

Blueprints: A Guide to School System Plans 403(b) and 457(b)

**IRS Hot Issues:
403(b) and 457(b) Comparison Chart**

This chart offers a side-by-side comparison of some important 403(b) plan and 457(b) plan and audit issues. It identifies all of the required and optional requirements of a 403(b) plan.

The sections in red lettering highlight key areas that have been identified by the Internal Revenue Service as common audit concerns.

Category	403(b) Plan	457(b) Plan
General Description	A tax-deferred annuity program that permits employees (on a voluntary basis) to reduce their salary by an amount not previously available and have that amount contributed to the program on their behalf, subject to certain IRS contribution limits. A plan may also permit a Designated Roth 403(b), employer contributions and matching contributions.	A deferred compensation plan that allows employees and/or independent contractors performing services for the employer to defer a portion of employees' salary to the plan, subject to certain IRS contribution limits.
Subject to the Requirements of Title 1 of ERISA	No. Public school plans are not subject to Title 1 of ERISA	No. Public school plans are not subject to Title 1 of ERISA.
Eligible Participants	Employees only are eligible. In general, independent contractors and leased employees may not be covered under a 403(b) plan. An employee is considered to be eligible to participate if performing services directly or indirectly for a public school system. School board members are not eligible to participate except in limited circumstances.	Participants may include employees/and or independent contractors.
Funding Vehicles	Assets are held in a trust (custodial account) or in an annuity for the exclusive benefit of the participants.	Assets must be held in either a trust, a custodial account or an annuity account for the exclusive benefit of the participants or their beneficiaries. Assets are not subject to claims of the employer's general creditors.

