typically did not recommend an overall standard for when permissive aggregation should be permitted, but identified certain specific practices which would be facilitated by permissive aggregation. In response, these regulations authorize the IRS to issue published guidance permitting other types of combinations of entities that include tax-exempt entities to elect to be treated as under common control for one or more specified purposes. This authority is limited to situations in which there are substantial business reasons for maintaining each entity in a separate trust, corporation, or other form, and under which common control treatment would be consistent with the anti-abuse standards in the regulations. It is expected that this authority would not be exercised unless the IRS determines that the organizations are so integrated in their operations as to effectively constitute a single coordinated employer for purposes of sections 414(b), (c), (m), and (o), including common employee benefit plans.

A comment was also received stating that a legally required trusteeship for a labor union that has been imposed in order to correct corruption or financial malpractice\(^{10}\) should not constitute control. In response, a change was made to the regulations to reflect the intent that whether a person has the power to appoint and replace a trustee or director is based on facts and circumstances. For example, that power would generally not exist if that power was extremely limited due to the application of other laws, such as where a labor union was put under trusteeship pursuant to a court order, the trusteeship is for the sole purpose of correcting corruption, financial malpractice, or similar circumstances, and the replacement trustees were permitted to serve only for the time necessary for that purpose.

\(^{10}\) See 29 USC 462.
These controlled group rules for tax-exempt entities generally do not apply to certain church entities under section 3121(w)(3). These rules also do not apply to a State or local government or a federal government entity. Until further guidance is issued, church entities under section 3121(w)(3)(A) and (B) and State or local government public schools that sponsor section 403(b) plans can continue to rely on the rules in Notice 89-23 for determining the controlled group.

**Employment Taxes**

These regulations include several new cross-references to certain rules concerning the application of employment taxes. For example, the definition of an elective deferral at §1.403(b)-2(a)(7) of these regulations refers to §1.402(g)(3)-1 of these regulations, which in turn refers to section 3121(a)(5)(D). See §31.3121(a)(5)-2T of the temporary regulations for additional guidance on section 3121(a)(5)(D) (defining salary reduction agreement for purposes of the Federal Insurance Contributions Act (FICA)).

As another example, §1.403(b)-7(f) of these regulations generally references the special income tax withholding rules under section 3405 for purposes of income tax withholding on distributions from section 403(b) contracts and also references the special rules at §1.72(p)-l, Q&A-15, and §35.3405(c)-1, Q&A-11, relating to income tax withholding for loans deemed distributed from qualified employer plans, including section 403(b) contracts. However, the general income tax withholding rules apply for purposes of income tax withholding for annuity contracts or custodial accounts that are not section 403(b) contracts, as well as for cases in which an annuity contract or custodial account ceases to qualify as a section 403(b) contract. See section 3401 and
§§1.83-8(a) and 35.3405-1T, Q&A-18.

Effect of These Regulations on Other Guidance

Since the existing regulations were issued in 1964, a number of revenue rulings and other items of guidance under section 403(b) have become outdated as a result of changes in law. In addition, as a result of the inclusion in these regulations of much of the guidance that the IRS has issued regarding section 403(b), these regulations effectively supersede or substantially modify a number of revenue rulings and notices that have been issued under section 403(b). Thus, as indicated in the preamble to the 2004 proposed regulations, the IRS anticipates taking action in the future to obsolete many revenue rulings, notices, and other guidance under section 403(b).\(^{11}\)

However, the positions taken in certain rulings and other outstanding guidance are expected to be retained. For example, it is intended that the existing rules\(^{12}\) for determining when employees are performing services for a public school will continue to apply. Further, as discussed above in the preamble under the heading, “Treatment of Controlled Groups that Include Tax-Exempt Entities,” church entities under section 3121(w)(3)(A) and (B) and public schools that sponsor section 403(b) plans can

\(^{11}\) When these regulations go into effect, the following guidance will be outdated or superseded by these regulations and it is expected that guidance will be issued in the future to formally supersede these items: Rev. Rul. 64-333 (1964-2 CB 114); Rev. Rul. 65-200 (1965-2 CB 141); Rev. Rul. 66-254 (1966-2 CB 125); Rev. Rul. 66-312 (1966-2 CB 127); Rev. Rul. 67-78 (1967-1 CB 94); Rev. Rul. 67-69 (1967-1 CB 93); Rev. Rul. 67-361 (1967-2 CB 153); Rev. Rul. 67-387 (1967-2 CB 153); Rev. Rul. 67-388 (1967-2 CB 153); Rev. Rul. 68-179 (1968-1 CB 179); Rev. Rul. 68-482 (1968-2 CB 186); Rev. Rul. 68-487 (1968-2 CB 187); Rev. Rul. 68-488 (1968-2 CB 188); Rev. Rul. 69-629 (1969-2 CB 101); Rev. Rul. 70-243 (1970-1 CB 107); Rev. Rul. 87-114 (1987-2 CB 116); Rev. Rul. 90-24 (1990-1 CB 97); Notice 90-73 (1990-2 CB 353); Notice 92-36 (1992-2 CB 364); and Announcement 95-48 (1995-23 IRB 13). In addition, Notice 89-23 (1989-1 CB 654) is likewise superseded as a result of these regulations, except to the extent described above under the heading “Treatment of Controlled Groups that Include Tax-Exempt Entities.” It is expected that the following guidance will not be superseded when these regulations are issued in final form: Rev. Rul. 66-254 (1966-2 CB 125); Rev. Rul. 68-33 (1968-1 CB 175); Rev. Rul 68-58 (1968-1 CB 176); Rev. Rul. 68-116 (1968-1 CB 177); Rev. Rul. 68-648 (1968-2 CB 49); Rev. Rul. 68-488 (1968-2 CB 188); and Rev. Rul. 69-146 (1969-1 CB 132).

