

Date:

**District Identification Number:**

**Name of District:**

**Person to Contact/ID Number:**

**Contact Telephone Number:**

**E-mail Address:**  
epcu.403b@irs.gov

Dear Sir or Madam:

Recently, the Employee Plans Compliance Unit sent you a compliance check letter that addressed the issue of whether your public school's section 403(b) plan complies with the "universal availability" requirement of section 403(b)(12)(A)(ii) of the Internal Revenue Code ("Code"). The universal availability requirement provides that if any employee is given the opportunity to make salary reduction contributions to the plan, then all employees must be given that opportunity, with certain specified exceptions. Based upon our review of your response to our compliance check, it appears that your public school's section 403(b) plan may not satisfy this requirement.

A violation of the universal availability requirement puts a section 403(b) plan at risk for losing its tax-favored status, resulting in the loss of the retirement savings and tax benefits provided to its participants.

In the interest of preserving the tax-favored status of your plan, the Internal Revenue Service is offering a **period of relief** to enable sponsors of section 403(b) plans to correct for failing to satisfy the universal availability requirement and bring their plans into compliance. This period of relief begins immediately and will end 240 calendar days after the date of this letter.

To correct a violation of the universal availability requirement, the public school should provide to each eligible employee the opportunity to participate in the plan for the current and future years. It may also need to make a contribution to the plan on behalf of each eligible employee for each year the employee was improperly excluded from participating in the plan.

**How can you tell if your plan has violated the universal availability requirement?**

As noted above, to satisfy the universal availability requirement, all employees of the public school (with certain exceptions discussed below) must be provided the opportunity to make salary reduction contributions, or deferrals, to the section 403(b) plan if any employee of the public school is offered the opportunity to make salary deferrals. This means that certain employees **may not** be excluded merely by

virtue of belonging to a certain classification of employee, such as nurses, substitute teachers, bus drivers, maintenance workers, and part-time, temporary and non-contract employees. Employees who **may** be excluded from participating in the plan include:

1. Employees who participate in an eligible governmental plan under Code section 457(b);
2. Employees who have made a one-time irrevocable election not to make salary deferrals to the section 403(b) plan at the time the employee was initially eligible to participate in the plan;
3. Employees who are non-resident aliens with no U.S. source income;
4. Employees who are students performing certain services;
5. Employees who normally work fewer than 20 hours per week;
6. Employees who wish to defer less than the minimum deferral amount of \$200 annually; and
7. Employees covered by a collectively bargained agreement (union).

You may want to consider contacting the custodian, administrator and/or trustee of your section 403(b) plan to assist in making this determination and with any correction necessary to be eligible for the relief.

### **What should you do?**

If, after considering the above information you believe your section 403(b) plan has not satisfied the universal availability requirement, to be eligible for the relief provided in this letter, your public school should make a fully vested contribution for each otherwise eligible employee for each year the employee was improperly excluded from making a salary deferral to the section 403(b) plan. A fully vested contribution is one in which the employee is entitled to the full amount of the contribution, whether or not the employee leaves the service of the employer. Additionally, if the employee would have been entitled to a matching contribution, then the public school should make an additional contribution to make the employee whole.

There are various ways in which the make-up contribution to the employees may be calculated. We provide two common methods here. Both of these methods utilize the concept of “lost opportunity cost,” which represents the benefits lost to the employee. Generally, the lost opportunity cost represents the loss of the tax benefit to the employee for having paid income tax on salary that could have been deferred and the loss of the ability of the salary deferral to grow tax-free in the section 403(b) plan. The Service has determined that the lost opportunity cost is equal to approximately fifty percent (50%) of the amount of the salary deferral the employee could have made to the section 403(b) plan.

The first method for calculating the contribution for the excluded employee is based on the average deferral rate of similarly situated employees. The employer determines the “average deferral percentage” (ADP) of the affected employee’s group (i.e., highly or nonhighly compensated). Refer to the enclosure for additional information concerning this test. Once the appropriate average deferral percentage is determined for each year affected, each excluded employee is entitled to a fully vested contribution equal to fifty percent (50%) of the employee’s compensation multiplied by the average deferral percentage for that year. If the employer matched the salary deferrals made under the plan, the employee is also entitled to any related matching contribution attributable to salary deferrals. For purposes of determining the amount of salary deferral to be matched, one-hundred percent (100% and not 50%) of the missed salary deferral is used.

Example: Employee A was a nonhighly compensated employee who was incorrectly excluded from participating in a school’s 403(b) plan. The ADP for the nonhighly paid group was 10%. The

amount the employer must contribute on the employee's behalf equals \$2,500 (10% multiplied by Employee A's compensation of \$50,000, or \$5,000 multiplied by 50%). The Plan also provides for a matching contribution equal to 10% of the salary deferred. The corrective contribution for the matching portion equals an additional contribution of \$500 (10% X \$5,000). Thus, the total required corrective contribution equals \$3,000 (\$2,500 + \$500) plus an adjustment for earnings. Refer to Revenue Procedure 2006-27 for additional correction information.

The Service recognizes that it is not always possible to make a precise calculation as to what the average deferral percentage would be for a particular year. In that case, reasonable estimates may be used. Even if it is possible to make a precise calculation, where the probable difference between the approximate and the precise calculation is insignificant and the administrative cost of determining the precise calculation would significantly exceed the probable difference, reasonable estimates may be used.

In addition, in lieu of calculating the average deferral percentage, an employer may deem the average deferral percentage to be equal to three percent (3%) of compensation. Under this second method, the employer would make a fully vested contribution for the excluded employee equal to one-and-a half percent (1.5%) multiplied by the employee's compensation for each year of exclusion. Again, if the employer matched the salary deferrals made under the plan, the employee would be entitled to any related matching contribution attributable to salary deferrals. For purposes of determining the amount of salary deferral to be matched, the average deferral percentage would be considered to be 3%, not 1.5%.

There may be other ways to correct a failure to comply with the universal availability requirement. If you would like to suggest an alternative method of correction or would like to discuss this compliance check further, please contact the person whose name and telephone number are shown above.

It is important to us that your employees are able to continue to enjoy the benefits of maintaining and participating in a 403(b) plan. For more information, please visit the Employee Plans Compliance Unit (EPCU) webpage at [www.irs.gov/ep](http://www.irs.gov/ep).

Sincerely,

Manager, EP Compliance Unit