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<p>Contribution Limits</p>	<p>Employee voluntary deferrals are limited to an elective deferral limit under Code Section 402(g) (2007 and 2008: \$15,500); subject to annual cost-of-living adjustments). An increase is available for employees with at least 15 years of service with the employer, provided that other requirements are satisfied. The maximum increase is \$3,000 per year and \$15,000 over a lifetime.</p> <p>The total of employee voluntary deferrals, non-elective employee contributions, and employer contributions is limited to dollar and percentage limits under Code Section 415(c):</p> <ul style="list-style-type: none"> • 100% of participant compensation up to • \$45,000 (2007) and \$46,000 (2008) (subject to annual cost-of-living adjustments) <p>Age 50 catch-up provisions:</p> <p>For an employee age 50 and older, once the employee has reached these contribution limits, he can contribute up to an additional \$5,000 per year (in 2007 and 2008), subject to annual cost-of-living adjustments. This contribution does not count toward either the 402(g) or 415(c) contribution limit.</p>	<p>Total of employer and employee contributions is limited to 100% of includible compensation to \$15,500 (for 2007 and 2008): subject to annual cost-of-living adjustment.</p> <p>An employee within 3 years of the year in which he reaches Normal Retirement Age, as defined in the 457 plan document, may be eligible to contribute a total of up to twice the basic limit. Use of this catch-up is limited to the amount of unused contributions in prior years that the 457(b) plan was available.</p> <p>For an employee age 50 and older, once the employee has reached these contribution limits, he can contribute up to an additional \$5,000 per year (in 2007 and 2008), subject to annual cost-of-living adjustments, or the amount of the employee's deferrals, whichever is less. An employee who is eligible for both the 457 special catch-up and the age 50+ catch-up in a 457(b) plan may only use the catch-up that yields the greatest amount.</p>
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<p>Contribution Limits</p>	<p>General Rule: The annual total of employee deferrals (other than the age 50+ catch-up contribution), Roth 403(b), and any employer contributions cannot exceed the lesser of:</p> <ol style="list-style-type: none"> 1. The section 415(c) limit on annual additions is, generally, the lesser amount of 100% includible compensation” up to \$45,000 (2007) or \$46,000 (2008) (subject to annual cost-of-living adjustments). 2. Section 402(g) limit on salary reduction contributions (\$15,500 for 2007 and 2008, subject to annual cost-of-living adjustments). This limit takes into consideration all employee elective deferrals and Roth 403(b) contributions (other than the age 50+ catch-up contribution) of an individual. <p>In the special catch-up provision for employees who have completed at least 15 years of service with their current school employer, the annual deferral is increased by the lesser of:</p> <ul style="list-style-type: none"> o \$3,000 o \$15,000, reduced by amounts not included in gross income for prior years due to the catch-up election o \$5,000 times years of service with the employer, minus all amounts of prior years’ contributions attributable to elective deferrals made to the current employer’s plans 	<p>General Rule: Deferrals, including salary reduction contributions (other than the age 50+ catch-up contribution) and any employer contribution, cannot exceed the lesser of \$15,500 (for 2007 and 2008) or 100 % of includible compensation. Subsequent annual cost-of-living adjustments are made in \$500 increments</p> <p>The special catch-up provision may, generally, defer up to twice the general deferral limit for the three-year period prior to the year in which the participant attains the elected normal retirement age under the plan.</p> <p>In the age 50-and-over catch-up provision, participants who are at least age 50 may make an additional \$5,000 (for 2007 and 2008) annual contributions. Subsequent annual cost-of-living adjustments are made in \$500 increments. A participant is not allowed to use the special catch-up and the 50-and-over catch-up in the same year.</p>
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<p>Nondiscrimination Requirements</p>	<p>Employee deferrals are subject to the universal availability rule. Generally, if any employee may defer compensation, all employees must be permitted to likewise defer compensation, subject to certain permitted exclusions described in the Internal Revenue Code. If an employer is using one of those permitted exclusions, the exclusion must be applied consistently.</p> <p>Employees normally working less than 20 hours per week can be excluded as a group. To determine what is “less than 20 hours per week,” the regulations provide a 1,000 hour test. Generally, this rule looks forward for newly hired employees (Are they expected to work at least 1,000 hours in their first year?), and backward for existing employees (Did they work at least 1,000 hours last year?)</p> <p>If the Roth 403(b) option is offered to any employee, it must be offered to all eligible employees, following the same eligibility rules as pre-tax deferrals. An employer cannot elect to offer only the after-tax Roth 403(b) alternative.</p> <p>Nondiscrimination rules generally do not apply to employer contributions to plans of public employers, although the IRS does limit the amount of compensation that can be taken into account for purposes of determining the amount of the employer contribution.</p>	<p>Nondiscrimination rules do not apply.</p>
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<p>Withdrawal Limits</p>	<p>Distributions of employee deferrals and earnings on those deferrals, whether from an annuity contract or a custodial account, are available:</p> <ul style="list-style-type: none"> • at age 59½ • upon severance from employment • upon death or disability • upon financial hardship (note that only earnings as of 12/31/88 can be withdrawn, but contributions are accessible regardless of when contributed) • upon qualifying plan termination (effective with the new regulations) <p>Distributions of employer contributions:</p> <ul style="list-style-type: none"> • if made to a custodial account are the same as above • if made to an annuity contract, new restrictions in the final regulations provide that employer contributions and earnings may be distributed upon include severance from employment, death or occurrence of stated event <p>Distributions of participant deferrals, employer contributions, and attributable earnings may be further limited by the employer’s plan and/or products funding the plan.</p>	<p>Distributions available:</p> <ul style="list-style-type: none"> • upon severance from employment • upon death • upon unforeseeable emergency • at age 70½ • if eligible for a one-time in service withdrawal of up to \$5,000 <p>Distributions of contributions and attributable earnings on those deferrals may be further limited by the employer’s plan and/or products funding the plan.</p>
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<p>Optional Provisions</p> <p>Types of Transfers Permitted</p>	<p>Transfers within the same 403(b) plan (contract exchanges) to providers under the plan which have entered into information sharing with the employer plan-to-plan transfers.</p> <p>A participant may purchase service credit in a qualified government retirement plan, if permitted by both the 403 (b) 457 plan and the retirement system.</p> <p>Distributions: QDRO (Qualified Domestic Relations Order) is a court-ordered divorce settlement.</p> <p>Permitted subject to terms of the plan.</p> <p>Financial hardship – an immediate and heavy financial need that cannot be satisfied by other financial resources of the participant. A 403(b) plan may decide to determine what is a hardship based on the IRS 401(k) safe harbor provisions (which would require the participant to cease making any voluntary contributions to all plans of the school for 6 months from the date of the hardship) or meet facts and circumstance test.</p>	<p>Transfers within the same 457 plan to approved providers under the 457plan.</p> <p>Plan-to-plan transfers: A participant may purchase service credit in a qualified government retirement plan, if permitted by both the 457 plan and the retirement system.</p> <p>Same as 403(b)</p> <p>Same as 403(b)</p> <p>Unforeseeable emergency withdrawal is a severe financial hardship of the participant, the participant’s spouse or the participant’s dependents resulting from an illness or accident, loss of the Participant’s property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.</p>
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	<p>Distributions can be made:</p> <ul style="list-style-type: none"> • at age 59½ • upon severance from employment, • upon death or disability • upon financial hardship (note that only earnings as of 12/31/88 can be withdrawn, but contributions are accessible regardless of when contributed) • upon qualifying plan termination (effective with the new regulations) <p>Distributions of employer contributions:</p> <ul style="list-style-type: none"> • if made to a custodial account, are the same as above • if made to an annuity contract, there are new restrictions in final regulations <ul style="list-style-type: none"> ○ can include severance from employment ○ death ○ occurrence of stated event <p>Distributions may be further limited by the employer’s plan and/or products funding the plan.</p>	<p>Distributions are made:</p> <ul style="list-style-type: none"> • upon severance from employment • death • upon unforeseeable emergency • at age 70½ • if eligible for a one-time in service withdrawal of up to \$5,000 <p>Distributions may be further limited by the employer’s plan and/or products funding the plan.</p>
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