

## 403(b) Plans

A 403(b) plan, also known as a tax-sheltered annuity plan, is a retirement plan for certain employees of public schools, employees of certain Code Section 501(c)(3) tax-exempt organizations and certain ministers. A 403(b) plan allows employees to contribute some of their salary to the plan. The employer may also contribute to the plan for employees.

### Which employers can establish a 403(b) plan?

Generally, public schools, Code Section 501(c)(3) tax-exempt organizations or churches can set up 403(b) plans.

### Who can participate in a 403(b) plan?

- Eligible employees of Code Section 501(c)(3) tax-exempt organizations;
- Eligible employees of public school systems. A public school system is defined in Code Section 170(b)(1)(A)(ii) as an education organization which normally maintains a regular faculty and curriculum, and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly conducted. Included in this category are employees of:
  - > Public schools
  - > State colleges
  - > Universities
- Eligible employees of churches;
- Employees of public school systems organized by Indian tribal governments;
- Ministers employed by Code Section 501(c)(3) organizations;
- Self-employed ministers, treated as employed by a tax-exempt organization that is a qualified employer; and
- Ministers (chaplains) who meet **both** the following requirements:
  1. They are employed by organizations that are not Code Section 501(c)(3) tax-exempt organizations, and
  2. They function as ministers in their day-to-day professional responsibilities with their employers.

### What are the benefits of participating in a 403(b) plan?

There are significant tax advantages for participants in a 403(b), including pre-tax contributions to the plan; earnings on these amounts are not taxed until they are distributed from the plan.

### When can an employee join a 403(b) plan?

The terms of the employer's 403(b) plan govern when an employee may enroll. However, a 403(b) plan is generally required to allow all eligible employees to participate in the plan as of their employment commencement date (the universal availability rule).

### **Can a 403(b) plan automatically enroll employees in the plan?**

Yes, a 403(b) plan can automatically enroll employees if the plan allows employees to contribute to the plan. The plan's provisions contain an automatic contribution arrangement, and the employee does not opt-out (affirmatively elect not to participate) of the plan's automatic enrollment.

### **What types of contributions can be made to a 403(b) plan?**

A 403(b) plan may allow:

- *Elective deferrals* – Employee contributions made under a salary reduction agreement. The agreement allows an employer to withhold money from an employee's salary and deposit it into a 403(b) account.
- *Non-elective employer contributions* – Contributions other than those made under a salary reduction agreement that includes matching contributions, discretionary contributions and certain mandatory contributions made by the employer. The employee pays income tax on these contributions only when they are withdrawn.
- *After-tax contributions* – Contributions (otherwise referred to as voluntary contributions that are not designated Roth contributions) made by an employee, which are reported as compensation in the year contributed and included in the employee's gross income for income tax purposes.
- *Designated Roth contributions* – Elective deferrals that the employee elects to include in gross income. The plan must keep separate accounting records for all contributions, gains and losses in the designated Roth account.

### **May an employer sponsoring a 403(b) plan exclude any employee from contributing to an account in the plan?**

A 403(b) plan must generally allow all employees to make elective deferrals to the plan. Under the universal availability rule, if an employer permits one employee to defer salary by contributing it to a 403(b) plan, the employer must extend t his offer to all employees of the organization. However, the following exception describes limited situations in which employees may be excluded:

- employees who will contribute \$200 or less annually;
- employees who participate in a 401(k) or 457(b) plan or in another 403(b) plan of the employer;
- non-resident aliens;
- employees who normally work less than 20 hours per week; and
- students performing services described in Code Section 3121(b)(10).

### **What is the maximum amount of elective deferrals an employee can contribute to a 403(b) plan?**

The maximum amount of elective deferrals an employee can contribute annually to a 403(b) is generally the lesser of:

- 100% of includible compensation; or
- \$19,500 in 2020 and 2021 (subject to annual cost-of-living increases).

However, this general limit is reduced by the amount of elective deferrals an employee makes to:

- 401(k) plans;
- SIMPLE IRA plans;
- Salary Reduction Simplified Employee Pension (SARSEP) plans;
- other 403(b) plans; and
- Code Section 501(c)(18) plans.

If the plan allows:

- an employee who has worked for a qualified organization for 15 or more years may, if he or she meets certain requirements, be able to make additional contributions of up to \$3,000 for up to five years (see 15-year rule in Pub. 571, Tax-Sheltered Annuity Plans (403(b) Plans); and
- an employee who is age 50 or older may make an additional catch-up contribution of \$6,500 in 2020 and 2021 (subject to annual cost-of-living increases), reduced by the amount of catch-up contributions made to other plans.

### **Does the employer have to contribute to a 403(b) plan for employees?**

No. An employer may, but is not required to, contribute to the 403(b) plan for employees.

