

§ 1.403(b)-4

26 CFR Ch. I (4-1-14 Edition)

with termination of a section 403(b) plan.

(B) *Partial vesting.* For purposes of applying this paragraph (d), if only a portion of a participant's interest in a contract becomes nonforfeitable in a year, then the portion that is nonforfeitable and the portion that fails to be nonforfeitable are each treated as separate contracts. In addition, for purposes of applying this paragraph (d), if a contribution is made to an annuity contract in excess of the limitations of section 415(c) and the excess is maintained in a separate account, then the portion of the contract that includes the excess contributions account and the remainder are each treated as separate contracts. Thus, if an annuity contract that includes an excess contributions account changes from forfeitable to nonforfeitable during a year, then the portion that is not attributable to the excess contributions account constitutes a section 403(b) contract (assuming it otherwise satisfies the requirements to be a section 403(b) contract) and is not included in gross income, and the portion that is attributable to the excess contributions account is included in gross income in accordance with section 403(c). See § 1.403(b)-4(f) for additional rules.

[T.D. 9340, 72 FR 41141, July 26, 2007; 72 FR 54352, Sept. 25, 2007]

§ 1.403(b)-4 Contribution limitations.

(a) *Treatment of contributions in excess of limitations.* The exclusion provided under § 1.403(b)-3(a) applies to a participant only if the amounts contributed by the employer for the purchase of an annuity contract for the participant do not exceed the applicable limit under sections 415 and 402(g), as described in this section. Under § 1.403(b)-3(a)(4), a section 403(b) contract is required to include the limits on elective deferrals imposed by section 402(g), as described in paragraph (c) of this section. See paragraph (f) of this section for special rules concerning excess contributions and deferrals. Rollover contributions made to a section 403(b) contract, as described in § 1.403(b)-10(d), are not taken into account for purposes of the limits imposed by section 415, § 1.403(b)-3(a)(9), section 402(g), § 1.403(b)-3(a)(4), and this section, but after-tax em-

ployee contributions are taken into account under section 415, § 1.403(b)-3(a)(9), and paragraph (b) of this section.

(b) *Maximum annual contribution*—(1) *General rule.* In accordance with section 415(a)(2) and § 1.403(b)-3(a)(9), the contributions for any participant under a section 403(b) contract (namely, employer nonelective contributions (including matching contributions), section 403(b) elective deferrals, and after-tax employee contributions) are not permitted to exceed the limitations imposed by section 415. Under section 415(c), contributions are permitted to be made for participants in a defined contribution plan, subject to the limitations set forth therein (which are generally the lesser of a dollar limit for a year or the participant's compensation for the year). For purposes of section 415, contributions made for a participant are aggregated to the extent applicable under sections 414(b), (c), (m), (n), and (o). For purposes of section 415(a)(2), §§ 1.403(b)-1 through 1.403(b)-3, this section, and §§ 1.403(b)-5 through 1.403(b)-11, a contribution means any annual addition, as defined in section 415(c).

(2) *Special rules.* See section 415(k)(4) for a special rule under which contributions to section 403(b) contracts are generally aggregated with contributions under other arrangements in applying section 415. For purposes of applying section 415(c)(1)(B) (relating to compensation) with respect to a section 403(b) contract, except as provided in section 415(c)(3)(C), a participant's includible compensation (as defined in § 1.403(b)-2) is substituted for the participant's compensation, as described in section 415(c)(3)(E). Any age 50 catch-up contributions under paragraph (c)(2) of this section are disregarded in applying section 415.

(c) *Section 403(b) elective deferrals*—(1) *Basic limit under section 402(g)(1).* In accordance with section 402(g)(1)(A), the section 403(b) elective deferrals for any individual are included in the individual's gross income to the extent the amount of such deferrals, plus all other elective deferrals for the individual, for the taxable year exceeds the applicable dollar amount under section

402(g)(1)(B). The applicable annual dollar amount under section 402(g)(1)(B) is \$15,000, adjusted for cost-of-living after 2006 in the manner described in section 402(g)(4). See § 1.403(b)-5(b) for a universal availability rule that applies if any employee is permitted to have any section 403(b) elective deferrals made on his or her behalf.

(2) *Age 50 catch-up*—(i) *In general.* In accordance with section 414(v) and the regulations thereunder, a section 403(b) contract may provide for catch-up contributions for a participant who is age 50 by the end of the year, provided that such age 50 catch-up contributions do not exceed the catch-up limit under section 414(v)(2) for the taxable year. The maximum amount of additional age 50 catch-up contributions for a taxable year under section 414(v) is \$5,000, adjusted for cost-of-living after 2006 in the manner described in section 414(v)(2)(C). For additional requirements, see regulations under section 414(v).