continue to rely on the rules in Notice 89-23 for determining the controlled group. In addition, certain positions taken in prior guidance are expected to be reevaluated in light of these regulations, such as Rev. Rul. 2004-67 (2004-28 IRB 28), which revised the group trust rules of Rev. Rul. 81-100 (1981-1 CB 326). With the issuance of these regulations, a number of conforming changes will be considered for the compliance programs maintained by the IRS, as most recently published in Rev. Proc. 2006-27 (2006-22 IRB 945) (EPCRS), including, for example, to reflect the written plan requirement and the positions described above in this preamble under the heading, “Effect of a Failure to Satisfy Section 403(b).”

The prior regulations under section 403(b) had included certain rules for determining the amount of the contributions made for an employee under a defined benefit plan, based on the employee’s pension under the plan. These rules are generally no longer applicable for section 403(b) because the limitations on contributions to a section 403(b) contract under section 415(c) are no longer coordinated with accruals under a defined benefit plan.\(^\text{13}\) However, the rules for determining the amount of contributions made for an employee under a defined benefit plan in the prior regulations under section 403(b) had also been used for purposes of section 402(b) (relating to nonqualified plans funded through trusts). These regulations replace those rules with regulations under section 402(b) that provide for the same rules (those in the section 403(b) regulations that were in effect prior to these regulations) to continue to apply for purposes of section 402(b). However, these section 402(b) regulations also authorize the Commissioner to issue guidance for determining the

\(^{13}\) However, see §1.403(b)-10(f)(2) of these regulations for a special rule applicable to certain church defined benefit plans that were in effect on September 3, 1982.
amount of the contributions made for an employee under a defined benefit plan under section 402(b).

**Applicability Date**

These regulations are generally applicable for taxable years beginning after December 31, 2008. Thus, because individuals will almost uniformly be on a calendar taxable year, these regulations will generally apply on January 1, 2009. However, these regulations include a number of explicit transition rules.

For a section 403(b) plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, the regulations do not apply until the earlier of: (1) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**); or (2) **[INSERT DATE THAT IS THREE YEARS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. For a section 403(b) plan maintained by a church-related organization for which the authority to amend the plan is held by a church convention (within the meaning of section 414(e)), the regulations do not apply before the beginning of the first plan year following December 31, 2009.

There are also special applicability dates for several of the specific provisions in these regulations. First, special rules apply to plans which may have included one or more of the exclusions that Notice 89-23 permitted for the universal availability rule, but which are no longer permitted under these regulations. Specifically, a special rule
applies if a plan has eligibility conditions for elective deferrals relating to employees who make a one-time election to participate in a governmental plan described in section 414(d) instead of a section 403(b) plan, professors who are providing services on a temporary basis to another school for up to one year and for whom section 403(b) contributions are being made at a rate no greater than the rate each such professor would receive under the section 403(b) plan of the original school, or employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement. If, as permitted by Notice 89-23, a plan excludes any of these three classes of employees from eligibility to make elective deferrals on [INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER], the plan is permitted to continue that exclusion until taxable years beginning on or after January 1, 2010. In addition, if a plan excludes employees covered by a collective bargaining agreement from eligibility to make elective deferrals on [INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER], the plan is permitted to continue that exclusion until the later of (i) the first day of the first taxable year that begins after December 31, 2008, or (ii) the earlier of (I) the date that such agreement terminates (determined without regard to any extension thereof after [INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]) or (II) [INSERT DATE THAT IS THREE YEARS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]. In the case of a governmental plan (as defined in section 414(d)) for which the authority to amend the plan is held by a legislative body that meets in legislative session, the plan is permitted to continue the
exclusion until the earlier of: (i) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2009; or (ii) January 1, 2011.

