt from taxation would be a boon.

If you're not as well-prepared for retirement as you'd like, pre-tax contributions make sense. Your income—and tax rate—are likely to drop. By making pre-tax contributions, you'll avoid paying taxes at a higher rate today and pay them at a lower rate in retirement.

There are other cases where the Roth does—or does not—make sense.

For more examples, turn the page.

Who might benefit from the Roth 403(b) . . .

Who	Why
You're financially well-fixed for retirement (high savings, good benefits).	Chances are you'll be in the same or a higher tax bracket in retirement. Any Roth savings would be exempt from taxation.
You contribute the maximum to the 403(b).*	Switching to the Roth increases your tax-advantaged saving. For example, if you contribute \$15,000 on a pre-tax basis, you will owe taxes on this amount, plus any earnings, in retirement. Contribute \$15,000 on a Roth basis instead, and all of it will be tax-free in retirement.
Your income prevents you from contributing to a Roth individual retirement account.**	You can obtain the advantages of a Roth within your 403(b), which has no income restrictions comparable to those of the Roth IRA.
You don't earn a lot today—but just wait.	Your career is just getting started. You expect your income—and tax rate—to rise in the years to come.
You pay taxes at a low rate today (10% or 15%).	Making Roth 403(b) contributions would cost you little today and could result in tax savings in retirement.

*The maximum 403(b) contribution is \$15,000 annually in 2006, or \$20,000 if you're age 50 or older and your plan allows catch-up contributions. After 2006 rates will be indexed for inflation and rise in \$500 increments.

**To contribute to a Roth IRA, your modified adjusted gross income cannot exceed \$160,000 for married taxpayers filing jointly or \$110,000 for single filers.

and who might not

Who	Why
You're behind on saving and expect Social Security to be the mainstay of your retirement.	Chances are your income will fall in retirement. Consequently, you'll be in a lower tax bracket.
You pay spikes thanks to big commissions or bonuses.	Your tax rate may be higher this year than in retirement. So you're better off deferring taxes now with the traditional 403(b) and paying at a lower rate later.
You have children, a family income generally between \$20,000 and \$50,000, and you receive the earned income tax credit or the additional child tax credit.	Making Roth contributions would raise your taxable income and cost you these valuable tax credits. These credits are more valuable than the Roth 403(b) would be to you.

The cost of switching to a Roth 403(b)

Before you switch to a Roth 403(b), it's important to remember that you'll see a drop in your take-home pay. That's because more of your income will be subject to income taxes today.

If you're in a low tax bracket, the cost may not be significant, especially if you're among the millions of Americans who currently receive a sizable tax refund.

Example: John is in the 15% tax bracket and saves \$3,000 a year to his 403(b). If he were to switch to Roth 403(b) contributions, John would pay \$450 more in taxes annually ($\$3,000 \times 0.15 = \450). John is paid biweekly, so each check would be reduced by \$17.30 ($\$450 \div 26 = \17.30).

*All references to taxes are federal taxes only. Individual state tax laws may vary.

You could also reduce your contribution rate so that your tax bill stays the same, of course. But that's a strategy you should probably avoid, especially if it means that you might forfeit employer matching contributions.

A Roth 403(b) could change your take-home pay

For an idea of how the Roth 403(b) might change your take-home pay, find the figure closest to your annual taxable income and deferral percentages in the table below. The dollar figure at the intersection of the two factors is the reduction in pay that you might experience on a biweekly basis (26 pay periods per year) to pay income taxes on Roth contributions.

The Roth 403(b) paycheck effect

Gross household income	Deferral percentage				
	3%	6%	9%	12%	15%
\$25,000	\$3	\$6	\$9	\$12	\$14
\$50,000	\$9	\$17	\$26	\$35	\$43
\$75,000	\$13	\$26	\$39	\$52	\$65
\$100,000	\$29	\$58	\$87	\$115	\$144

Figures are rounded to nearest whole dollar.

Assumptions: Married filing joint return. Taxpayers with \$25,000 gross household income have 10% withheld for income taxes; taxpayers with \$50,000 and \$75,000 gross household income have 15% withheld; taxpayers with \$100,000 gross household income have 25% withheld.