(ii) *Coordination with special section 403(b) catch-up.* In accordance with sections 414(v)(6)(A)(ii) and 402(g)(7)(A), the age 50 catch-up described in this paragraph (c)(2) may apply for any taxable year in which a participant also qualifies for the special section 403(b) catch-up under paragraph (c)(3) of this section.

(3) *Special section 403(b) catch-up for certain organizations*—(i) *Amount of the special section 403(b) catch-up.* In the case of a qualified employee of a qualified organization for whom the basic section 403(b) elective deferrals for any year are not less than the applicable dollar amount under section 402(g)(1)(B), the section 403(b) elective deferral limitation of section 402(g)(1) for the taxable year of the qualified employee is increased by the least of—

- (A) \$3,000;
- (B) The excess of—
 - (1) \$15,000, over

(2) The total elective deferrals described in section 402(g)(7)(A)(ii) made for the qualified employee by the qualified organization for prior years; or

- (C) The excess of—

(1) \$5,000 multiplied by the number of years of service of the employee with the qualified organization, over

(2) The total elective deferrals (as defined at § 1.403(b)-2) made for the employee by the qualified organization for prior years.

(ii) *Qualified organization.* (A) For purposes of this paragraph (c)(3), *qualified organization* means an eligible employer that is—

- (1) An educational organization described in section 170(b)(1)(A)(ii);
- (2) A hospital;
- (3) A health and welfare service agency (including a home health service agency);
- (4) A church-related organization; or
- (5) Any organization described in section 414(e)(3)(B)(ii).

(B) All entities that are in a church-related organization or an organization controlled by a church-related organization under section 414(e)(3)(B)(ii) are treated as a single qualified organization (so that years of service and any special section 403(b) catch-up elective deferrals previously made for a qualified employee for a church or other entity within a church-related organization or an organization controlled by the church-related organization are taken into account for purposes of applying this paragraph (c)(3) to the employee with respect to any other entity within the same church-related organization or organization controlled by a church-related organization).

(C) For purposes of this paragraph (c)(3)(ii), a *health and welfare service agency* means—

(1) An organization whose primary activity is to provide services that constitute medical care as defined in section 213(d)(1) (such as a hospice);

(2) A section 501(c)(3) organization whose primary activity is the prevention of cruelty to individuals or animals;

(3) An adoption agency; or

(4) An agency that provides substantial personal services to the needy as part of its primary activity (such as a section 501(c)(3) organization that either provides meals to needy individuals, is a home health service agency, provides services to help individuals who have substance abuse, or provides help to the disabled).

(iii) *Qualified employee.* For purposes of this paragraph (c)(3), *qualified employee* means an employee who has

completed at least 15 years of service (as defined under paragraph (e) of this section) taking into account only employment with the qualified organization. Thus, an employee who has not completed at least 15 years of service (as defined under paragraph (e) of this section) taking into account only employment with the qualified organization is not a qualified employee.

(iv) *Coordination with age 50 catch-up.* In accordance with sections 402(g)(1)(C) and 402(g)(7), any catch-up amount contributed by an employee who is eligible for both an age 50 catch-up and a special section 403(b) catch-up is treated first as an amount contributed as a special section 403(b) catch-up to the extent a special section 403(b) catch-up is permitted, and then as an amount contributed as an age 50 catch-up (to the extent the catch-up amount exceeds the maximum special section 403(b) catch-up after taking into account sections 402(g) and 415(c), this paragraph (c)(3), and any limitations on the special section 403(b) catch-up that are imposed by the terms of the plan).

(4) *Coordination with designated Roth contributions.* See regulations under section 402A for rules for determining whether an elective deferral is a pre-tax elective deferral or a designated Roth contribution.

(5) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. (i) *Facts illustrating application of the basic dollar limit.* Participant B, who is 45, is eligible to participate in a State university section 403(b) plan in 2006. B is not a qualified employee, as defined in paragraph (c)(3)(iii) of this section. The plan permits section 403(b) elective deferrals, but no other employer contributions are made under the plan. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1) and (3) of this section and the additional age 50 catch-up amount described in paragraph (c)(2) of this section. For 2006, B will receive includible compensation of \$42,000 from the eligible employer. B desires to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is \$15,000 and the additional dollar amount permitted under the age 50 catch-up is \$5,000.

(ii) *Conclusion.* B is not eligible for the age 50 catch-up in 2006 because B is 45 in 2006. B is also not eligible for the special section 403(b) catch-up under paragraph (c)(3) of this section because B is not a qualified employee. Accordingly, the maximum section 403(b) elective deferral that B may elect for 2006 is \$15,000.

Example 2. (i) *Facts illustrating application of the includible compensation limitation.* The facts are the same as in *Example 1*, except B's includible compensation is \$14,000.

(ii) *Conclusion.* Under section 415(c), contributions may not exceed 100 percent of includible compensation. Accordingly, the maximum section 403(b) elective deferral that B may elect for 2006 is \$14,000.

