



Navigating life together

403(b) Plans – Tax Sheltered Annuities (TSAs)



403(b) Plans – Tax Sheltered Annuities (TSAs)

What is a 403(b) Plan?

- A tax-advantaged, defined contribution, retirement savings plan, sometimes called a tax-sheltered annuity, available for public education organizations, institutions of higher education, some not-for-profit employers (only 501(c)(3) organizations), cooperative hospital service organizations and self-employed ministers in the United States
- May be subject to ERISA. 403(b) plans are either considered ERISA or non-ERISA
- Employee contributions, which are payroll deducted into a 403(b) plan, are generally made on a pre-tax basis and are allowed to grow tax deferred; Withdrawals from the plan are taxed as ordinary income

403(b) Plans – Tax Sheltered Annuities (TSAs)

What is a 403(b) Plan?

- 403(b) plans are funded with annuity contracts and/or a mutual fund platform
- Roth contributions may be allowed and are taxable subject to certain requirements; Earnings on Roth contributions that meet certain requirements are not subject to Federal income tax*
- Some plans provide for employer match and/or non-match contributions on behalf of plan participants
- FICA taxes are currently withheld from salary reduction contributions to the 403(b)

**Subject to certain requirements as state tax treatment varies*

Section 403(b)

- Section 403(b) of the tax code permits employees of public educational organizations and Section 501(c)(3) nonprofit organizations to:
 - purchase an annuity contract and,
 - subject to certain limitations, exclude the amount of the contributions from gross income for income tax purposes or, otherwise, pay tax and allocate the amount to a Roth account.

Section 403(b)

- A 403(b) annuity is normally funded by payroll deductions:
 - Employee authorizes the employer to reduce his/her salary by a specified amount to contribute to a 403(b)
 - Employer forwards this amount to an insurance company to fund a 403(b) on behalf of the employee
- No federal income taxes are currently withheld on the portion of salary contributed to the 403(b) and it is excluded from the employee's gross income for federal and most state income tax purposes, (except in the case of designated Roth contributions).
- However, FICA taxes are currently withheld from the portion of salary contributed to the 403(b).

Section 403(b)

- Each employee who wishes to participate in a 403(b) generally must submit a “salary reduction agreement (SRA)” (also referred to as an “amendment to employment contract”) to the employer specifying the amount by which the employee’s salary is to be reduced.
- Some 403(b) plans have automatic enrollment features that automatically begin salary reduction contributions when employees become eligible to participate, unless the participant affirmatively opts out. These automatic enrollment plans are also known as “negative election” plans.

Section 403(b)

- The tax code limits the amount each employee can contribute to a 403(b) plan. This amount depends on a number of factors and should be determined annually for each employee using a formula that complies with applicable tax requirements.
 - More details on this will be discussed later in the section on Maximum Allowable Contributions.

403(b) Retirement Benefits

- A 403(b) annuity contract may be annuitized at any time after becoming eligible for distribution
- There are 2 periods to an annuity; pay in (accumulation) and payout (annuitization)
- Until a 403(b) account is annuitized, required minimum distribution rules generally require taxable amounts begin the year in which you reach the age of 72 or separation of service if later. This went into effect January 1st of 2020.

403(b) Retirement Benefits

- The CARES Act¹ provided for a waiver of required minimum distributions due in calendar year 2020 from most defined contribution plans and IRAs.

¹The CARES Act provides for coronavirus-related distributions for amounts up to \$100,000 from an individual's available vested account balance without regard to the normal withdrawal restrictions. This relief is offered through to December 31, 2020. Eligible retirement accounts include most profit sharing, money purchase, 401(k), 403(b), governmental 457(b) plans and individual retirement accounts (IRAs).

403(b) Retirement Benefits

- The annual required distribution amount is calculated based on life expectancy tables provided by the IRS
- A federal tax penalty of 50% will apply to any required distribution amounts that are not taken
- Distributions can be made in one lump sum or at periodic intervals, including as annuity payments, depending on plan terms
- Income taxes are payable in the year a taxable distribution is received

403(b) - Payout Options Other Than Lump Sum

- Life income – Provides income payments during lifetime of annuitant. Upon death of annuitant there are no payments to beneficiary
- Life Income with Period Certain – Provides income payments for period certain elected (5, 10, 15 or 20 years) or lifetime of annuitant, whichever is longer. If annuitant death occurs prior to end of elected period, beneficiary will receive payments for remainder of period certain. Beneficiary may not take remaining monies in lump sum

403(b) - Payout Options Other Than Lump Sum

- Joint and Survivor Annuity – Provides income payments for lifetime of two annuitants. Upon death of either annuitant, income continues to survivor for his/her lifetime. Payments to survivor may continue at the same amount or can be a reduced amount of two thirds or one half.
- Income for a Specified Period (AKA “Income for a Designated Period” or “Period Certain” – Provides income payments for a selected period of time. Periods available are usually 3 to 30 years; This is a popular option because it allows the annuitant to individually customize distributions in the time period suited for his/her retirement needs

403(b) Regulations – Effective as of January 1, 2009

- Any employer that makes a 403(b) plan available to its employees must adhere to certain requirements, including, in most cases, adopting and maintaining a written plan. Subject to certain restrictions, the plan must have been adopted by December 31, 2009
- The employer must establish and maintain the plan:
 - Adopt a written plan document
 - Identify the approved providers that are available as part of the plan
 - Determine employee eligibility and enforce universal availability requirements

