

403(b) FINAL REGULATIONS

Let's Explore the
Final **403(b)** Regulations

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(Self-explanatory)

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(Feel free to change this slide to include your own information as a presenter.)

403(b) Final Regulations

- ▶ Forty-three years since the last issuance of 403(b) regulations
- ▶ Package includes regulations under 414(c)

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Final regulations were **published July 26, 2007.**

There have been major, major pieces of legislation passed in the past 43 years and the regulations encompass these changes.

414(c) – controlled group rules for tax-exempt entities

General Effective Date ¹

- ▶ Taxable years beginning after **December 31, 2008**
- ▶ Notable exceptions

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1 – 1.403(b)-11(a)

The earliest these would come into play would be the timeframe listed on the slide.

Delayed Effective Dates²

- Collective bargaining situations
- Churches sponsoring 403(b)s
- Removal of certain permissively excluded groups for universal availability purposes
- Certain governmental 403(b)s
 - For limited universal availability exclusions

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2 – 1.403(b)-11(b)-(d)

Churches, collective bargaining situations, governmental 403(b)s, and the removal of certain permissively excluded groups have discreet later effective dates. Due to the complexity of these later effective dates, I strongly suggest you refer to the regulations directly to find **your** effective date.

Grandfathered Items

- ▶ Annuities – In-service distributions
- ▶ Incidental life insurance contracts
- ▶ Post Rev. Rul. 90-24 contract exchanges
 - ▶ Prior 90-24s grandfathered

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3 – 1.403(b)-11(e)-(g)

Primary Purpose

- ▶ Theme
 - ▶ To diminish the extent to which 403(b)s differ from other salary reduction arrangements
 - ▶ 401(k)s
 - ▶ 457(b) governmental eligibles

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The final regulations are attempting to put the rules for 403(b), 401(k), and 457(b) on the same footing. The purpose is to make the differences running these plans less and to make administration simpler (getting compliance).

Regulation Highlights ⁴

- ▶ First and Foremost
 - ▶ A 403(b) program must be maintained pursuant to a written DC plan
 - ▶ Both form and operation satisfy 403(b) and contain all terms and conditions for eligibility, limitations and benefits under the plan
 - ▶ See model plan provisions revenue procedure

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4 – 1.403(b)-3(b)(3) and 1.403(b)-3(d)(1)(i)&(ii)

You now need a written plan. All terms and conditions must be in the plan.

NOTE: Nowhere in the regulations does it say you need a plan **document**. A written plan could be gleaned by bundling the salary reduction agreement, summary plan description, custodial account, annuity arrangement, etc. and would satisfy this requirement.

Be certain you know what your program provides and follow the terms of the plan in operation (many agents are finding this problem on examination).

A written plan will not automatically subject a non-ERISA 403(b) to become subject to ERISA (remember gov't plans and non-electing church plans are not subject to ERISA anyway). See DOL Field Assistance Bulletin XXXX at www.dol.gov/ebsa.

ERISA Implications

- ▶ Non-ERISA 403(b)s
 - ▶ Written plan – Not automatically ERISA
 - ▶ See www.dol.gov/ebsa for guidance
- ▶ Governments not subject to ERISA

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Regulation Highlights⁵

- ▶ Underlying annuities/custodial accounts
 - ▶ In addition to language on 401(a)(30), 401(a)(31), and 401(g) (annuities only):

Funding contract must also have language satisfying 401(a)(9) and the incidental benefit requirements.

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5- 1.403(b)-3(a)(4)-(8)

401(a)(30) – deferral limitations

401(a)(31) – rollover distributions

401(g) – transferability of annuity contracts

401(a)(9) – minimum distribution requirements

Explain that this is in addition to the written plan requirement.

Regulation Highlights

- ▶ Vesting is recognized – non-electives only ⁶
- ▶ Elective deferral ordering – 402(g)(1), 402(g)(7), 414(v) ⁷
 - ▶ 402(g)(7) – formula required
 - ▶ See examples ⁸
- ▶ Disaggregation 401(a)/403(b) ⁹
- ▶ Post-severance elective deferrals ¹⁰
 - ▶ Regular, sick and vacation pay

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6 - 1.403(b)-3(d)(2)

7 - 1.403(b)-4(c)(3)(iv)

8 - 1.403(b)-4(c)(5) examples #4, 11 and 12

9 - 1.403(b)-4(b)(2)

10 - 1.403(b)-3(b)(4)(ii)

ELECTIVE DEFERL ORDERING –

IRC 402(g)(1) -Basic limit is \$15,500 for 2007.

