Customer Assistance

The following publications cover 403(b) tax-sheltered annuity plans, other retirement plans and correction programs:

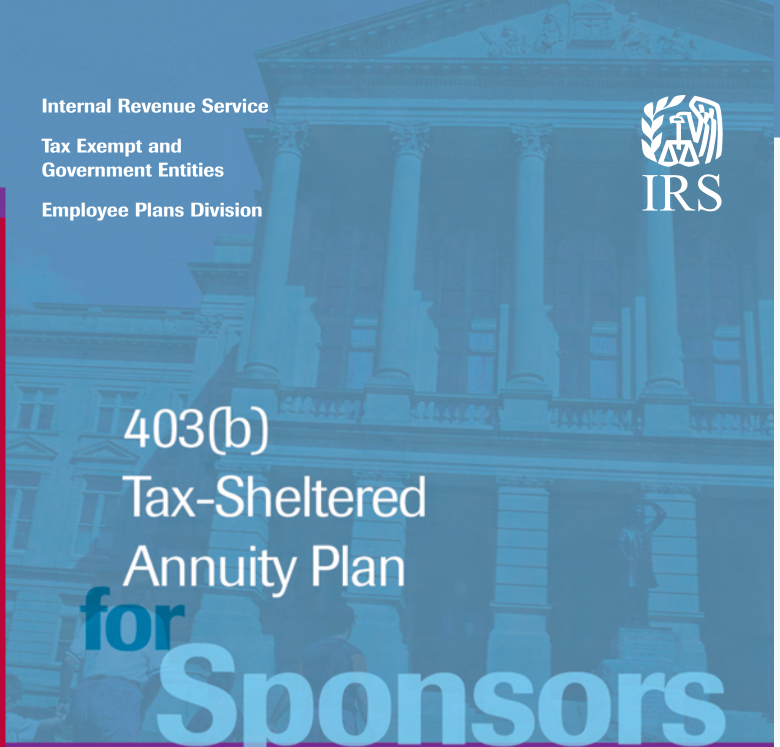
- Publication 15, *Circular E, Employer's Tax Guide*
- Publication 571, *Tax-Sheltered Annuity Plans (403(b) Plans) for Employees of Public Schools and Certain Tax-Exempt Organizations*
- Publication 590, *Individual Retirement Arrangements (IRAs)*
- Publication 4482, *403(b) Tax-Sheltered Annuity for Participant*
- Publication 4484, *Choose a retirement plan for employees of tax exempt and government entities*
- Publication 4546, *403(b) Plan Checklist*
- Publication 4224, *Retirement Plan Correction Programs*

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

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

- a checklist for maintaining your plan,
- 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.

Publication 4483 (3-2010) Catalog Number 47243V
Department of the Treasury **Internal Revenue Service** www.irs.gov



Internal Revenue Service

Tax Exempt and Government Entities

Employee Plans Division

IRS

403(b) Tax-Sheltered Annuity Plan for Sponsors

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.**

Highlights for Employers on the Final 403(b) Regulations

IRS published 403(b) Regulations on July 26, 2007. These regulations were generally effective on January 1, 2009, and cover the changes made by legislation from the past 43 years.

Written Plan Requirement: The 403(b) Regulations require 403(b) programs be maintained pursuant to a written plan that satisfies the requirements of IRC 403(b), both in form and operation, and contains all the terms and conditions for eligibility, limitations and benefits under the plan. This means all provisions of the way the plan works have to be spelled out in a plan and it must be operated accordingly.

Many organizations may already have these types of programs. For example, the plan may be composed of the aggregate of a salary reduction agreement, the contracts that fund the plan and administrative procedures regarding eligibility, benefits, dollar limitations and nondiscrimination for universal availability for salary reductions and non-elective contributions.

Revenue Procedure 2007-71 contains model plan language that would enable a 403(b) sponsoring public school to put together a basic 403(b) program.

