403(b) Plans – FAQs on Coverage, Nondiscrimination and Termination

A 403(b) plan is a retirement plan offered by a public school or 501(c)(3) tax-exempt organization for its employees. An employee can only obtain a 403(b) annuity or custodial account under an employer's 403(b) plan. These annuities and custodial accounts are funded by employee elective deferrals made under salary reduction agreements, employer contributions or a combination of both.

There are numerous tax advantages associated with 403(b) plans. For example, contributions and earnings in a traditional 403(b) annuity are not taxed until they are distributed. To obtain these tax advantages, the Internal Revenue Code (Code) imposes numerous compliance requirements on 403(b) plans, including requirements related to coverage and nondiscrimination and termination of the plan.

This Compliance Overview includes frequently asked questions (FAQs) from the IRS on 403(b) coverage and nondiscrimination and termination issues.

LINKS AND RESOURCES

- IRS webpage on 403(b) plans, which includes links to many 403(b) resources
- IRS Revenue Ruling 2011-7, which addresses 403(b) plan termination
- IRS Publication 4483, 403(b) Tax-Sheltered Annuity Plan for Sponsor

Coverage and Nondiscrimination

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.

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 Code Section 3121(b)(10).

Are there nondiscrimination rules that apply to employer contributions?

Yes, non-governmental and non-church 403(b) plans must satisfy the nondiscrimination requirements for both employer nonelective and matching contributions.

An employer's nonelective contributions must satisfy all of the following nondiscrimination requirements in the same manner as a qualified plan under Code Section 401(a):

- Code Section 401(a)(4) – relating to nondiscrimination in contributions and benefits;
- Code Section 410(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.

Termination of Plan

Can an employer terminate a 403(b) plan?

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

The IRS has issued guidance for employers and employees with terminating 403(b) plans that fund benefits through 403(b)(7) custodial accounts to reflect changes provided in the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act).

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. IRS 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.

Source: U.S. Internal Revenue Service