### **What is the maximum annual combined amount the employer and employee can contribute to a 403(b) plan for an employee?**

The maximum combined amount both the employer and the employee can contribute annually to the plan is generally the lesser of:

- \$58,000 for 2021 (\$57,000 for 2020 subject to annual cost-of-living increases); or
- an employee's includible compensation for his or her most recent year of service.

Employees meeting certain requirements and plan participants may be eligible to make additional contributions.

### **How are 403(b) plan assets invested?**

Assets in a 403(b) plan can be placed in any of the following investment types:

- an annuity contract provided through an insurance company;
- a custodial account invested in mutual funds; or
- a retirement income account set up for church employees.

### **Can employees take loans from their 403(b) account?**

Yes, a 403(b) plan may, but is not required to, allow loans. If permitted by the plan, employees may obtain a loan to the extent and in the manner allowed by the plan.

### **Can employees get a hardship distribution from their 403(b) account?**

A 403(b) plan may, but is not required to, allow hardship distributions. If permitted by the plan, participants may obtain a hardship distribution to the extent and in the manner allowed by the plan.

### **When can employees take money out of a 403(b) plan?**

In addition to loans and hardship distributions, a 403(b) plan may allow employees to take money out of the plan when they:

- reach age 59½;
- have a severance from employment;
- become disabled;
- die; or
- encounter a financial hardship.

Employees may also receive a qualified reservist distribution.

Eligible distributions may be rolled over to another plan or an IRA.

The employee will have to pay taxes on any amount of the distribution that was not from designated Roth or after-tax contributions, and may have to pay an additional 10% early distribution tax unless an exception to this tax applies.

### **How are benefits paid to an employee from a 403(b) plan?**

403(b) plans may provide employees with a choice on how benefits will be paid. For example, an employee can choose to have benefits paid in a lump sum.

Certain distributions may be eligible for rollover to another plan or an IRA.

### **What is the “written plan” requirement?**

A 403(b) plan must be maintained under a written program that contains all the terms and conditions for eligibility, benefits, limitations, the form and timing of distributions and contracts available under the plan, and the party responsible for plan administration, to satisfy Code Section 403(b).

The written plan requirement does not mean that the plan must be contained in a single document. For example, the plan can consist of multiple documents that contain the various plan provisions regarding salary reduction agreements, contracts that fund the plan, eligibility rules, how the plan will pay benefits, and the non-discrimination rules.

Church plans that do not contain any retirement income accounts are exempt from having a 403(b) written plan.

### **What is “universal availability”?**

Generally, universal availability means that if an employer permits one employee to defer salary into a 403(b) plan, the employer must extend this offer to all employees, other than those whom the law allows to be excluded.

Universal availability also requires the plan to give meaningful notice to employees of their right to make elective deferrals. The notice must notify the employees of:

- their right to make elective deferrals;
- when to make an election; and
- when and how often during the year they can change that election.

A 403(b) plan generally may not place conditions on an employee’s right to make elective deferrals. For example, the plan sponsor cannot require that an employee take out a certain level of health insurance before being allowed to make elective deferrals to the 403(b) plan.

If you haven’t permitted eligible employees to defer their salary into your 403(b) plan, find out how to correct this mistake.

### **Which employees can be excluded from the plan?**

A 403(b) plan may exclude certain employees from universal availability for elective deferrals:

- employees who normally work less than 20 hours per week (this does not necessarily mean all part-time employees);
- employees who will contribute \$200 annually or less;
- employees who participate in a 401(k) or 457 plan, or in another 403(b) plan of the employer;
- non-resident aliens; and
- students performing services described in Section 3121(b)(10).

### **Are there non-discrimination rules that apply to employer contributions?**

Yes, non-governmental and non-Church 403(b) plans must satisfy the non-discrimination requirements for both employer non-elective and matching contributions.

An employer's non-elective contributions must satisfy all of the following non-discrimination requirements in the same manner as a qualified plan under Code §401(a):

- *Code Section 401(a)(4)* – relating to non-discrimination in contributions and benefits;
- *Code Section 401(b)* – relating to minimum coverage;
- *Code Section 401(a)(17)* – limiting the amount of compensation that can be taken into account; and
- *Code Section 401(m)* – relating to matching and after-tax employee contributions.

### **Can an employer terminate a 403(b) plan?**

Yes, subject to the termination guidelines in Treasury Regulation Section 1.403(b)-10.

### **What happens to a participant's assets when a 403(b) plan is terminated?**

Generally, a terminating 403(b) plan must distribute all accumulated benefits to the participants and beneficiaries as soon as administratively feasible. Revenue Ruling 2011-7 provides examples of how to terminate a 403(b) retirement plan funded in different ways and explains when the terminating plan's distributions are taxable.