If this is exceeded, you need to determine if EE worked for your organization (explain the types of organizations eligible) for 15 or more years –

If so, IRC 402(g)(7) allows catch-up contribution of up to \$3K for up to 5 years. The complete formula for determining this amount is contained in the regulations and Publication 571.

If still over the limit, you need to determine if EE is age 50 or older –

If so, IRC 414(v) catch-up is \$5K for 2007.

DISAGGREGATION -

Example – a superintendent, under his/her 403(b), has the \$15K in elective deferrals and \$30K in ER contributions. In other words, is maxed out under IRC 415 at \$45K (2007). If there is a 401(a) DC arrangement in which this superintendent is a participant, his individual overall limit is \$90K for 2007 as there is disaggregation of the two plans.

Regulation Highlights

11, 12

- ▶ Determining years of service
 - ▶ 402(g)(7) – 15 year catch-up
 - ▶ Includible compensation for contribution limit (lesser of 100% of includible compensation or overall limit)
- ▶ Years of service = Employee's annual work period/not taxable year

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11 - 1.403(b)-4(e)(2)

12 - 1.403(b)-4(e)(5) and 1.403(b)-4(e)(9) examples 1 and 2

Questions?

Regulation Highlights

- ▶ Non-elective contributions for the 5 taxable years after employment plus end-of-taxable year when employment ceases¹³
- ▶ No additional contributions after death¹⁴

See examples cited in
Addendum

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13 - 1.403(b)-4(d)(1)

14 - 1.403(b)-3(d)(2) examples 1, 2, and 3

Five years plus – through end of taxable year of severance plus next five taxable years.

Don't confuse this five-year provision (unique to 403(b)) with post-severance elective deferral opportunities.

Regulation Highlights¹⁵

When using the 5-year post-retirement non-elective provision in a non-governmental environment...

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15 - 1.403(b)-3(d)(2) examples 1 and 2

(This is the first of three slides that are related.)

Regulation Highlights

Assure that in accordance with 1.401(a)(4)-10(b) and under the facts and circumstances that contributions made for those satisfying the minimum age and service requirements **and...**

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(Rule continues on next slide...)

Regulation Highlights

...who retire by the designated date **do not discriminate** in favor of former employees who are highly compensated employees (HCEs).

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See example in the regulations.

Regulation Highlights

- ▶ For 403(b) and 402(g) purposes, elective deferrals are limited to contributions under a cash or deferred election as defined under 401(k)¹⁶
- ▶ Hardship distributions follow 401(k) rules and safe harbors¹⁷

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16 – 1.402(g)(3)-1(b)

17 – 1.403(b)-6(d)(2)

HARDSHIP – in determining hardship, follow the rules contained in IRC 401(k). Plan must provide for hardships.

Regulation Highlights

Elective Non-Discrimination/ Universal Availability¹⁸

- ▶ Effective opportunity needed to satisfy universal availability¹⁹
 - ▶ Meaningful notice
 - ▶ Election timing
- ▶ Universal availability generally applies separately to each common law entity²⁰

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18 - 1.403(b)-5(b)(1)

19 - 1.403(b)-5(b)(2)

20 - 1.403(b)-5(b)(3)

Here's the place to give a general review of universal availability –

ordinarily violated by poor plan design attempting to eliminate less than full-time employees from participating. Explain ordinarily works 20 hour per week rule.

MEANINGFUL NOTICE – agents examining 403(b)s ask the Human Resource office if employees know they have the right to make salary reduction elections. They then ask and confirm how this right is communicated. This is where we find the problem. A reasonable attempt to communicate this right is needed, whether it is through a new employee package, an e-mail, a newsletter, etc.

Regulation Highlights

Effective opportunity to make cash or deferred election to a 403(b) in order to satisfy the universal availability requirement embraces a 401(k) anti-conditioning approach

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For example, a 403(b) arrangement cannot state that you must enroll in the organization's health plan in order to be able to elect to have deferrals made on your behalf.