Example 3. (i) *Facts illustrating application of the age 50 catch-up.* Participant C, who is 55, is eligible to participate in a State university section 403(b) plan in 2006. The plan permits section 403(b) elective deferrals, but no other employer contributions are made under the plan. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1) and (c)(3) of this section and the additional age 50 catch-up amount described in paragraph (c)(2) of this section. For 2006, C will receive includible compensation of \$48,000 from the eligible employer. C desires to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is \$15,000 and the additional dollar amount permitted under the age 50 catch-up is \$5,000. C does not have 15 years of service and thus is not a qualified employee, as defined in paragraph (c)(3)(iii) of this section.

(ii) *Conclusion.* C is eligible for the age 50 catch-up in 2006 because C is 55 in 2006. C is not eligible for the special section 403(b) catch-up under paragraph (c)(3) of this section because C is not a qualified employee (as defined in paragraph (c)(3)(iii) of this section). Accordingly, the maximum section 403(b) elective deferral that C may elect for 2006 is \$20,000 (\$15,000 plus \$5,000).

Example 4. (i) *Facts illustrating application of both the age 50 and the special section 403(b) catch-up.* The facts are the same as in *Example 3*, except that C is a qualified employee for purposes of the special section 403(b) catch-up provisions in paragraph (c)(3) of this section. For 2006, the maximum additional section 403(b) elective deferral for which C qualifies under the special section 403(b) catch-up under paragraph (c)(3) of this section is \$3,000.

(ii) *Conclusion.* The maximum section 403(b) elective deferrals that C may elect for 2006 is \$23,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to \$15,000, plus the \$3,000 additional special

section 403(b) catch-up amount for which C qualifies under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of \$5,000.

Example 5. (i) *Facts illustrating calculation of years of service with a predecessor organization for purposes of the special section 403(b) catch-up.* Participant A is an employee of hospital H and is eligible to participate in a section 403(b) plan of H in 2006. A does not have 15 years of service with H, but A has previously made special section 403(b) catch-up deferrals to a section 403(b) plan maintained by hospital P which has since been acquired by H.

(ii) *Conclusion.* The special section 403(b) catch-up amount for which A qualifies under paragraph (c)(3) of this section must be calculated taking into account A's prior years of service and section 403(b) elective deferrals with the predecessor hospital if and only if A did not have any severance from service in connection with the acquisition.

Example 6. (i) *Facts illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 4*, except that the employer makes a nonelective contribution for each employee equal to 20 percent of C's compensation (which is \$48,000). Thus, the employer makes a nonelective contribution for C for 2006 equal to \$9,600. The plan provides that a participant is not permitted to make section 403(b) elective deferrals to the extent the section 403(b) elective deferrals would result in contributions in excess of the maximum permitted under section 415 and provides that contributions are reduced in the following order: the special section 403(b) catch-up elective deferrals under paragraph (c)(3) of this section are reduced first; the age 50 catch-up elective deferrals under paragraph (c)(2) of this section are reduced second; and then the basic section 403(b) elective deferrals under paragraph (c)(1) of this section are reduced. For 2006, the applicable dollar limit under section 415(c)(1)(A) is \$44,000.

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is \$23,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to \$15,000, plus the \$3,000 additional special section 403(b) catch-up amount for which C qualifies under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of \$5,000. The limit in paragraph (b) of this section would not be exceeded because the sum of the \$9,600 nonelective contribution and the \$23,000 section 403(b) elective deferrals does not exceed the lesser of \$49,000 (which is the sum of \$44,000 plus the \$5,000 additional age 50 catch-up amount) or \$53,000 (which is the sum of C's includible compensation for 2006 (\$48,000) plus the \$5,000 additional age 50 catch-up amount).

Example 7. (i) *Facts further illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 6*, except that C's includible compensation for 2006 is \$58,000 and the plan provides for a nonelective contribution equal to 50 percent of includible compensation, so that the employer nonelective contribution for C for 2006 is \$29,000 (50 percent of \$58,000).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is \$20,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(A) plus the additional age 50 catch-up amount, because the sum of the employer's nonelective contribution of \$29,000 plus a section 403(b) elective deferral in excess of \$20,000 would exceed \$49,000 (the sum of the \$44,000 limit in section 415(c)(1)(A) plus the \$5,000 additional age 50 catch-up amount). (Note that a section 403(b) elective deferral in excess of \$20,000 would also exceed the limitations of section 402(g) unless a special section 403(b) catch-up were permitted.)

Example 8. (i) *Facts further illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 7*, except that the plan provides for a nonelective contribution for C equal to \$44,000 (which is the limit in section 415(c)(1)(A)).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is \$5,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(A) plus the additional age 50 catch-up amount (\$5,000), because the sum of the employer's nonelective contribution of \$44,000 plus a section 403(b) elective deferral in excess of \$5,000 would exceed \$49,000 (the sum of the \$44,000 limit in section 415(c)(1)(A) plus the \$5,000 additional age 50 catch-up amount).

