Eligibilty Requirements for 403(b) Plans Differ From 401(k) Plans

By David Pearsonon March 16, 2011

Employers who sponsor a 403(b) tax-deferred annuity plan for their employees need to be aware of the "universal availability" eligibility requirement for employee pre-tax deferral contributions. This rule requires that all employees must be eligible to make deferral contributions to the plan as of their first day of employment.

The universal availability requirement for 403(b) plans is *significantly different* from the rules applicable to qualified retirement plans. For example, a 401(k) plan can require employees to wait for up to a year before becoming eligible to make deferral contributions.

One of our tax-exempt clients who sponsors a 403(b) plan ran afoul of the universal availability requirement by requiring employees to complete a 90-day "probationary" period before being eligible to make deferral contributions. This service requirement could have been included in a 401(k) plan, but not in a 403(b) plan.

The result? The employer had to go through a costly correction process, involving both a submission to the IRS under the Voluntary Correction Program (including the payment of a significant compliance fee), plus making corrective "deferral" contributions to the plan on behalf of the excluded employees. The employer had to make this expensive correction *even though* the employees had been paid the entire amount that they presumably would have contributed to the plan!