

Introduction

The AICPA Employee Benefit Plan Audit Quality Center has developed this primer to provide Center members with a general understanding of 403(b) plans. This document provides information about the nature and characteristics of 403(b) plans, a discussion of recent regulatory developments, and information about other helpful resources.

403(b) plans

Also known as tax-sheltered annuity (TSA) plans.

A 403(b) tax-sheltered annuity (TSA) plan is a retirement plan offered by schools, hospitals, churches, charities and certain other 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 may include non-elective employer contributions.

Participants may include:

- employees of public school systems, colleges or universities (teachers, school administrators, school personnel, professors, researchers, librarians)
- employees of entities tax-exempt under section 501(c)(3) of the Internal Revenue Code (charitable, scientific, educational, etc.)
- employees of cooperative hospital service organizations (for example, nurses and doctors)
- church employees and ministers
- employees of public school systems organized by Indian tribal governments

How 403(b) plans work

403(b) plans work very similar to 401(k) plans.

403(b) plans allow employees to defer some of their salary to make contributions to the plan. Contributions can be made by elective deferrals under a salary reduction agreement, non-elective contributions including employer matching or discretionary contributions, employee after-tax contributions, or any combination of these. Contributions and investment earnings in a 403(b) are tax-deferred until withdrawn (assumed to be retirement), at which time they are taxed as ordinary income. 403(b) plans can also accept designated Roth contributions if properly amended.

Employee elective deferrals are subject to limitations, and are immediately 100% vested. As with 401(k) plans, special 403(b) catch-up contributions are permitted if the participant has reached age 50 by the end of the year, and the maximum amount of elective deferrals that can be made to the 403(b) account have been made for the plan year. Employer contributions may be made, with vesting over a specified time period in accordance with plan terms. Withdrawals are permitted after a distributable event occurs (e.g., retirement, death, disability, severance from employment), and rollovers or transfers are permitted to an eligible retirement plan.

Plan investments

403(b) plans comprise individual investment accounts.

The individual investment account in a 403(b) plan can be any of the following types:

- Fixed and variable annuity contracts with insurance companies (403(b)(1) annuities)
- Custodial account made up of mutual funds (403(b)(7) accounts)
- A retirement income account set up for church employees (403(b)(9) accounts)

Recent regulatory developments

The DOL has issued new regulations eliminating an exemption from the annual Form 5500 reporting requirements.

In November 2007, the Department of Labor issued amended regulations eliminating an exemption granted to 403(b) plans from the annual Form 5500 reporting, disclosure and audit requirements under Part 1 of Subtitle B of Title I of ERISA. The removal of this exemption subjects ERISA-covered 403(b) plans to the same Form 5500 reporting and audit requirements as 401(k) plans, effective with their 2009 Form 5500 filings. Generally, 403(b) plans sponsored by charities are subject to ERISA, whereas 403(b) plans sponsored by religious organizations and governments are not covered under ERISA.

“Large” ERISA-covered 403(b) plans (generally plans with 100 or more participants) will be required to file audited financial statements beginning with their 2009 Form 5500 filing. “Small” 403(b) plans (generally fewer than 100 participants) may be eligible to use a new Short Form 5500 and thus may be eligible to use abbreviated reporting forms without audited financial statements. The DOL estimates that approximately 7,000 “large” 403(b) plans will be subject to the new audit requirements and another 9,000 “small” 403(b) plans may be eligible to use the abbreviated reporting forms.

The IRS has issued new comprehensive 403(b) regulations and model plan language.

On July 23, 2007, the IRS issued the first comprehensive regulations for 403(b) plans in 43 years (published in the July 26, 2007 Federal Register). In summary, the new regulations impose due diligence and compliance criteria; require 403(b) programs to be maintained pursuant to a written defined contribution plan that satisfies 403(b) in both form and operation and contains all the terms and conditions for eligibility, limitations and benefits under the plan; provide stricter transfer rules; and establish a bright-line universal availability test. The general effective date is for taxable years beginning after December 31, 2008, with some exceptions.

The IRS also issued Revenue Procedure 2007-71, which provides model plan language that may be used by public schools to either adopt a written §403(b) plan or to amend its §403(b) plan to reflect the requirements of the Internal Revenue Code and final 403(b) regulations. See <http://www.irs.gov/pub/irs-drop/rp-07-71.pdf>

Additional resources

DOL Field Assistance Bulletin No. 2007-02, which addresses how the Treasury/IRS regulations governing 403(b) tax-sheltered annuity programs affect the status of such programs under the DOL’s safe harbor regulation at 29 C.F.R. § 2510.3-2(f). See <http://www.dol.gov/ebsa/regs/fab2007-2.html>

IRS Web site on IRC 403(b) Tax-Sheltered Annuity Plans at <http://www.irs.gov/Retirement-Plans/IRC-403%28b%29-Tax-Sheltered-Annuity-Plans>

IRS Publication 571 Tax-Sheltered Annuity Plans (403(b) Plans) (Rev. November 2007) Cat. No. 46581C <http://www.irs.gov/pub/irs-pdf/p571.pdf>

Other IRS publications:

Pub. 4484, Choose a retirement plan for employees of tax-exempt and government entities (schools, hospitals, churches, charities)

Pub. 4483, 403(b) Tax-Sheltered Annuity Plan for Sponsor

Pub. 4482, 403(b) Tax-Sheltered Annuity for Participants

Pub. 4547, Have you had your check-up this year? for 403(b) Retirement Plans

Pub. 4546, 403(b) Plan Checklist

Pub. 4530, Designated Roth Accounts under a 401(k) or 403(b) Plan.

This primer is a non-authoritative practice tool developed by the AICPA Employee Benefit Plan Audit Quality Center to assist member firms in preparing staff for the employee benefit plan audits they perform. We have assembled general and background information on the Medicare Prescription Drug, Improvement and Modernization Act of 2003, along with information about the relevant accounting standards, in an easy-to-understand format. This primer also provides information about additional sources that may be consulted when researching the Act and the Retiree Drug Subsidy.