These regulations (at §1.403(b)-6(b)) also provide that a section 403(b) contract is permitted to distribute retirement benefits to the participant no earlier than the earliest of the participant’s severance from employment or upon the prior occurrence of some event, subject to a number of exceptions (relating to distributions from custodial accounts, distributions attributable to section 403(b) elective deferrals, correction of excess deferrals, distributions at plan termination, and payment of after-tax employee contributions). This rule does not apply for contracts issued before January 1, 2009. In addition, in order to permit plans to comply with the rules relating to in-service distributions for contracts issued before January 1, 2009, the regulations provide that an amendment adopted before January 1, 2009, to comply with these rules does not violate the anti-cutback rules of section 204(g) of ERISA.

These regulations (at §1.403(b)-8(c)(2)) also do not permit a life insurance contract, an endowment contract, a health or accident insurance contract, or a property, casualty, or liability insurance contract to constitute an annuity contract for purposes of section 403(b). This rule does not apply for contracts issued before [ENTER DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

These regulations also include specific rules relating to contract exchanges that were permitted under Rev. Rul. 90-24. These new rules do not apply to contracts received in an exchange that occurred on or before [INSERT DATE THAT IS 60 DAYS
AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER, assuming that the exchange (including the contract received in the exchange) satisfies applicable pre-existing legal requirements (including Rev. Rul. 90-24).

Finally, these regulations include special applicability date rules to coordinate with recently issued regulations under sections 402A and 415.

For periods following [INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER] and before the applicable date, taxpayers can rely on these regulations, except that (1) such reliance must be on a consistent and reasonable basis and (2) the special rule at §1.403(b)-10(a) of these regulations permitting accumulated benefits to be distributed on plan termination can be relied upon only if all of the contracts issued under the plan at that time satisfy all of the applicable requirements of these regulations (other than the requirement at §1.403(b)-3(b)(3)(i) of these regulations that there be a written plan).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the determination that respondents will need to spend minimal time (an average of 4.1 hours per year) complying with the contract exchange requirements in these
regulations, and small entities are generally expected to spend much less time. Thus, the cost of complying with this statutory requirement is small, even for small entities. Therefore, a Regulatory Flexibility Analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal authors of these regulations are R. Lisa Mojiri-Azad and John Tolleris, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

26 CFR Part 54

Excise taxes, Pensions, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.
Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31, 54 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.403(b)-3 and adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 ***

§1.403(b)-6 also issued under 26 U.S.C. 403(b)(10). ***
§1.414(c)-5 also issued under 26 U.S.C. 414(b), (c), and (o). ***

Par. 2. Section 1.402(b)-1 is amended by revising paragraphs (a)(2) and (b)(2)(ii) to read as follows:

§1.402(b)-1 Treatment of beneficiary of a trust not exempt under section 601(a)

(a) ***

(2) Determination of amount of employer contributions. If, for an employee, the actual amount of employer contributions referred to in paragraph (a)(1) of this section for any taxable year of the employee is not determinable or for any other reason is not known, then, except as set forth in rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), such amount shall be either--

(i) The excess of--

(A) The amount determined as of the end of such taxable year in accordance with the formula described in §1.403(b)-1(d)(4), as it appeared in the April 1, 2006, edition of 26 CFR Part 1; over

(B) The amount determined as of the end of the prior taxable year in accordance with the formula described in paragraph (a)(2)(i)(A) of this section; or
§1.414(c)-5 also issued under 26 U.S.C. 414(b), (c), and (o).

Par. 2. Section 1.402(b)-1 is amended by revising paragraphs (a)(2) and (b)(2)(ii) to read as follows:

§1.402(b)-1 Treatment of beneficiary of a trust not exempt under section 501(a).

(a) ** *

(2) Determination of amount of employer contributions. If, for an employee, the actual amount of employer contributions referred to in paragraph (a)(1) of this section for any taxable year of the employee is not determinable or for any other reason is not known, then, except as set forth in rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), such amount shall be either--

(i) The excess of--

(A) The amount determined as of the end of such taxable year in accordance with the formula described in §1.403(b)-1(d)(4), as it appeared in the April 1, 2006, edition of 26 CFR Part 1; over

(B) The amount determined as of the end of the prior taxable year in accordance with the formula described in paragraph (a)(2)(i)(A) of this section; or

(ii) The amount determined under any other method utilizing recognized actuarial principles that are consistent with the provisions of the plan under which such contributions are made and the method adopted by the employer for funding the benefits under the plan.

(b) ** *

(2) ** **
(ii) If a separate account in a trust for the benefit of two or more employees is not maintained for each employee, the value of the employee's interest in such trust is determined in accordance with rules prescribed by the Commissioner under the authority in paragraph (a)(2) of this section.

* * * *

Par. 3. Section 1.402(g)(3)-1 is added to read as follows:

§1.402(g)(3)-1 Employer contributions to purchase a section 403(b) contract under a salary reduction agreement.