Example 9. (i) *Facts illustrating application of the age 50 catch-up and the section 415(c) includible compensation limitation.* The facts are the same as in *Example 7*, except that C's includible compensation for 2006 is \$28,000, so that the employer nonelective contribution for C for 2006 is \$14,000 (50 percent of \$28,000).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is \$19,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(B) plus the additional age 50 catch-up amount, because C's includible compensation is \$28,000 and the sum of the employer's nonelective contribution of \$14,000 plus a section 403(b) elective deferral in excess of \$19,000 would exceed \$33,000 (which is the sum of 100 percent of C's includible compensation plus the \$5,000 additional age 50 catch-up amount).

Example 10. (i) *Facts illustrating that section 403(b) elective deferrals cannot exceed compensation otherwise payable.* Employee D is

age 60, has includible compensation of \$14,000, and wishes to contribute section 403(b) elective deferrals of \$20,000 for the year. No nonelective contributions are made for Employee D.

(i) *Conclusion.* Because a contribution is a section 403(b) elective deferral only if it relates to an amount that would otherwise be included in the participant's compensation, the effective limitation on section 403(b) elective deferrals for a participant whose compensation is less than the basic dollar limit for section 403(b) elective deferrals is the participant's compensation. Thus, D cannot make section 403(b) elective deferrals in excess of D's actual compensation, which is \$14,000, even though the basic dollar limit exceeds that amount.

Example 11. (i) *Facts illustrating calculation of the special section 403(b) catch-up.* For 2006, employee E, who is age 53, is eligible to participate in a section 403(b) plan of hospital H, which is a section 501(c)(3) organization. H's plan permits section 403(b) elective deferrals and provides for an employer contribution of 10 percent of a participant's compensation. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1), (2), and (3) of this section. For 2006, E's includible compensation is \$50,000. E wishes to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. E has previously made \$62,000 of section 403(b) elective deferrals under the plan, but has never made an election for a special section 403(b) catch-up elective deferral. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is \$15,000, the additional dollar amount permitted under the age 50 catch-up is \$5,000. E's employer will make a nonelective contribution of \$5,000 (10% of \$50,000 compensation), and E is a qualified employee of a qualified employer as defined in paragraph (c)(3) of this section.

(ii) *Conclusion.* The maximum section 403(b) elective deferrals that E may elect under H's section 403(b) plan for 2006 is \$23,000. This is the sum of the basic limit on section 403(b) elective deferrals for 2006 under paragraph (c)(1) of this section equal to \$15,000, plus the \$3,000 maximum additional special section 403(b) catch-up amount for which D qualifies in 2006 under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of \$5,000. The limitation on the additional special section 403(b) catch-up amount is not less than \$3,000 because the limitation at paragraph (c)(3)(i)(B) of this section is \$15,000 (\$15,000 minus zero) and the limitation at paragraph (c)(3)(i)(C) of this section is \$13,000 (\$5,000 times 15, minus \$62,000 of total deferrals in prior years). These conclusions would be unaffected if H were an eligible governmental employer under section 457(b) that has a section 457(b)

eligible governmental plan and E were in the past to have made annual deferrals to that plan, because contributions to a section 457(b) eligible governmental plan do not constitute elective deferrals; and these conclusions would also be the same if H had a section 401(k) plan and E were in the past to have made elective deferrals to that plan, assuming that those elective deferrals did not exceed \$10,000 (\$5,000 times 15, minus the sum of \$62,000 plus \$10,000, equals \$3,000), so as to result in the limitation at paragraph (c)(3)(i)(C) of this section being less than \$3,000.

Example 12. (i) *Facts illustrating calculation of the special section 403(b) catch-up in the next calendar year.* The facts are the same as in *Example 11*, except that, for 2007, E has includible compensation of \$60,000. For 2007, E now has previously made \$85,000 of section 403(b) elective deferrals (\$62,000 deferred before 2006, plus the \$15,000 in basic section 403(b) elective deferrals in 2006, the \$3,000 maximum additional special section 403(b) catch-up amount in 2006, plus the \$5,000 age 50 catch-up amount in 2006). However, the \$5,000 age 50 catch-up amount deferred in 2006 is disregarded for purposes of applying the limitation at paragraph (c)(3)(i)(C) of this section to determine the special section 403(b) catch-up amount. Thus, for 2007, only \$80,000 of section 403(b) elective deferrals are taken into account in applying the limitation at paragraph (c)(3)(i)(C) of this section. For 2007, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is assumed to be \$16,000, the additional dollar amount permitted under the age 50 catch-up is assumed to be \$5,000, and E's employer contributes \$6,000 (10% of \$60,000) as a non-elective contribution.