Same rules as with 401(k) where contribution to another plan is based on a 403(b) salary reduction election.

Regulation Highlights

Universal Availability

Permissive Exclusions

- Employees eligible under other deferral plans ²¹
- Non-resident aliens
- Students
- Those who normally work less than 20 hours per week ²²

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21 - 1.403(b)-5(b)(4)(ii)(A)

22 - 1.403(b)-5(b)(4)(ii)(E)

Governments – no non-elective non discrimination. Only 401(a)(17) applicability.

Regulation Highlights²³

- ▶ For determining if an employee works < 20 hours/week so that they can be permissively excluded from universal eligibility:
 - ▶ On date of hire, employer must reasonably expect employee to work < 1000 hours for ensuing 12-month period

AND...

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23 - 1.403(b)-5(b)(4)(iii)(B)

This section of the regulations would deal with permanent substitute teachers, bus drivers, cafeteria workers, janitors, etc. It would also deal with those hired for full-time work for a short period of the year, such as camp counselors.

Regulation Highlights

- ▶ For determining if an employee works < 20 hours/week so that they can be permissively excluded from universal eligibility:

AND...

- ▶ For every subsequent plan year or 12-month period the employee actually worked < 1000 hours in the preceding 12-month period

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For subsequent years after year of hire, this provides you a year to look back and test.

Regulation Highlights

- ▶ So, a 1000 hour standard...
- ▶ If subject to ERISA see 1.403(b)-5(b)(4)(iii)(B)(2) of the regulations

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If ERISA applies to your arrangement, you need to consult ERISA.

Regulation Highlights²⁴

Regulations **DO NOT** adopt permissive exclusions for universal availability concerning:

- Collective bargaining employees
- Visiting professors
- Employees who have taken a vow of poverty
- Employees who make a one-time election to participate in a governmental non-403(b) plan.

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24 - 1.403(b)-11(d)(1)&(2)

Regulation Highlights²⁵ Non-Elective Non-Discrimination

- Regulations **DO NOT** adopt good faith reasonable standard of Notice 89-23 for purposes of non-elective non-discrimination
- Now 401(a)(4) and 401(m) testing as in a qualified plan
- Not relevant for governments

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25 - 1.403(b)-5(a)(1)

Governments – no non-elective non-discrimination. Only 401(a)(17) applicability.

Regulation Highlights²⁶

- ▶ Amounts not subject to 403(b)(7) and 403(b)(11) distribution restrictions may be distributed only:
 - ▶ After severance
 - ▶ Occurrence of an event
 - ▶ After a fixed number of years
 - ▶ Attainment of a stated age, or
 - ▶ Disability

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26 - 1.403(b)-6(b)

403(b)(7) – custodial accounts

430(b)(11) – salary reduction (elective deferrals)

are statutory restrictions.

This rule applies to non-restricted, non-elective ER contributions to annuities.

Regulation Highlights²⁷

Contribution amounts must be transferred to providers within a period no longer than is reasonable for proper plan administration.

EXAMPLE

→ Transferring elective deferrals within 15 business days following the month in which these amounts would have been paid to the participant

ERISA – tighter standards

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27 - 1.403(b)-8(b)

Many phone calls are received at the IRS complaining about their elective deferral monies not being placed in their annuity/custodial accounts in a timely fashion. Thus, this was included in the regulations.

The example provided is a safe harbor example, i.e., if this rule is followed, it will automatically be determined to be reasonable. The example is **not** a rule. Another example of attempting to put the rules for 403(b), 401(k), and 457(b) on the same footing.

Regulation Highlights

- ▶ No more separate contracts of incidental life insurance with 403(b) ²⁸
 - ▶ Exception – contracts issued up to 60 days after publication of the regulations are grandfathered
 - ▶ Incidental benefits permitted
 - ▶ Death
 - ▶ Disability ²⁹

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28 - 1.403(b)-8(c)(2)

29 - 1.403(b)-6(g)

In the past, you could have a teacher with \$100K in his/her account. No form of life insurance is provided. The teacher takes \$25K into “cyberspace” to purchase a term life policy. The plan sponsor has no control over these type of transactions.

Therefore, the regulations added this rule.

This does not mean that a 403(b) annuity cannot offer an incidental death or disability benefit.