(a) General rule. With respect to an annuity contract under section 403(b), except as provided in paragraph (b) of this section, an elective deferral means an employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement within the meaning of section 3121(a)(5)(D).

(b) Special rule. Notwithstanding paragraph (a) of this section, for purposes of section 403(b), an elective deferral only includes a contribution that is made pursuant to a cash or deferred election (as defined at §1.401(k)-1(a)(3)). Thus, for purposes of section 402(g)(3)(C), an elective deferral does not include a contribution that is made pursuant to an employee's one-time irrevocable election made on or before the employee's first becoming eligible to participate under the employer's plans or a contribution made as a condition of employment that reduces the employee's compensation.

(c) Applicable date. This section is applicable for taxable years beginning after December 31, 2008.

Par. 4. Section 1.402A-1, A-1 is revised to read as follows:
§1.402A-1 Designated Roth Accounts.

* * * * *

A-1. A designated Roth account is a separate account under a qualified cash or deferred arrangement under a section 401(a) plan, or under a section 403(b) plan, to which designated Roth contributions are permitted to be made in lieu of elective contributions and that satisfies the requirements of §1.401(k)-1(f) (in the case of a section 401(a) plan) or §1.403(b)-3(c) (in the case of a section 403(b) plan).

Par. 5. Section 1.403(b)-0 is added to read as follows:

§1.403(b)-0 Taxability under an annuity purchased by a section 501(c)(3) organization or a public school

This section lists the headings that appear in §§1.403(b)-1 through 1.403(b)-11.

§1.403(b)-1 General overview of taxability under an annuity contract purchased by a section 501(c)(3) organization or a public school.

§1.403(b)-2 Definitions.

(a) Application of definitions.
(b) Definitions.

§1.403(b)-3 Exclusion for contributions to purchase section 403(b) contracts.

(a) Exclusion for section 403(b) contracts.
(b) Application of requirements.
(c) Special rules for designated Roth section 403(b) contributions.
(d) Effect of failure.

§1.403(b)-4 Contribution limitations.

(a) Treatment of contributions in excess of limitations.
(b) Maximum annual contribution.
(c) Section 403(b) elective deferrals.
(d) Employer contributions for former employees.
(e) Special rules for determining years of service.
(f) Excess contributions of deferrals.
§1.403(b)-5  Nondiscrimination rules.

(a) Nondiscrimination rules for contributions other than section 403(b) elective deferrals.
(b) Universal availability required for section 403(b) elective deferrals.
(c) Plan required.
(d) Church plans exception.
(e) Other rules.

§1.403(b)-6  Timing of distributions and benefits.

(a) Distributions generally.
(b) Distributions from contracts other than custodial accounts or amounts attributable to section 403(b) elective deferrals.
(c) Distributions from custodial accounts that are not attributable to section 403(b) elective deferrals.
(d) Distribution of section 403(b) elective deferrals.
(e) Minimum required distributions for eligible plans.
(f) Loans.
(g) Death benefits and other incidental benefits.
(h) Special rule regarding severance from employment.

§1.403(b)-7  Taxation of distributions and benefits.

(a) General rules for when amounts are included in gross income.
(b) Rollovers to individual retirement arrangements and other eligible retirement plans.
(c) Special rules for certain corrective distributions.
(d) Amounts taxable under section 72(p)(1).
(e) Special rules relating to distributions from a designated Roth account.
(f) Certain rules relating to employment taxes.

§1.403(b)-8  Funding.

(a) Investments.
(b) Contributions to the plan.
(c) Annuity contracts.
(d) Custodial accounts.
(e) Retirement income accounts.
(f) Combining assets.

§1.403(b)-9  Special rules for church plans.

(a) Retirement income accounts.
(b) Retirement income account defined.
(c) Special deduction rule for self-employed ministers.
§1.403(b)-10 Miscellaneous provisions.

(a) Plan terminations and frozen plans.
(b) Contract exchanges and plan-to-plan transfers.
(c) Qualified domestic relations orders.
(d) Rollovers to a section 403(b) contract.
(e) Deemed IRAs.
(f) Defined benefit plans.
(g) Other rules relating to section 501(c)(3) organizations.

§1.403(b)-11 Applicable date.

(a) General rule.
(b) Collective bargaining agreements.
(c) Church conventions.
(d) Special rules for plans that exclude certain types of employees from elective deferrals.
(e) Special rules for plans that permit in-service distributions.
(f) Special rule for life insurance contracts.
(g) Special rule for contracts received in an exchange.

Par. 6. Sections 1.403(b)-1, 1.403(b)-2, and 1.403(b)-3 are revised to read as follows:

§1.403(b)-1 General overview of taxability under an annuity contract purchased by a section 501(c)(3) organization or a public school.