(ii) *Conclusion.* The maximum section 403(b) elective deferral that D may elect under H's section 403(b) plan for 2007 is \$21,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to \$16,000, plus the additional age 50 catch-up amount of \$5,000. E is not entitled to any additional special section 403(b) catch-up amount for 2007 under paragraph (c)(3) of this section due to the limitation at paragraph (c)(3)(i)(C) of this section (16 times \$5,000 equals \$80,000, minus D's total prior section 403(b) elective deferrals of \$80,000 equals zero).

(d) *Employer contributions for former employees—(1) Includible compensation deemed to continue for nonelective contributions.* For purposes of applying paragraph (b) of this section, a former employee is deemed to have monthly includible compensation for the period through the end of the taxable year of the employee in which he or she ceases

to be an employee and through the end of each of the next five taxable years. The amount of the monthly includible compensation is equal to one twelfth of the former employee's includible compensation during the former employee's most recent year of service. Accordingly, nonelective employer contributions for a former employee must not exceed the limitation of section 415(c)(1) up to the lesser of the dollar amount in section 415(c)(1)(A) or the former employee's annual includible compensation based on the former employee's average monthly compensation during his or her most recent year of service.

(2) *Examples.* The provisions of paragraph (d)(1) of this section are illustrated by the following examples:

Example 1. (i) *Facts.* Private college M is a section 501(c)(3) organization operated on the basis of a June 30 fiscal year that maintains a section 403(b) plan for its employees. In 2004, M amends the plan to provide for a temporary early retirement incentive under which the college will make a nonelective contribution for any participant who satisfies certain minimum age and service conditions and who retires before June 30, 2006. The contribution will equal 110 percent of the participant's rate of pay for one year and will be payable over a period ending no later than the end of the fifth fiscal year that begins after retirement. It is assumed for purposes of this *Example 1* that, in accordance with § 1.401(a)(4)-10(b) and under the facts and circumstances, the post-retirement contributions made for participants who satisfy the minimum age and service conditions and retire before June 30, 2006, do not discriminate in favor of former employees who are highly compensated employees. Employee A retires under the early retirement incentive on March 12, 2006, and A's annual includible compensation for the period from March 1, 2005, through February 28, 2006 (which is A's most recent one year of service) is \$30,000. The applicable dollar limit under section 415(c)(1)(A) is assumed to be \$44,000 for 2006 and \$45,000 for 2007. The college contributes \$30,000 for A for 2006 and \$3,000 for A for 2007 (totaling \$33,000 or 110 percent of \$30,000). No other contributions are made to a section 403(b) contract for A for those years.

(ii) *Conclusion.* The contributions made for A do not exceed A's includible compensation for 2006 or 2007.

Example 2. (i) *Facts.* Private college N is a section 501(c)(3) organization that maintains a section 403(b) plan for its employees. The plan provides for N to make monthly nonelective contributions equal to 20 percent of the monthly includible compensation for

each eligible employee. In addition, the plan provides for contributions to continue for 5 years following the retirement of any employee after age 64 and completion of at least 20 years of service (based on the employee's average annual rate of base salary in the preceding 3 calendar years ended before the date of retirement). It is assumed for purposes of this *Example 2* that, in accordance with § 1.401(a)(4)-10(b) and under the facts and circumstances, the post-retirement contributions made for participants who satisfy the minimum age and service conditions do not discriminate in favor of former employees who are highly compensated employees. Employee B retires on July 1, 2006, at age 64 after completion of 20 or more years of service. At that date, B's annual includible compensation for the most recently ended fiscal year of N is \$72,000 and B's average monthly rate of base salary for 2003 through 2005 is \$5,000. N contributes \$1,200 per month (20 percent of 1/12th of \$72,000) from January of 2006 through June of 2006 and contributes \$1,000 (20 percent of \$5,000) per month for B from July of 2006 through June of 2011. The applicable dollar limit under section 415(c)(1)(A) is \$44,000 for 2006 through 2011. No other contributions are made to a section 403(b) contract for B for those years.

(ii) *Conclusion.* The contributions made for B do not exceed B's includible compensation for any of the years from 2006 through 2010.

Example 3. (i) *Facts.* A public university maintains a section 403(b) under which it contributes annually 10% of compensation for participants, including for the first 5 calendar years following the date on which the participant ceases to be an employee. The plan provides that if a participant who is a former employee dies during the first 5 calendar years following the date on which the participant ceases to be an employee, a contribution is made that is equal to the lesser of—

(A) The excess of the individual's includible compensation for that year over the contributions previously made for the individual for that year; or

(B) The total contributions that would have been made on the individual's behalf thereafter if he or she had survived to the end of the 5-year period.

