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By CHRISTINA MAJASKI Updated April 15, 2023

457 Plan vs. 403(b) Plan: What's the Difference?

457 Plan vs. 403(b) Plan: An Overview

For previous generations, working in the public sector ensured a guaranteed income in retirement through a pension benefit. However, public-sector and nonprofit organizations now offer employer-sponsored plans, the 403(b) and the 457, to help fund an employee's retirement. These plans function similarly to a private employer's 401(k) plan.

KEY TAKEAWAYS

- Public-sector and nonprofit organizations don't offer their employees 401(k) plans.
- These organizations offer other employer-sponsored plans, such as the 403(b) and the 457 plans.
- The 457(b) is offered to state and local government employees and the 457(f) is for top executives in nonprofits.
- A 403(b) plan is typically offered to employees of private nonprofits and government workers, including public school employees.
- If you are eligible for both plans, you can split your contributions between them.

What is a 457 Plan?

The 457 Plan

There are two types of 457 plans. A 457(b) is offered to state and local government employees, while a 457(f) is for top-level executives at non-profits.

457(b)

If you have a 457(b) plan, you can contribute up to $22,500 for 2023. You can also contribute an additional $7,500 in 2023 in "catch-up" contributions if you’re 50 or older. Beginning after Dec. 31, 2024, with the passage of the SECURE Act 2.0, the catch-up limits for 457 plan participants increase for those aged 60 to 63 to the greater of $10,000 or 150% of the “standard” catch-up amount for that year.

You can contribute even more if you are within three years of normal retirement age. You may be able to contribute as much as twice the limit if you're within three years of normal retirement age. This amount is $45,000 for 2023, up from $41,000 in 2022.

However, your maximum contribution when you are within three years of normal retirement age is the lesser of twice the contribution limit or the annual limit plus the unused annual limit from prior years.

457(f)

The 457(f) plans differ significantly from their 457(b) counterpart. Often described as golden handcuffs, the 457(f) is used to recruit executives from the private sector, where the pay tends to be higher and the benefits more generous.

Under a 457(f) plan, compensation is deferred from taxation without income limitations. However, this deferred compensation is subject to a "substantial risk of forfeiture," which means executives risk losing the benefit if they fail to meet specific requirements for length of service and performance. When the compensation becomes guaranteed and is no longer subject to the risk of forfeiture, it becomes taxable as gross income.

Unless you become the head of a nonprofit organization (NPO), you're unlikely to run into the 457(f) plan. Because the deferred compensation is not yet paid and is sheltered from taxation, the benefits remain in the hands of the employer. Rules require that executives perform services for at least two years to receive benefits under a 457(f) plan.

Advantages and Disadvantages of a 457 Plan

Pros

- 457(b) participants can double their contributions if they are within three years of normal retirement age.
- Catch-up contributions are allowed after age 50.
- Your 457(b) benefits become available when you no longer work for the employer providing the 457(b) plan.
- You can roll a 457(b) account into a Roth IRA or 401(k).

Cons

- The contribution that your employer matches will count as part of your maximum contribution.
- There are much higher contribution limits in a 401(k) plan.
- Few government employers provide matching programs within the 457(b) plan.
- The 457(f) plan requires that employees stay on the job for a minimum of two years. Those who leave earlier forfeit their right to the 457(f) plan.

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The IRS makes annual adjustments to contribution and deduction limits based on inflation through COLAs or Cost of Living Adjustments.

The 403(b) Plan

A 403(b) plan is typically offered to employees of private nonprofits and government workers, including public school employees. Like 401(k), 403(b) plans are defined-contribution plans that allow participants to save on a tax-deferred basis for retirement.

When these plans were created in 1958, they could only invest in annuity contracts. So, they were known as tax-sheltered annuity (TSA) plans or tax-deferred annuity (TDA) plans.

These plans are most commonly used by educational institutions. However, any entity that qualifies under IRS Section 501(c)(3) can adopt it.

Contribution and Deferral Limits

The contribution limits for 403(b) plans are now identical to those of 401(k) plans. All employee deferrals are made on a pretax basis and reduce the participant's adjusted gross income (AGI) accordingly.