Section 403(b) and §§1.403(b)-2 through 1.403(b)-10 provide rules for the Federal income tax treatment of an annuity purchased for an employee by an employer that is either a tax-exempt entity under section 501(c)(3) (relating to certain religious, charitable, scientific, or other types of organizations) or a public school, or for a minister described in section 414(e)(5)(A). See section 403(a) (relating to qualified annuities) for rules regarding the taxation of an annuity purchased under a qualified annuity plan that meets the requirements of section 404(a)(2), and see section 403(c) (relating to nonqualified annuities) for rules regarding the taxation of other types of annuities.
§1.403(b)-2 Definitions.

(a) Application of definitions. The definitions set forth in this section are applicable for purposes of §1.403(b)-1, this section and §§1.403(b)-3 through 1.403(b)-11.

(b) Definitions--(1) Accumulated benefit means the total benefit to which a participant or beneficiary is entitled under a section 403(b) contract, including all contributions made to the contract and all earnings thereon.

(2) Annuity contract means a contract that is issued by an insurance company qualified to issue annuities in a State and that includes payment in the form of an annuity. See §1.401(f)-1(d)(2) and (e) for the definition of an annuity, and see §1.403(b)-8(c)(3) for a special rule for certain State plans. See also §§1.403(b)-8(d) and 1.403(b)-9(a) for additional rules regarding the treatment of custodial accounts and retirement income accounts as annuity contracts.

(3) Beneficiary means a person who is entitled to benefits in respect of a participant following the participant’s death or an alternate payee pursuant to a qualified domestic relations order, as described in §1.403(b)-10(c).

(4) Catch-up amount or catch-up limitation for a participant for a taxable year means a section 403(b) elective deferral permitted under section 414(v) (as described in §1.403(b)-4(c)(2)) or section 402(g)(7) (as described in §1.403(b)-4(c)(3)).

(5) Church means a church as defined in section 3121(w)(3)(A) and a qualified church-controlled organization as defined in section 3121(w)(3)(B).

(6) Church-related organization means a church or a convention or association of churches, including an organization described in section 414(e)(3)(A).
(7) Elective deferral means an elective deferral under §1.402(g)-1 (with respect to an employer contribution to a section 403(b) contract) and any other amount that constitutes an elective deferral under section 402(g)(3).

(8) (i) Eligible employer means--

(A) A State, but only with respect to an employee of the state performing services for a public school;

(B) A section 501(c)(3) organization with respect to any employee of the section 501(c)(3) organization;

(C) Any employer of a minister described in section 414(e)(5)(A), but only with respect to the minister; or

(D) A minister described in section 414(e)(5)(A), but only with respect to a retirement income account established for the minister.

(ii) An entity is not an eligible employer under paragraph (a)(8)(i)(A) of this section if it treats itself as not being a State for any other purpose of the Internal Revenue Code, and a subsidiary or other affiliate of an eligible employer is not an eligible employer under paragraph (a)(8)(i) of this section if the subsidiary or other affiliate is not an entity described in paragraph (a)(8)(i) of this section.

(9) Employee means a common-law employee performing services for the employer, and does not include a former employee or an independent contractor. Subject to any rules in §1.403(b)-1, this section and §§1.403(b)-3 through 1.403(b)-11 that are specifically applicable to ministers, an employee also includes a minister described in section 414(e)(5)(A) when performing services in the exercise of his or her ministry.
(10) **Employee performing services for a public school** means an employee performing services as an employee for a public school of a State. This definition is not applicable unless the employee's compensation for performing services for a public school is paid by the State. Further, a person occupying an elective or appointive public office is not an employee performing services for a public school unless such office is one to which an individual is elected or appointed only if the individual has received training, or is experienced, in the field of education. The term **public office** includes any elective or appointive office of a State.

(11) **Includible compensation** means the employee's compensation received from an eligible employer that is includible in the participant's gross income for Federal income tax purposes (computed without regard to section 911) for the most recent period that is a year of service. Includible compensation for a minister who is self-employed means the minister's earned income as defined in section 401(c)(2) (computed without regard to section 911) for the most recent period that is a year of service. Includible compensation does not include any compensation received during a period when the employer is not an eligible employer. Includible compensation also includes any elective deferral or other amount contributed or deferred by the eligible employer at the election of the employee that would be includible in the gross income of the employee but for the rules of section 125, 132(f)(4), 402(e)(2), 402(h)(1)(B), 402(k), or 457(b). The amount of includible compensation is determined without regard to any community property laws. See section 415(c)(3)(A) through (D) for additional rules, and see §1.403(b)-4(d) for a special rule regarding former employees.
(12) **Participant** means an employee for whom a section 403(b) contract is currently being purchased, or an employee or former employee for whom a section 403(b) contract has previously been purchased and who has not received a distribution of his or her entire accumulated benefit under the contract.

(13) **Plan** means a plan as described in §1.403(b)-3(b)(3).

(14) **Public school** means a State-sponsored educational organization described in section 170(b)(1)(A)(ii) (relating to educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where educational activities are regularly carried on).