(ii) Individual C's annual includible compensation is \$72,000 (so that C's monthly includible compensation is \$6,000). A \$600 contribution is made for C for January of the first taxable year following retirement (10% of individual C's monthly includible compensation of \$6,000). Individual C dies during February of that year. The university makes a contribution for individual C for February equal to \$11,400 (C's monthly includible compensation for January and February, reduced by \$600).

(iii) *Conclusion.* The contribution does not exceed the amount of individual C's includible compensation for the taxable year for purposes of section 415(c), but any additional contributions would exceed C's includible compensation for purposes of section 415(c).

(3) *Disabled employees.* See also section 415(c)(3)(C) which sets forth a special rule under which compensation may be treated as continuing for purposes of section 415 for certain former employees who are disabled.

(e) *Special rules for determining years of service—(1) In general.* For purposes of determining a participant's includible compensation under paragraph (b)(2) of this section and a participant's years of service under paragraphs (c)(3) (special section 403(b) catch-up for qualified employees of certain organizations) and (d) (employer contributions for former employees) of this section, an employee must be credited with a full year of service for each year during which the individual is a full-time employee of the eligible employer for the entire work period, and a fraction of a year for each part of a work period during which the individual is a full-time or part-time employee of the eligible employer. An individual's number of years of service equals the aggregate of the annual work periods during which the individual is employed by the eligible employer.

(2) *Work period.* A year of service is based on the employer's annual work period, not the employee's taxable year. For example, in determining whether a university professor is employed full time, the annual work period is the school's academic year. However, in no case may an employee accumulate more than one year of service in a twelve-month period.

(3) *Service with more than one eligible employer—(i) General rule.* With respect to any section 403(b) contract of an eligible employer, except as provided in paragraph (e)(3)(ii) of this section, any period during which an individual is not an employee of that eligible employer is disregarded for purposes of this paragraph (e).

(ii) *Special rule for church employees.* With respect to any section 403(b) contract of an eligible employer that is a church-related organization, any period during which an individual is an

employee of that eligible employer and any other eligible employer that is a church-related organization that has an association (as defined in section 414(e)(3)(D)) with that eligible employer is taken into account on an aggregated basis, but any period during which an individual is not an employee of a church-related organization or is an employee of a church-related organization that does not have an association with that eligible employer is disregarded for purposes of this paragraph (e).

(4) *Full-time employee for full year.* Each annual work period during which an individual is employed full time by the eligible employer constitutes one year of service. In determining whether an individual is employed full-time, the amount of work which he or she actually performs is compared with the amount of work that is normally required of individuals performing similar services from which substantially all of their annual compensation is derived.

(5) *Other employees.* (i) An individual is treated as performing a fraction of a year of service for each annual work period during which he or she is a full-time employee for part of the annual work period and for each annual work period during which he or she is a part-time employee either for the entire annual work period or for a part of the annual work period.

(ii) In determining the fraction that represents the fractional year of service for an individual employed full time for part of an annual work period, the numerator is the period of time (such as weeks or months) during which the individual is a full-time employee during that annual work period, and the denominator is the period of time that is the annual work period.

(iii) In determining the fraction that represents the fractional year of service of an individual who is employed part time for the entire annual work period, the numerator is the amount of work performed by the individual, and the denominator is the amount of work normally required of individuals who perform similar services and who are employed full time for the entire annual work period.

(iv) In determining the fraction representing the fractional year of service of an individual who is employed part time for part of an annual work period, the fractional year of service that would apply if the individual were a part-time employee for a full annual work period is multiplied by the fractional year of service that would apply if the individual were a full-time employee for the part of an annual work period.

(6) *Work performed.* For purposes of this paragraph (e), in measuring the amount of work of an individual performing particular services, the work performed is determined based on the individual's hours of service (as defined under section 410(a)(3)(C)), except that a plan may use a different measure of work if appropriate under the facts and circumstances. For example, a plan may provide for a university professor's work to be measured by the number of courses taught during an annual work period in any case in which that individual's work assignment is generally based on a specified number of courses to be taught.

(7) *Most recent one-year period of service.* For purposes of paragraph (d) of this section, in the case of a part-time employee or a full-time employee who is employed for only part of the year determined on the basis of the employer's annual work period, the employee's most recent periods of service are aggregated to determine his or her most recent one-year period of service. In such a case, there is first taken into account his or her service during the annual work period for which the last year of service's includible compensation is being determined; then there is taken into account his or her service during his or her next preceding annual work period based on whole months; and so forth until the employee's service equals, in the aggregate, one year of service.

(8) *Less than one year of service considered as one year.* If, at the close of a taxable year, an employee has, after application of all of the other rules in this paragraph (e), some portion of one year of service (but has accumulated less than one year of service), the employee is deemed to have one year of service. Except as provided in the pre-

vious sentence, fractional years of service are not rounded up.

