403(b) Tax-Sheltered Annuities for Sponsors

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.

Read on to learn about:

- Common 403(b) plan mistakes, and
- IRS products (including the 403(b) Fix-It Guide), services and assistance to help you keep your 403(b) plan healthy.

Be aware of common mistakes.

As a 403(b) plan sponsor, it's important to know the tax rules that apply to your 403(b) plan and to pay attention to the operation of your plan so you can:

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

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*Unless otherwise stated, references to 403(b) annuities in this publication will generally also apply to 403(b) custodial accounts.

403(b) Plan

Common Mistakes

The IRS commonly finds mistakes in 403(b) plans in these areas:

Written plan requirement. You must have a written plan that describes the way the plan will work, and you must operate your plan accordingly. Plan sponsors must have adopted a written plan by December 31, 2009, that complies in good faith with Internal Revenue Code Section 403(b).

A 403(b) plan doesn't need to be a single plan document. For example, you may compile the salary reduction agreements, the contracts that fund the plan, and written procedures for eligibility, benefits, dollar limitations, nondiscrimination and universal availability. However, a single plan document makes administration easier, especially if your plan has multiple vendors.

Ineligible employer. Generally, only public schools and 501(c)(3) tax-exempt organizations may sponsor a 403(b) plan.

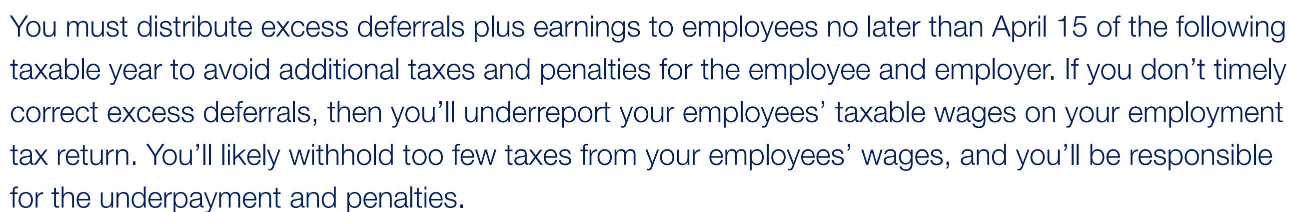
Universal availability. If you allow one employee to make elective deferrals, you must allow all eligible employees to make them. You may exclude certain groups of employees, such as those normally working fewer than 20 hours per week (less than 1,000 hours per year), students performing certain services, employees who are eligible for elective deferrals under another plan you sponsor and non-resident aliens. You must notify employees of their eligibility to make an initial or change an existing deferral election at least once a year.

Depositing elective deferrals. You must send your employees' deferrals to their annuity providers as soon as is reasonable for proper plan administration (but no later than 15 days following the month of the pay date). If your plan provides an earlier time for transferring elective deferrals, you must follow it.

Excess elective deferrals. The general limit on employee elective deferrals is **$19,500** (in 2021, indexed for inflation). If the plan allows, eligible employees may also make catch-up contributions.

- 15-years-of-service catch-up contribution
  - available for certain employers (such as schools, hospitals and churches)
  - employee must have 15 years of service
  - limited to least of:
    - $3,000,
    - $15,000 less previously excluded special catch-ups, or
    - $5,000 multiplied by years of service minus previously excluded deferrals
- Age-50 catch-up contribution
  - additional **$6,500** (in 2021, indexed for inflation)

Catch-up contributions must be applied to the 15-years-of-service catch-up (if available) before being applied to the age-50 catch-up. See **403(b) Contribution Limits** for examples of how the ordering works.



You must distribute excess deferrals plus earnings to employees no later than April 15 of the following taxable year to avoid additional taxes and penalties for the employee and employer. If you don't timely correct excess deferrals, then you'll underreport your employees' taxable wages on your employment tax return. You'll likely withhold too few taxes from your employees' wages, and you'll be responsible for the underpayment and penalties.

Employer and employee contributions. The limit on total employer and employee contributions is **$58,000** (for 2021, indexed for inflation). The 15-years-of-service catch-up is included in this limit, but the age-50 catch-up isn't. Therefore, the limit for employees who are at least age 50 is up to $64,500 for 2021.

Loans. Loans that don't meet the **tax rules** may be deemed a taxable distribution that's reported to the employee as income. This can happen when required loan payments are missed or loans exceed the allowed limit, often due to loans from multiple vendors.

Hardship distributions. Hardship distributions are considered early distributions if:

- you didn't get adequate documentation of the financial need,
- the employee didn't use other reasonably available financial means, or
- distributions from all vendors exceed the amount of the hardship.

Post-severance contributions. Plans may allow for elective deferrals and employer contributions after an employee separates from service.

- **Elective deferrals.** Employees may generally defer—up to their annual limits—their unpaid regular pay and unused vacation and sick pay if paid before the end of the limitation year they left your employment, or 2½ months from the date of severance, if later.
- **Employer contributions.** You may contribute up to the annual limit to a former employee's account for up to five years following the end of the year they left your employment. (Note: The former employee can't elect to receive this money in cash instead of depositing it to their 403(b) account.) All contributions must end upon the employee's death.

In-service exchanges and transfers.

- In-service contract exchanges take place within the same plan. The 403(b) plan must permit the movement of the funds and you must follow the plan terms. Benefits can't be reduced and the moved funds must have at least the same distribution restrictions. You and the receiving annuity issuer must agree to share certain information needed for plan administration.
- Plan transfers take place between two 403(b) plans. Both plans must permit the movement of the funds. In addition, the participant must be a current or former employee of the receiving plan sponsor. Benefits can't be reduced and the moved funds must be subject to at least the same distribution restrictions.

If you find a mistake in your 403(b) plan, take steps to bring it into compliance so your employees can continue to save for retirement on a tax-favored basis. You need to timely correct plan mistakes to avoid additional taxes and penalties that may affect you and your employees. Consider contacting a tax professional for help. You can correct most 403(b) plan mistakes using IRS correction programs. See **Correcting Plan Errors** for additional information.

To Learn More...

The following publications cover 403(b) plans, other retirement plans and IRS correction programs:

- **Publication 15**, (Circular E), Employer's Tax Guide
- **Publication 571**, Tax-Sheltered Annuity Plans (403(b) Plans) For Employees of Public Schools and Certain Tax-Exempt Organizations
- **Publication 575**, Pension and Annuity Income
- **Publication 590-A**, Contributions to Individual Retirement Arrangements (IRAs)
- **Publication 590-B**, Distributions from Individual Retirement Arrangements (IRAs)
- **Publication 4224**, Retirement Plan Correction Programs
- **Publication 4482**, 403(b) Tax-Sheltered Annuities for Participants
- **Publication 4484**, Choose a Retirement Plan
- **Publication 4546**, 403(b) Plan Checklist

Visit www.irs.gov/retirement for online resources covering retirement plans (including 403(b) plans). This site has tools such as:

- the **403(b) Plan Fix-It Guide**,
- answers to **frequently asked questions**, and
- a page devoted to **correction programs** to assist you in correcting errors if you discover them in the operation of your plan.