(15) **Retirement income account** means a defined contribution program established or maintained by a church-related organization to provide benefits under section 403(b) for its employees or their beneficiaries as described in §1.403(b)-9.

(16) **Section 403(b) contract; section 403(b) plan**—(i) **Section 403(b) contract** means a contract that satisfies the requirements of §1.403(b)-3. If for any taxable year an employer contributes to more than one section 403(b) contract for a participant or beneficiary, then, under section 403(b)(5), all such contracts are treated as one contract for purposes of section 403(b) and §1.403(b)-1, this section, and §§1.403(b)-3 through 1.403(b)-11. See also §1.403(b)-3(b)(1).

(ii) **Section 403(b) plan** means the plan of the employer under which the section 403(b) contracts for its employees are maintained.

(17) **Section 403(b) elective deferral; designated Roth contribution**—(i) **Section 403(b) elective deferral** means an elective deferral that is an employer contribution to a
section 403(b) plan for an employee. See §1.403(b)-5(b) for additional rules with respect to a section 403(b) elective deferral.

(ii) **Designated Roth contribution** under a section 403(b) plan means a section 403(b) elective deferral that satisfies §1.403(b)-3(c).

(18) **Section 501(c)(3) organization** means an organization that is described in section 501(c)(3) (relating to certain religious, charitable, scientific, or other types of organizations) and exempt from tax under section 501(a).

(19) **Severance from employment** means that the employee ceases to be employed by the employer maintaining the plan. See §1.401(k)-1(d) for additional guidance concerning severance from employment. See also §1.403(b)-6(h) for a special rule under which severance from employment is determined by reference to employment with the eligible employer.

(20) **State** means a State, a political subdivision of a State, or any agency or instrumentality of a State. For this purpose, the District of Columbia is treated as a State. In addition, for purposes of determining whether an individual is an employee performing services for a public school, an Indian tribal government is treated as a State, as provided under section 7871(a)(6)(B). See also section 1450(b) of the Small Business Job Protection Act of 1996 (110 Stat. 1755, 1814) for special rules treating certain contracts purchased in a plan year beginning before January 1, 1995, that include contributions by an Indian tribal government as section 403(b) contracts, whether or not those contributions are for employees performing services for a public school.
(21) **Year of service** means each full year during which an individual is a full-time employee of an eligible employer, plus fractional credit for each part of a year during which the individual is either a full-time employee of an eligible employer for a part of the year or a part-time employee of an eligible employer. See §1.403(b)-4(e) for rules for determining years of service.

**§1.403(b)-3 Exclusion for contributions to purchase section 403(b) contracts.**

(a) **Exclusion for section 403(b) contracts.** Amounts contributed by an eligible employer for the purchase of an annuity contract for an employee are excluded from the gross income of the employee under section 403(b) only if each of the requirements in paragraphs (a)(1) through (9) of this section is satisfied. In addition, amounts contributed by an eligible employer for the purchase of an annuity contract for an employee pursuant to a cash or deferred election (as defined at §1.401(k)-1(a)(3)) are not includible in an employee's gross income at the time the cash would have been includible in the employee's gross income (but for the cash or deferred election) if each of the requirements in paragraphs (a)(1) through (9) of this section is satisfied. However, the preceding two sentences generally do not apply to designated Roth contributions; see paragraph (c) of this section and §1.403(b)-7(e) for special taxation rules that apply with respect to designated Roth contributions under a section 403(b) plan.

(1) **Not a contract issued under qualified plan or eligible governmental plan.** The annuity contract is not purchased under a qualified plan (under section 401(a) or 403(a)) or an eligible governmental plan under section 457(b).
(2) Nonforfeitability. The rights of the employee under the annuity contract (disregarding rights to future premiums) are nonforfeitable. An employee's rights under a contract fail to be nonforfeitable unless the employee for whom the contract is purchased has at all times a fully vested and nonforfeitable right (as defined in regulations under section 411) to all benefits provided under the contract. See paragraph (d)(2) of this section for additional rules regarding the nonforfeitability requirement of this paragraph (a)(2).

(3) Nondiscrimination. In the case of an annuity contract purchased by an eligible employer other than a church, the contract is purchased under a plan that satisfies section 403(b)(12) (relating to nondiscrimination requirements, including universal availability). See §1.403(b)-5.

(4) Limitations on elective deferrals. In the case of an elective deferral, the contract satisfies section 401(a)(30) (relating to limitations on elective deferrals). A contract does not satisfy section 401(a)(30) as required under this paragraph (a)(4) unless the contract requires that all elective deferrals for an employee not exceed the limits of section 402(g)(1), including elective deferrals for the employee under the contract and any other elective deferrals under the plan under which the contract is purchased and under all other plans, contracts, or arrangements of the employer. See §1.401(a)-30.

(5) Nontransferability. The contract is not transferable. This paragraph (a)(5) does not apply to a contract issued before January 1, 1963. See section 401(g).