(9) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. (i) *Facts.* Individual G is employed half-time in 2004 and 2005 as a clerk by H, a hospital which is a section 501(c)(3) organization. G earns \$20,000 from H in each of those years, and retires on December 31, 2005.

(ii) *Conclusion.* For purposes of determining G's includible compensation during G's last year of service under paragraph (d) of this section, G's most recent periods of service are aggregated to determine G's most recent one-year period of service. In this case, since D worked half-time in 2004 and 2005, the compensation D earned in those two years are aggregated to produce D's includible compensation for D's last full year in service. Thus, in this case, the \$20,000 that D earned in 2004 and 2005 for D's half-time work are aggregated, so that D has \$40,000 of includible compensation for D's most recent one-year of service for purposes of applying paragraphs (b)(2), (c)(3), and (d) of this section.

Example 2. (i) *Facts.* Individual H is employed as a part-time professor by public University U during the first semester of its two-semester 2004-2005 academic year. While H teaches one course generally for 3 hours a week during the first semester of the academic year, U's full-time faculty members generally teach for 9 hours a week during the full academic year.

(ii) *Conclusion.* For purposes of calculating how much of a year of service H performs in the 2004-2005 academic year (before application of the special rules of paragraphs (e)(7) and (8) of this section concerning less than one year of service), paragraph (e)(5)(iv) of this section is applied as follows: since H teaches one course at U for 3 hours per week for 1 semester and other faculty members at U teach 9 hours per week for 2 semesters, H is considered to have completed $\frac{3}{18}$ or $\frac{1}{6}$ of a year of service during the 2004-2005 academic year, determined as follows:

(A) The fractional year of service if H were a part-time employee for a full year is $\frac{3}{9}$ (number of hours employed divided by the usual number of hours of work required for that position).

(B) The fractional year of service if H were a full-time employee for half of a year is $\frac{1}{2}$ (one semester, divided by the usual 2-semester annual work period).

(C) These fractions are multiplied to obtain the fractional year of service: $\frac{3}{9}$ times $\frac{1}{2}$, or $\frac{3}{18}$, equals $\frac{1}{6}$ of a year of service.

(f) *Excess contributions or deferrals—(1) Inclusion in gross income.* Any contribution made for a participant to a section 403(b) contract for the taxable year

that exceeds either the maximum annual contribution limit set forth in paragraph (b) of this section or the maximum annual section 403(b) elective deferral limit set forth in paragraph (c) of this section constitutes an excess contribution that is included in gross income for that taxable year. See § 1.403(b)-3(d)(1)(iii) and (2)(i) for additional rules, including special rules relating to contracts that fail to be non-forfeitable. See also section 4973 for an excise tax applicable with respect to excess contributions to a custodial account and section 4979(f)(2)(B) for a special rule applicable if excess matching contributions, excess after-tax employee contributions, and excess section 403(b) elective deferrals do not exceed \$100.

(2) *Separate account required for certain excess contributions; distribution of excess elective deferrals.* A contract to which a contribution is made that exceeds the maximum annual contribution limit set forth in paragraph (b) of this section is not a section 403(b) contract unless the excess contribution is held in a separate account which constitutes a separate account for purposes of section 72. See also § 1.403(b)-3(a)(4) and paragraph (f)(4) of this section for additional rules with respect to the requirements of section 401(a)(30) and any excess deferral.

(3) *Ability to distribute excess contributions.* A contract does not fail to satisfy the requirements of § 1.403(b)-3, the distribution rules of § 1.403(b)-6 or 1.403(b)-9, or the funding rules of § 1.403(b)-8 solely by reason of a distribution made from a separate account under paragraph (f)(2) of this section or made under paragraph (f)(4) of this section.

(4) *Excess section 403(b) elective deferrals.* A section 403(b) contract may provide that any excess deferral as a result of a failure to comply with the limitation under paragraph (c) of this section for a taxable year with respect to any section 403(b) elective deferral made for a participant by the employer will be distributed to the participant, with allocable net income, no later than April 15 of the following taxable year or otherwise in accordance with section 402(g). See section 402(g)(2)(A) for rules permitting the participant to allocate excess deferrals among the

plans in which the participant has made elective deferrals, and see section 402(g)(2)(C) for special rules to determine the tax treatment of such a distribution.

(5) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. (i) *Facts.* Individual D's employer makes a \$46,000 contribution for 2006 to an individual annuity insurance policy for Individual D that would otherwise be a section 403(b) contract. The contribution does not include any elective deferrals and the applicable limit under section 415(c) is \$44,000 for 2006. The \$2,000 section 415(c) excess is put into a separate account under the policy. Employer includes \$2,000 in D's gross income as wages for 2006 and, to the extent of the amount held in the separate account for the section 415(c) excess contribution, does not treat the account as a contract to which section 403(b) applies.