The annual contribution limit is $22,500 for 2023. Individuals can invest an additional catch-up contribution of $7,500 for 2023 if they're 50 or over.Like 457 Plans, the catch-up limits for 403(b) plan participants aged 60 to 63 will increase to the greater of $10,000 or 150% of the "standard" catch-up amount for the relevant tax year, beginning after Dec. 31, 2024.

These plans offer a special additional catch-up contribution provision known as the lifetime catch-up provision or 15-year rule. Employees who have at least 15 years of tenure are eligible for this provision, which allows for an extra $3,000 payment a year. However, this provision also has a lifetime employer-by-employer limit of $15,000.

After-tax contributions are allowed in some cases, and Roth contributions are also available for employers who opt for this feature. Like with 401(k) plans, employers can institute automatic 403(b) plan contributions for all workers, although the employees may opt out at their discretion. Eligible participants may also qualify for the Retirement Saver's Credit.

When calculating 403(b) contribution limits for an individual, the IRS applies them in a specific order. First, they apply the elective deferral. The IRS then uses the 15-year service catch-up provision. These are followed by the catch-up contribution. It is an employer's responsibility to limit contributions to the correct amounts.

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403(b) Limits

Employers can make matching contributions, but the total contributions from employer and employee cannot exceed $66,000 for 2023.

Rollovers

Employees who leave their employers can now take their plans to another employer. They can roll their plans over into another 403(b), a 401(k), or another qualified plan. They can also choose to roll their plans over into a self-directed IRA instead.

This means employees can maintain one retirement plan throughout their careers instead of having to open a separate IRA account or leave their plans with their previous employers.

Distributions

403(b) plan distribution rules resemble those of 401(k) plans and are reported each year on Form 1099-R, which is mailed to plan participants:

- You can start taking distributions at age 59½, whether or not you're still working at that organization.
- Distributions taken before age 59½ are subject to a 10% early-withdrawal penalty unless a special exception applies.
- All normal distributions are taxed as ordinary income.
- Roth distributions are tax-free. However, employees must either contribute to the plan or have a Roth IRA open for at least five years before being able to take tax-free distributions.
- Required minimum distributions (RMDs) must begin at age 73 in 2023 with the passage of the SECURE Act of 2022. Failure to take a required minimum distribution will result in a 25% excise tax on the amount that should have been withdrawn.
- Loan provisions may also be available at the employer's discretion. The loan rules are also mostly the same as those for 401(k) plans. Participants cannot access more than the lesser of $50,000 or half of the plan balance. Any outstanding loan balance not repaid within five years is treated as a taxable or premature distribution.
- Beginning in 2024, participants will be able to access up to $1,000 annually from retirement savings for emergency personal or family expenses without paying the 10% early withdrawal penalties.

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Miscellaneous Issues

Importantly, 403(b) plans differ from their 401(k) counterparts in that, in theory, the contributions are immediately vested and cannot be forfeited. In practice, however, employers can make contributions to a separate account and, as benefits vest, retroactively apply them to the 403(b) plan.

In addition, due to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 403(b) plans also now receive the same level of protection from creditors as qualified plans.

Plan participants should also be aware of all the fees charged by their plan and investment providers. The plan administrator must provide all plan participants with a complete breakdown of these fees.

Which Is Better a 403(b) or a 457(b)?

A 457(b) plan is better if you need more time to earn money to use toward your retirement. A 403(b) might be better if you want more investment options.

Should I Contribute to Both a 403(b) and 457(b)?

You can contribute to both, but you are still bound by the total contribution limits set by the IRS. If you're wondering whether it benefits your situation to contribute to both, it's best to talk to a financial planning professional to see if it makes sense.

What Is The Difference Between a 401(k), a 403(b), and a 457(b)?

The main difference is who offers these plans. Private employers offer 401(k)s, and 403(b)s and 457(b)s are generally offered by public sector employers.

The Bottom Line

If you need more time to put aside money for retirement, a 457(b) plan is best for you. A 403(b) often offers a larger array of investment options. However, you can also split your contributions between both plans. In 2023, you can save $45,000 between the two plans, not including any catch-up contributions if you're eligible.