(6) Minimum required distributions. The contract satisfies the requirements of section 401(a)(9) (relating to minimum required distributions). See §1.403(b)-6(e).
(7) **Rollover distributions.** The contract provides that, if the distributee of an eligible rollover distribution elects to have the distribution paid directly to an eligible retirement plan, as defined in section 402(c)(8)(B), and specifies the eligible retirement plan to which the distribution is to be paid, then the distribution will be paid to that eligible retirement plan in a direct rollover. See §1.403(b)-7(b)(2).

(8) **Limitation on incidental benefits.** The contract satisfies the incidental benefit requirements of section 401(a). See §1.403(b)-6(g).

(9) **Maximum annual additions.** The annual additions to the contract do not exceed the applicable limitations of section 415(c) (treating contributions and other additions as annual additions). See paragraph (b) of this section and §1.403(b)-4(b) and (f).

(b) **Application of requirements—(1) Aggregation of contracts.** In accordance with section 403(b)(5), for purposes of determining whether this section is satisfied, all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract. Additional aggregation rules apply under section 402(g) for purposes of satisfying paragraph (a)(4) of this section and under section 415 for purposes of satisfying paragraph (a)(9) of this section.

(2) **Disaggregation for excess annual additions.** In accordance with the last sentence of section 415(a)(2), if an excess annual addition is made to a contract that otherwise satisfies the requirements of this section, then the portion of the contract that includes such excess annual addition fails to be a section 403(b) contract (as further described in paragraph (d)(1) of this section) and the remaining portion of the contract is a section 403(b) contract. This paragraph (b)(2) is not satisfied unless, for the year of
the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. Thus, the entire contract fails to be a section 403(b) contract if an excess annual addition is made and a separate account is not maintained with respect to the excess.

(3) **Plan in form and operation.** (i) A contract does not satisfy paragraph (a) of this section unless it is maintained pursuant to a plan. For this purpose, a plan is a written defined contribution plan, which, in both form and operation, satisfies the requirements of §1.403(b)-1, §1.403(b)-2, this section, and §§1.403(b)-4 through 1.403(b)-11. For purposes of §1.403(b)-1, §1.403(b)-2, this section, and §§1.403(b)-4 through 1.403(b)-11, the plan must contain all the material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made. For purposes of §1.403(b)-1, §1.403(b)-2, this section, and §§1.403(b)-4 through 1.403(b)-11, a plan may contain certain optional features that are consistent with but not required under section 403(b), such as hardship withdrawal distributions, loans, plan-to-plan or annuity contract-to-annuity contract transfers, and acceptance of rollovers to the plan. However, if a plan contains any optional provisions, the optional provisions must meet, in both form and operation, the relevant requirements under section 403(b), this section and §§1.403(b)-4 through 1.403(b)-11.

(ii) The plan may allocate responsibility for performing administrative functions, including functions to comply with the requirements of section 403(b) and other tax requirements. Any such allocation must identify responsibility for compliance with the requirements of the Internal Revenue Code that apply on the basis of the aggregated
contracts issued to a participant under a plan, including loans under section 72(p) and
the conditions for obtaining a hardship withdrawal under §1.403(b)-6. A plan is
permitted to assign such responsibilities to parties other than the eligible employer, but
not to participants (other than employees of the employer a substantial portion of whose
duties are administration of the plan), and may incorporate by reference other
documents, including the insurance policy or custodial account, which thereupon
become part of the plan.

(iii) This paragraph (b)(3) applies to contributions to an annuity contract by a
church only if the annuity is part of a retirement income account, as defined in
§1.403(b)-9.

(4) Exclusion limited for former employees—(i) General rule. Except as provided
in paragraph (b)(4)(ii) of this section and in §1.403(b)-4(d), the exclusion from gross
income provided by section 403(b) does not apply to contributions made for former
employees. For this purpose, a contribution is not made for a former employee if the
contribution is with respect to compensation that would otherwise be paid for a payroll
period that begins before severance from employment.

(ii) Exceptions. The exclusion from gross income provided by section 403(b)
applies to contributions made for former employees with respect to compensation
described in §1.415(c)-2(e)(3)(i) (relating to certain compensation paid by the later of 2
½ months after severance from employment or the end of the limitation year that
includes the date of severance from employment), and compensation described in
§1.415(c)-2(e)(4), §1.415(c)-2(g)(4), or §1.415(c)-2(g)(7) (relating to compensation paid
to participants who are permanently and totally disabled or relating to qualified military service under section 414(u)).