Regulation Highlights³⁰

As with 457(b) governmental eligibles, 403(b) plan provisions may permit **plan termination** with distribution and rollover in cases where no successor 403(b) arrangement for 12 months.

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30 - 1.403(b)-10(a)(1)

Rare in the K-12 arena.

Again, another example of attempting to make it easier to administer these arrangements and another example of attempting to put the rules for 403(b), 401(k), and 457(b) on the same footing.

Termination = administratively practicable distribution of all accumulated benefits. Includes distribution of a fully paid individual annuity contract.

Regulation Highlights³¹

- ▶ Severance from employment occurs where employee:
 - ▶ No longer works for eligible employer, or
 - ▶ Works in a capacity that is not employment with an eligible employer

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31 - 1.403(b)-6(h)

Examples include:

An employee transferring from a not-for-profit to a for-profit hospital.

An employee ceasing to work for a public school but still is employed by the State.

Regulation Highlights³²

Old Revenue Ruling 90-24 – **annuity-to-annuity transfers** with no employer involvement

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32 - 1.403(b)-10(b)(1)

Old 90-24 Example: use same teacher with the \$100K balance. You have one vendor or three or five, but this teacher does not like any of the vendors. Under Revenue Ruling 90-24, this teacher can take the money to another vendor (new custodial account).

When an agent does an examination, he/she comes to the plan sponsor looking for compliance. The employer cannot police over these new accounts in which it has no control (e.g., 401(a)(9), loans and hardships).

NOTE that this is for plan-to-plan transfers and **not** rollovers.

Regulation Highlights

The New Transfer Regime ³³

- Within same plan
 - Plan permits
 - Benefit not diminished
 - Undiminished distribution restrictions
 - Employer and issuer enter into information sharing agreement

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33 - 1.403(b)-10(b)(2)

NOTE: Employer involvement, but no need to add this new vendor who receives the transfer to current vendors receiving salary reduction contributions.

Regulation Highlights

The New Transfer Regime ³⁴

- Plan-to-plan
 - Participant is employee or former employee of employer for receiving plan
 - Transferor and receiving plans permit
 - Benefit not diminished
 - Undiminished distribution restrictions

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34 - 1.403(b)-10(b)(3)

NOTE: Similar to qualified plan transfers.

Regulation Highlights³⁵

- ▶ Church 403(b)(9) retirement income accounts:
 - ▶ There must not only be a plan, but it must state intent to constitute a retirement income account
 - ▶ Exclusive benefit rule

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35 – 1.403(b)-9(a)(2)

(Self-explanatory.)

Regulation Highlights³⁶

Even if a 403(b)(9) retirement income account invested in stock of regulated investment company, it is not a custodial account.

Therefore

No § 4973 excise tax

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36 - 1.403(b)-9(a)(4)

Retirement income accounts allow for a broader range of investments. Retirement income accounts that invest in mutual funds are not 403(b)(7) custodial accounts. Thus, the excise tax does not apply to any overage.

Regulation Highlights³⁷

403(b)(9) retirement income
accounts:

Trust is granted tax-exempt status

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37 - 1.403(b)-9(a)(7)

(Self-explanatory.)

Regulation Highlights³⁸

- 414(c) Common Control – For all tax-exempt organizations for all 414(c) purposes:
 - Addresses aggregation to determine employer for all control group benefit purposes for all exempt organizations
 - Except governments and steeple churches

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38 – 1.414(c)-5(a)

Perhaps the most significant and overlooked portion of the regulations package. Distinguish 3121(w)(3) churches from 414(e).

Regulation Highlights³⁹

- ▶ 414(c) Common Control – For all tax-exempt organizations for all 414(c) purposes:
 - ▶ Based upon an 80% director/trustee common control test
 - ▶ Permissive aggregation for those tax-exempts with common exempt purpose

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1.414(c)-5(b)

Examples on the test are contained in the regulations.

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IRC 403(b) Tax-Sheltered Annuity Plans

A 403(b) tax-sheltered annuity (TSA) plan is a retirement plan offered by [public schools](#) and [certain tax-exempt organizations](#). An individual's 403(b) annuity can be obtained only under an employer's TSA plan.