(ii) *Conclusion.* The separate account for the section 415(c) excess contribution is a contract to which section 403(c) applies, but the excess contribution does not cause the rest of the contract to fail section 403(b).

Example 2. (i) *Facts.* Same facts as *Example 1*, except that the contribution is made to purchase mutual funds that are held in a custodial account, instead of an individual annuity insurance policy.

(ii) *Conclusion.* The conclusion is the same as in *Example 1*, except that the purchase constitutes a transfer described in section 83.

Example 3. (i) *Facts.* Same facts as *Example 1*, except that the amount held in the separate account for the section 415(c) excess contribution is subsequently distributed to D.

(ii) *Conclusion.* The distribution is included in gross income to the extent provided under section 72 relating to distributions from a section 403(c) contract.

Example 4. (i) *Facts.* Individual E makes section 403(b) elective deferrals totaling \$15,500 for 2006, when E is age 45 and the applicable limit on section 403(b) elective deferrals is \$15,000. On April 14, 2007, the plan refunds the \$500 excess along with applicable earnings of \$65.

(ii) *Conclusion.* The \$565 payment constitutes a distribution of an excess deferral under paragraph (f)(4) of this section. Under section 402(g), the \$500 excess deferral is included in E's gross income for 2006. The additional \$65 is included in E's gross income for 2007 and, because the distribution is made by April 15, 2007 (as provided in section

402(g)(2)), the \$65 is not subject to the additional 10 percent income tax on early distributions under section 72(t).

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§ 1.403(b)-5 Nondiscrimination rules.

(a) *Nondiscrimination rules for contributions other than section 403(b) elective deferrals*—(1) *General rule.* Under section 403(b)(12)(A)(i), employer contributions and after-tax employee contributions to a section 403(b) plan must satisfy all of the following requirements (the nondiscrimination requirements) in the same manner as a qualified plan under section 401(a):

(i) Section 401(a)(4) (relating to nondiscrimination in contributions and benefits), taking section 401(a)(5) into account.

(ii) Section 401(a)(17) (limiting the amount of compensation that can be taken into account).

(iii) Section 401(m) (relating to matching and after-tax employee contributions).

(iv) Section 410(b) (relating to minimum coverage).

(2) *Nonapplication to section 403(b) elective deferrals.* The requirements of this paragraph (a) do not apply to section 403(b) elective deferrals.

(3) *Compensation for testing.* Except as may otherwise be specifically permitted under the provisions referenced in paragraph (a)(1) of this section, compliance with those provisions is tested using compensation as defined in section 414(s) (and without regard to section 415(c)(3)(E)). In addition, for purposes of paragraph (a)(1) of this section, there may be excluded employees who are permitted to be excluded under paragraph (b)(4)(ii)(D) and (E) of this section. However, as provided in paragraph (b)(4)(i) of this section, the exclusion of any employee listed in paragraph (b)(4)(ii)(D) or (E) of this section is subject to the conditions applicable under section 410(b)(4).

(4) *Employer aggregation rules.* See regulations under section 414(b), (c), (m), and (o) for rules treating entities as a single employer for purposes of the nondiscrimination requirements.

(5) *Special rules for governmental plans.* Paragraphs (a)(1)(i), (iii), and (iv) of

this section do not apply to a governmental plan as defined in section 414(d) (but contributions to a governmental plan must comply with paragraphs (a)(1)(ii) and (b) of this section).

(b) *Universal availability required for section 403(b) elective deferrals*—(1) *General rule.* Under section 403(b)(12)(A)(ii), all employees of the eligible employer must be permitted to have section 403(b) elective deferrals contributed on their behalf if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals. Further, the employee's right to make elective deferrals also includes the right to designate section 403(b) elective deferrals as designated Roth contributions.

(2) *Effective opportunity required.* For purposes of paragraph (b)(1) of this section, an employee is not treated as being permitted to have section 403(b) elective deferrals contributed on the employee's behalf unless the employee is provided an effective opportunity that satisfies the requirements of this paragraph (b)(2). Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections. A section 403(b) plan satisfies the effective opportunity requirement of this paragraph (b)(2) only if, at least once during each plan year, the plan provides an employee with an effective opportunity to make (or change) a cash or deferred election (as defined at §1.401(k)-1(a)(3)) between cash or a contribution to the plan. Further, an effective opportunity includes the right to have section 403(b) elective deferrals made on his or her behalf up to the lesser of the applicable limits in §1.403(b)-4(c) (including any permissible catch-up elective deferrals under §1.403(b)-4(c)(2) and (3)) or the applicable limits under the contract with the largest limitation, and applies to part-time employees as well as full-time employees. An effective opportunity is not considered to exist if there are any other rights or benefits (other than rights or benefits listed in §1.401(k)-1(e)(6)(i)(A), (B), or (D)) that are conditioned (directly or indirectly) upon a