

Internal Revenue Service

Tax Exempt and  
Government Entities

Employee Plans Division

# 403(b) Tax-Sheltered Annuity Plan for Sponsor



## Be Aware of Common Mistakes

As a 403(b) plan sponsor/ employer, you need to pay attention to the operation of your 403(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.

# 403(b) Tax-Sheltered Annuity

It is important to know the tax rules applicable to a 403(b) plan to: 1) help you comply with the tax law; and 2) help you ensure that your employees get the maximum benefit out of your 403(b) plans.

In a national sample of audited 403(b) plans, the IRS found recurring mistakes in the following areas:

**Failure to be a Qualified Employer.**

Only employers established as public schools and certain tax-exempt charitable organizations classified under IRC section 501(c)(3) may sponsor a 403(b) plan.

**Failure to Properly Apply Universal Availability.** This failure arises when employers exclude eligible employees from participation. These employers often misapply eligibility and coverage conditions to improperly exclude employees who are otherwise eligible to make elective deferrals under section 403(b)(12). Under this failure, eligible employees, often part-time employees who would otherwise be eligible to participate, are not given the right to make salary reduction contributions.



# Plan—COMMON MISTAKES

**Failure to Limit Employee Elective Deferrals.** The general limit on employee elective deferrals is \$14,000 in 2005, \$15,000 in 2006, and indexed thereafter. Additional catch-up contributions are permitted if certain criteria are met. Failure to limit deferrals to these amounts can result in additional taxes and penalties that may affect both the employee and the employer.

**Failure to Timely Return Excess Elective Deferrals and Earnings.** Excess elective deferrals plus earnings must be distributed to the employee no later than April 15th of the following year to avoid additional taxes and penalties for both employee and employer. Excess deferrals, distributed timely, are included as income for the year contributed with the applicable earnings being reported as income for the year distributed. Report corrective distributions of excess deferrals (including earnings) on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA, Insurance Contracts, etc.*

**Failure to Properly Withhold and Report Withholdings on Form 941, Employer's Quarterly Federal Tax Return.**

If you allow excess deferrals to be contributed into a 403(b) annuity, then taxable wages are under-reported on your quarterly employment tax return—Form 941. If you withheld less than the right amount of income, social security, or Medicare taxes from an employee's wages and fail to correct this prior to the last day of the applicable calendar year, the employer is responsible for the underpayment and penalties.



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**Failure to Identify and Report Defaulted Loans.** Loans that fail to comply with the provisions of section 72(p) may be deemed a taxable distribution that is reported to the employee as income. For example: Loan defaults often occur when required payments are missed or aggregate loans exceed the \$50,000 maximum limit, often as a result of loans from multiple vendors.

### **Failure to Satisfy Hardship Distribution**

**Requirements.** “Hardship distributions” are considered premature distributions when:

- adequate documentation of the financial hardship is not obtained,
- other available financial means were not previously exhausted, or
- distributions from multiple vendors, in aggregate, exceed the amount needed to relieve the hardship.

If you find mistakes in your 403(b) plan, take steps to bring it into compliance so that your employees can continue to benefit on a tax-favored basis. As an employer, mistakes on your retirement plan need to be corrected timely to avoid additional taxes and penalties that may affect both you and your employees. You may want to contact a tax professional for help.

Most 403(b) plan mistakes can be corrected through the Employee Plans Compliance Resolution System (EPCRS). Information on EPCRS is available through [www.irs.gov/ep](http://www.irs.gov/ep). See CORRECTION.



403(b)  
Tax-Sheltered  
Annuity Plan

for **Sponsor**

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. Generally, these annuities are funded by elective deferrals made under salary reduction agreements and nonelective employer contributions.

Read on to learn about specific 403(b) topics where mistakes are common, and learn about Internal Revenue Service (IRS) products, services, and assistance to help you keep your 403(b) tax-sheltered annuity plan healthy.



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Note: Underlined topics identify electronic links for detailed information on that topic. For those reading a print version of this product, you can access an electronic version on-line at [www.irs.gov/ep](http://www.irs.gov/ep) to link to your topic of interest.

# Customer Assistance

The following publications cover 403(b) tax-sheltered annuity plans, other retirement plans, and 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 590, *Individual Retirement Arrangements (IRAs)*
- Publication 3998, *Choosing a Retirement Solution for Your Small Business*
- Publication 4050, *Retirement Plan Correction Programs CD-ROM*
- Publication 4224, *Retirement Plan Correction Programs pamphlet*
- Publication 4406, *403(b) and 457 Retirement Plans with plan feature comparison chart*

Download these publications at [www.irs.gov/ep](http://www.irs.gov/ep), or order a free copy through the IRS by dialing (800) 829-3676.

For assistance or information on retirement plan tax-related issues:

[\*\*www.irs.gov/ep\*\*](http://www.irs.gov/ep)

Visit this site for on-line resources covering specific retirement plans (including 403(b) plans). Site has tools such as a checklist for maintaining your plan, source documents, and worksheets.

(877) 829-5500

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