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IRS snapshots show continued focus on 403(b) plan compliance

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Two new IRS issue snapshots reflect the agency's continued focus on Section 403(b) plan compliance. One snapshot reviews the [universal availability requirement](#) for plans that prohibit employees from participating under Section 403(b)'s statutory exclusions. The other addresses how to [apply the Section 415 limit](#) when a 403(b) annuity contract is aggregated with a qualified defined contribution (DC) plan. Snapshots generally summarize existing guidance rather than provide new information, but they may alert plan sponsors to the kinds of issues IRS agents review during plan audits.

Universal availability requirement

Elective deferrals in 403(b) plans not offered by churches or qualified church-controlled organizations must satisfy the universal availability requirement: If the plan gives any employees the opportunity to make elective deferrals, then the plan generally must make the opportunity available to all employees.

Section 403(b) lets a plan exclude only certain groups of employees:

- Employees normally working less than 20 hours a week
- Students employed by the school, college or university they attend
- Nonresident aliens
- Employees eligible to make elective deferrals under a 401(k), 403(b) or 457(b) plan sponsored by the same employer

A plan may not use a generic classification for this purpose, such as part-time, seasonal or temporary employees.

IRS auditors may check to ensure plans using the four statutory exclusions are applying them correctly. In particular, the snapshot cautions that plans often erroneously exclude all part-time employees, rather than excluding only those the employer reasonably expects to work less than 20 hours per week — meaning the employer expects the employee to work less than 1,000 hours in a year.

IRS may also check that plans are complying with the “once in, always in” (OIAI) rule, which says an employer cannot use the statutory exclusion for a part-time worker once the employee has worked at least 1,000 hours in a year. Plans that have run afoul of the rule before 2020 may be eligible for IRS’s 2018 OIAI transition relief in [Notice 2018-95](#).

Applying 415(c) limit when aggregating 403(b) and qualified DC plans

If a Section 403(b) plan participant also participates in another qualified DC plan, the Section 415(c) annual additions limit is usually applied separately to the two plans. However, an exception to this rule can apply if the participant is deemed to be in control of the sponsor of the other DC plan. This can occur, for instance, when a university professor participates in the school’s 403(b) plan and owns a separate consulting company that sponsors a 401(k) plan. In this case, contributions from both plans must be aggregated to demonstrate compliance with the 415(c) limit. If the participant’s aggregate contributions exceed the limit, any excess contributions are attributed to the 403(b) plan and includable in the participant’s gross income.

IRS auditors most frequently come across this issue in plans sponsored by governmental and tax-exempt healthcare organizations and universities. IRS considers aggregation to be a low audit risk if the 403(b) plan sponsor prohibits outside employment. However, if the sponsor permits or is silent about outside employment, the snapshot instructs auditors to examine the procedures used to inform employees about aggregation and any information provided by employees regarding outside employment and plan contributions.

To ensure compliance with the 415(c) limit, sponsors that don’t prohibit outside employment should solicit information from participants about any businesses they control and any retirement plans offered by those businesses.

Focus on 403(b) plan compliance continues

In its 2020 fiscal year priorities letter, IRS announced it would be examining compliance with the 403(b) universal availability requirement, excess contributions and catch-up contributions limits. IRS’s [Compliance Program and Priorities](#) webpage notes that those efforts continue to be an area of focus in fiscal year 2021, along with the agency’s other priorities from 2020. These new snapshots, as well as one on [catch-up contributions](#) issued last year, reflect the agency’s commitment to these compliance issues.

Related resources

Non-Mercer resources

- [403\(b\) plan — Application of IRC Section 415\(c\) when a 403\(b\) plan is aggregated with a Section 401\(a\) defined contribution plan](#) (IRS, Aug. 20, 2021)
- [403\(b\) plan — The universal availability requirement](#) (IRS, Aug. 12, 2021)
- [403\(b\) plans — Catch-up contributions](#) (IRS, Aug. 12, 2021)

Mercer resources

- [IRS sets fiscal 2021 compliance priorities for tax-exempt entities](#) (Nov. 20, 2020)

- [IRS focuses on 457\(b\), 403\(b\) plan catch-up contributions](#) (June 16, 2020)
- [IRS issues relief for 403\(b\) plan 'once in, always in' rule for part-time employees](#) (Jan. 21, 2019)

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