403(b) Regulations – Effective as of January 1, 2009

- Determine if the plan will allow employees to effect exchanges and transfers
 - Decide what type of contributions will be permitted, including Roth contributions
 - Decide if the plan will allow employees to take a loan or hardship distribution
 - Ensure contributions are remitted to approved providers in a timely manner
 - For ERISA plans, comply with DOL Plan and Participant-Level Fee Disclosure Regulations
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- If the employer doesn't operate the plan in accordance with IRS and ERISA guidelines, it can have a severe adverse impact on plan participants and the tax-deferred status of the plan

403(b) Plans – Key Provision:

Written Plan

- Sponsors of 403(b) plans are required to have a written plan document
- MetLife Offers an IRS pre-approved prototype formatted volume submitter 403(b) plan document
- The written plan must satisfy 403(b) regulatory requirements in form and operation

403(b) Plans – Key Provision:

Written Plan

- Written plan must contain all material terms and conditions including:
 - Eligibility
 - Time and form of distributions
 - Applicable limitations
 - Approved providers under the plan
 - Assignment of compliance and administrative responsibility (Third party administrator (TPA), if applicable)
- Information sharing agreements are needed to maintain the 403(b) status of contracts and accounts that receive exchanges after 9/24/07 if the contract or account is not already part of the employer's plan.

403(b) Plans – Key Provision:

Universal Availability & Effective Opportunity Requirement

- Significant IRS audit focus
- “Everyone or no one” Rule - If the Plan is offered to one employee, it must be offered to all employees
- Employees who normally work less than 20 hours per week can be excluded. Employer need to keep records of actual hours
- Subject to certain transitional rules, collectively-bargained groups may no longer be excluded from eligibility to participate
- Effective opportunity requirement:
 - Employees must be notified at least once per year of the availability to make salary reduction contributions; Plan must keep records of notifications for audit purposes
 - Opportunity at least once per plan year to start or change deferrals
 - Anti-conditioning requirement: A plan can’t make participation conditional on another benefit or employer program

**Note that ERISA provisions may contain more stringent rules.*

Maximum Allowable Contributions (MAC) Calculation

- 401(k) and 403(b) plans defer taxes on income by allowing elective before-tax contributions
- Roth after-tax elective contributions are also permitted and when eventually distributed with earnings will be distributed tax-free subject to certain restrictions
- Before-tax and Roth elective contributions are aggregated for MAC purposes

Maximum Allowable Contributions (MAC) Calculation

- Two separate Internal Revenue Codes apply to contribution limits for the individual employee:
 - Limit I. Section 415(c) General Limit: applies to both employer and employee contributions, and reallocated forfeitures
 - Limit II. Section 402(g) Elective Deferral Limit: applies to only the employee's voluntary salary reduction contributions and Roth deferrals (elective deferrals)
- A special increased elective deferral limit for certain employees is also permitted, and contains specific rules regarding aggregating 403(b) contributions and accrued benefits with those of other plans

Maximum Allowable Contributions (MAC) Calculation

- Limit I. Section 415 (c) General Limit
 - Annual additions to a defined contribution plan on behalf of a participant (employer and employee contributions) cannot exceed the lesser of 100% of the participant's compensation or \$61,000 (for 2022).
- Limit II. Section 402(g) Elective Deferral Limit
 - Limit applies equally to all salary reduction contributions and Roth contributions (elective deferrals) whether made by an individual to a 403(b), 401(k), SEP or SIMPLE IRA.
 - All elective deferrals made by employee to other plans must be aggregated with the 403(b) contribution to determine if limit has been exceeded. (Contributions to 457(b) plans are not aggregated into the 402(g) limit for the above plans).
 - The 2022 annual limit is the lesser of 100% of compensation or \$20,500.

Maximum Allowable Contributions (MAC) Calculation

- Employees over age 50 are eligible to use a catch-up contribution of \$6,500 for 2022 (Not available for 457(b) tax-exempt age 50 and over)

**Refer to www.IRS.gov for more details on current limits*

Maximum Allowable Contributions (MAC) Calculation

Catch-Up Contributions for employees with 15-years of service

To qualify for the 15-years of service catch-up (if the employer's plan includes this provision) the employee must have 15 years of service with the same eligible 403(b) employer. The limit on elective deferrals to the participant's 403(b) account may be increased by up to \$3,000 in any taxable year (lifetime employer-by-employer limit of \$15,000) if the employee has at least 15 years of service with the same employer in a, public school system, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches.

Maximum Allowable Contributions (MAC) Calculation

Catch-Up Contributions for employees with 15-years of service

There are several calculations to determine a participant's eligibility to make up to a \$3,000 catch-up contribution.

The amount of the special 15-year catch-up and the underused amount is equal to the lesser of:

- \$3,000;
- \$15,000 reduced by the sum of prior years' 15-year catch-up deferrals; or
- \$5,000 x years of service with the employer, minus the total of all elective deferrals made to a 403(b), 401(k), SARSEP or SIMPLE IRA plan maintained by the employer, including the 15-year catch-up, but excluding the age 50 catch-up.

Maximum Allowable Contributions (MAC) Calculation

Catch-Up Contributions for Employees with 15 Years of Service

The ordering for participants eligible for both types of catch-up contributions is:

- 15-year catch-up, then
- age 50 catch-up.

If a participant uses an age 50 catch-up, but was eligible for the 15-year catch-up, the rules first count the contribution toward the 15-year catch-up lifetime maximum

Disclosure

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