Sample plan language for certain 403(b) plans is contained in Announcement 2009-34.

Depositing Elective Deferrals: 403(b) elective deferral contributions must be handed over to the annuity or custodial account as soon as is reasonable for the proper administration of the plan. The plan may provide that a plan participant's elective deferrals be transferred to the annuity contract within a set number of days after the date the amounts would have been paid to the participant. ERISA plans may be subject to stricter time frames.

Post-Severance Contributions: Plans may permit two separate and unrelated provisions for contributions to be made to 403(b) plans after an employee separates from service.

- **Elective deferrals:** Employees may defer some (up to their annual deferral limits) of their regular, accrued vacation and sick pay into their 403(b) accounts if received by the later of 2 ½ months from the date of severance or the end of the limitation year (in most cases, calendar year) in which the severance occurred.
- **Employer non-elective post-severance contributions:** The employer may make non-elective post-severance contributions up to the maximum legal overall limit into a former employee's 403(b) account for up to five years following the end of the year in which the employee severed service with the employer. (Note: The former employee can have no part in electing whether to receive this money in cash or have it deferred into their 403(b) account.) All post-severance contributions must end upon the former employee's death.

New In-Service Exchanges and Transfer Rules: The Regulations impose new requirements on in-service exchanges and transfers. The new rules distinguish between within-plan exchanges to vendors not currently on the plan's approved list and the moving of funds to another plan. These replace the old rules under Revenue Ruling 90-24.

- **In-service exchanges** take place within the same plan. To be allowable, the 403(b) plan must permit the movement of the funds and the terms must be followed in operation.

  Benefits cannot be reduced and if the moved funds were subject to distribution restrictions, they must continue to be subject to the same restrictions.

  The employer and the contract issuer must agree to share certain required information so the employer can follow the rules of the Code and Regulations, especially those concerning loan restrictions and hardship distributions.

- **Plan transfers** are the plan-to-plan movement of funds. To be allowable, the transferor plan must permit the movement out and the receiving plan must permit and approve the acceptance of the funds. In addition, the participant must be an employee or former employee of the employer of the receiving plan. Benefits cannot be reduced and if the moved funds were subject to distribution restrictions, they must continue to be subject to the same restrictions.

403(b) Tax-Sheltered Annuity Plan—COMMON MISTAKES

Stay informed. Subscribe today to the *Retirement News for Employers* at www.irs.gov/ep. See NEWSLETTERS.

403(b) Tax-Sheltered Annuity Plan for Sponsors

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

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 §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 not give employees who are otherwise eligible (for example, otherwise eligible part-time employees) the right to make employee elective deferrals.

The Regulations allow employers to use a 1,000-hour concept to identify eligible part-time employees (ERISA plans should consult their tax advisor to see if this approach is a good fit for their organization). The regulations also discuss the requirement for issuing meaningful notice to eligible participants of their right to make elective deferrals.

Failure to Limit Employee Elective Deferrals. The general limit on employee elective deferrals is $16,500 in 2010, 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 15 of the following year to avoid additional taxes and penalties for both the employee and employer. Excess deferrals, distributed timely, are included as income for the year contributed with the applicable earnings 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, you are responsible for the underpayment and penalties.

Failure to Identify and Report Defaulted Loans. Loans that fail to comply with the provisions of §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 maximum limit, often as a result of loans from multiple vendors.

Failure to Satisfy Hardship Distribution Requirements. The Regulations clarify that 403(b) plan hardship distributions will follow the 401(k) rules. Hardship distributions are considered premature distributions when:

- adequate documentation of the financial hardship was not obtained,
- other available financial means were not previously exhausted, or
- total distributions from multiple vendors exceeded the amount needed to relieve the hardship.

If you find a mistake in your 403(b) plan, take steps to bring it into compliance so your employees can continue to benefit on a tax-favored basis. As an employer, mistakes in your 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. See *Correcting Plan Errors*.

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 non-elective employer contributions.

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

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