<p>General Questions</p> <p>Who can establish a 403(b) plan? You are allowed to have a 403(b) plan if you are a:</p> <ul style="list-style-type: none"> • Public school, college or university or • Charitable entity tax-exempt under section 501(c)(3) of the Code. <p>How do 403(b) plans work? Basically, 403(b) plans are similar to 401(k) plans. Just as with a 401(k) plan, a 403(b) plan lets employees defer some of their salary. In this case, their deferred money goes to a 403(b) plan sponsored by the employer.</p> <p>What are the advantages of participating in a 403(b) plan? There are significant tax advantages for participants in a 403(b) tax-sheltered annuity:</p> <ul style="list-style-type: none"> • Contributions to a 403(b) annuity are tax deferred. • Earnings are tax deferred, and • The annuity is portable. <p>Ask Bob Architect!!!</p> <p>Bob Architect, Senior Tax Law Specialist and the resident expert on 403(b) plans, receives many questions while presenting the latest 403(b) information to organizations. See the most frequently asked questions and Bob's answers here.</p>	<p>Resources:</p> <p>Guidance: 403(b) Final Regulations Issued July XX, 2007, with a general effective date of taxable years beginning after December 31, 2008.</p> <p>Overview News Articles Presentations</p> <p>Related Guidance: Notice 2007-7, Pension Protection Act Guidance Final 415 Regulations Notice 2006-5, Automatic Rollover</p> <p>Prior Law Guidance Exam Guidelines I.T. Reg. 1.403(b)-1 I.T. Reg. 1.403(b)-2</p> <p>Correcting Plan Errors</p> <p>Publications: Choose a Retirement Plan for</p>
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This button provides information on starting and maintaining a retirement plan including what kinds of plans are available, how they work and the benefits of having a retirement plan.

Request Publication 4482

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Internal Revenue Service
Tax Exempt and
Government Entities
Employee Plans Division

403(b) Tax-Sheltered Annuity for Participant

Be Aware of Common Mistakes

As a 403(b) plan participant,
you need to pay attention to
the operation of your 403(b)
tax-sheltered annuity so that
you can:

- be compliant with the law,
- maximize your retirement
benefits, and
- avoid additional taxes and
penalties.



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Internal Revenue Service
Tax Exempt and
Government Entities
Employee Plans Division

408(b) Tax-Sheltered Annuity Plan for Sponsor

**Be Aware of
Common Mistakes**

As a 408(b) plan sponsor/
employer, you need to pay
attention to the operation
of your 408(b) tax-sheltered
annuity plan so that you can:

- be compliant with the law,
- maximize your employees'
retirement benefits, and
- avoid additional taxes and
penalties.

The cover features a blue background with a classical building facade. Below the title, there are three small images: a group of people, a person in a white coat, and a building with a clock tower.



Request Publication 4484

PLAN FEATURE COMPARISON CHART – easy, quick-glance format to help you pick the plan that's good for you and your employees!

PLAN	KEY ADVANTAGE	SPONSOR/ELIGIBLE EMPLOYER	EMPLOYER'S ROLE	CONTRIBUTORS TO THE PLAN
Payroll Deduction IRA	easy to set up and maintain	any employer	<ul style="list-style-type: none"> - arrange for employees to make payroll deduction contributions - transmit contributions for employees to IRA - no annual filing requirement 	employee can decide how much to contribute any time
SEP	easy to set up and maintain	any employer	<ul style="list-style-type: none"> - set up plan - employer may use Form 5305-SEP - transmit contributions for employees to IRA - generally, no annual filing requirement - bank or financial institution handles most of the paperwork 	employer can decide whether to make contributions year-to-year

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Addendum

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2. 1.403(b)-11(b)-(d)
3. 1.403(b)-11(e)-(g)
4. 1.403(b)-3(b)(3) and 1.403(b)-3(d)(1)(i)&(ii)
5. 1.403(b)-3(a)(4)-(8)
6. 1.403(b)-3(d)(2)
7. 1.403(b)-4(c)(3)(iv)
8. 1.403(b)-4(c)(5) examples 4, 11 and 12
9. 1.403(b)-4(b)(2)
10. 1.403(b)-3(b)(4)(ii)

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23. 1.403(b)-5(b)(4)(iii)(B)
24. 1.403(b)-11(d)(1)&(2)
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