A final note on Roth 403(b) costs

Switching to the Roth causes your taxable income to increase. This could reduce your eligibility for various tax credits and deductions, such as those for children and daycare expenses, education costs, and the phase-out of deductions and exemptions for higher-income households.

Before you switch to the Roth, it pays to check your tax return (or ask your tax preparer) to see what deductions or credits might be lower or eliminated. Most of these credits and deductions (except for the credits noted in the chart on page 5) phase out gradually. That said, the impact could be large or small depending on your situation. Before you switch to the Roth, it pays to double-check.

Roth 403(b) questions and answers

What is a Roth 403(b)?

The Roth 403(b) was created by a provision in the Economic Growth and Tax Relief Reconciliation Act of 2001. Effective January 1, 2006, plans are permitted to allow participants to designate all or a portion of their elective deferrals as Roth 403(b) contributions.

You get no current-year tax deduction for your Roth 403(b) contributions. However, you can withdraw your contributions and their earnings tax-free if you meet certain conditions.



What are the conditions for tax-free withdrawals?

In general, to make a qualified tax- and penalty-free withdrawal of Roth 403(b) contributions and earnings, the account must have been established for at least five years and the withdrawal must meet one of the following conditions:

- Be taken after age 59½.
- Be as a result of permanent disability or death.

If a participant dies, his or her beneficiary will also be entitled to tax-free withdrawals if the account has been held at least five years from the time the participant first made a Roth 403(b) contribution.

What if a withdrawal doesn't meet these conditions?

Withdrawals that do not meet these conditions are considered nonqualified withdrawals. Nonqualified withdrawals are treated as a pro-rata return of Roth contributions and earnings. The portion of the distribution that represents earnings will be subject to ordinary income tax and possibly a 10% federal penalty tax for premature distributions. However, the portion of the withdrawal that represents a return of Roth 403(b) *contributions* would not be subject to tax.

Are Roth 403(b) contributions subject to IRA contribution limits?

No, contributions are subject to 403(b) limits. In 2006 you can contribute up to \$15,000 to a 403(b), plus an additional \$5,000 if you're age 50 or older at any time during the year and your plan permits catch-up contributions. (Plan rules apply; your plan may have a lower limit.)

If I make Roth 403(b) contributions, can I still contribute to a Roth IRA?

Yes, as long as you meet the income limits for a Roth IRA. For certain participants, switching to Roth 403(b) contributions may push them above the qualifying income level for a Roth IRA.

Will my employer match my Roth 403(b) contributions?

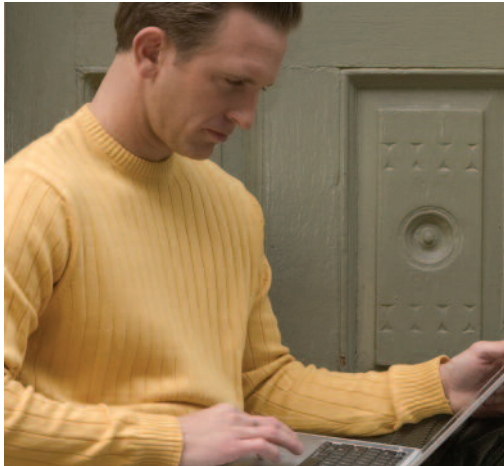
Your employer may match Roth 403(b) contributions; however, the match would be on a pre-tax (not after-tax Roth) basis. This means you would owe income taxes on the matching funds and their earnings at withdrawal. If you withdraw them prematurely (generally before age 59½), you might owe an additional 10% federal penalty tax on the match and earnings.

Can I convert my traditional 403(b) balance to the Roth 403(b)?

No.

Do I have to take required minimum distributions (RMDs) from my Roth 403(b)?

Yes, but you can avoid them by rolling your money from a Roth 403(b) to a Roth IRA. Otherwise, you would be required to make withdrawals from the Roth 403(b) after age 70½.



For more information:

To learn more about enrolling in the Roth 403(b), contact your benefits department.

To learn more about how Roth 403(b) fits into your retirement planning, contact your investment company.

To contact Vanguard, go to www.vanguard.com or call Participant Services at **800-523-1188**.