(c) Special rules for designated Roth section 403(b) contributions. (1) The rules of §1.401(k)-1(f)(1) and (2) for designated Roth contributions under a qualified cash or deferred arrangement apply to designated Roth contributions under a section 403(b) plan. Thus, a designated Roth contribution under a section 403(b) plan is a section 403(b) elective deferral that is designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution that is being made in lieu of all or a portion of the section 403(b) elective deferrals the employee is otherwise eligible to make under the plan; that is treated by the employer as includible in the employee's gross income at the time the employee would have received the amount in cash if the employee had not made the cash or deferred election (such as by treating the contributions as wages subject to applicable withholding requirements); and that is maintained in a separate account (within the meaning of §1.401(k)-1(f)(2)).

(2) A designated Roth contribution under a section 403(b) plan must satisfy the requirements applicable to section 403(b) elective deferrals. Thus, for example, designated Roth contributions under a section 403(b) plan must satisfy the requirements of §1.403(b)-6(d). Similarly, a designated Roth account under a section 403(b) plan is subject to the rules of section 401(a)(9)(A) and (B) and §1.403(b)-6(e).

(d) Effect of failure--(1) General rules. (i) If a contract includes any amount that fails to satisfy the requirements of section 403(b), §1.403(b)-1, §1.403(b)-2, this section, or §§1.403(b)-4 through 1.403(b)-11, then, except as otherwise provided in paragraph (d)(2) of this section (relating to failure to satisfy nonforfeitability requirements) or
§1.403(b)-4(f) (relating to excess contributions under section 415 and excess deferrals under section 402(g)), the contract is not a section 403(b) contract. In addition, section 403(b)(5) and paragraph (b)(1) of this section provide that, for purposes of determining whether a contract satisfies section 403(b), all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract. Thus, except as provided in paragraph (b)(2) of this section or as otherwise provided in this paragraph (d), a failure to satisfy section 403(b) with respect to any contract issued to an individual by an employer adversely affects all contracts issued to that individual by that employer.

(ii) In accordance with paragraph (b)(3) of this section, a failure to operate in accordance with the terms of a plan adversely affects all of the contracts issued by the employer to the employee or employees with respect to whom the operational failure occurred. Such a failure does not adversely affect any other contract if the failure is neither a failure to satisfy the nondiscrimination requirements of §1.403(b)-5 (a nondiscrimination failure) nor a failure of the employer to be an eligible employer as defined in §1.403(b)-2 (an employer eligibility failure). However, any failure that is not an operational failure adversely affects all contracts issued under the plan, including: a failure to have contracts issued pursuant to a written defined contribution plan which, in form, satisfies the requirements of §1.403(b)-1, §1.403(b)-2, this section and §§1.403(b)-4 through 1.403(b)-11 (a written plan failure); a nondiscrimination failure; or an employer eligibility failure.

(iii) See other applicable Internal Revenue Code provisions for the treatment of a contract that is not a section 403(b) contract, such as sections 61, 83, 402(b), and
403(c). Thus, for example, section 403(c) (relating to nonqualified annuities) applies if any annuity contract issued by an insurance company fails to satisfy section 403(b), based on the value of the contract at the time of the failure. However, see paragraph (d)(2) of this section for special rules with respect to the nonforfeitability requirement of paragraph (a)(2) of this section.

(2) Failure to satisfy nonforfeitability requirement--(i) Treatment before contract becomes nonforfeitable. If an annuity contract issued by an insurance company would qualify as a section 403(b) contract but for the failure to satisfy the nonforfeitability requirement of paragraph (a)(2) of this section, then the contract is treated as a contract to which section 403(c) applies. See §1.403(b)-8(d)(4) for a rule under which a custodial account that fails to satisfy the nonforfeitability requirement of paragraph (a)(2) of this section is treated as a section 401(a) qualified plan for certain purposes.

(ii) Treatment when contract becomes nonforfeitable--(A) In general. Notwithstanding paragraph (d)(2)(i) of this section, on or after the date on which the participant’s interest in a contract described in paragraph (d)(2)(i) of this section becomes nonforfeitable, the contract may be treated as a section 403(b) contract if no election has been made under section 83(b) with respect to the contract, the participant’s interest in the contract has been subject to a substantial risk of forfeiture (as defined in section 83) before becoming nonforfeitable, each contribution under the contract that is subject to a different vesting schedule is maintained in a separate account, and the contract has at all times satisfied the requirements of paragraph (a) of this section other than the nonforfeitability requirement of paragraph (a)(2) of this section. Thus, for example, for the current year and each prior year, no contribution can
have been made to the contract that would cause the contract to fail to be a section 403(b) contract as a result of contributions exceeding the limitations of section 415 (except to the extent permitted under paragraph (b)(2) of this section) or to fail to satisfy the nondiscrimination rules described in §1.403(b)-5. See also §1.403(b)-10(a)(1) for a special rule in connection 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.

Par. 7. Sections 1.403(b)-4, 1.403(b)-5, 1.403(b)-6, 1.403(b)-7, 1.403(b)-8, 1.403(b)-9, 1.403(b)-10, and 1.403(b)-11 are added to read as follows:

§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 employee 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 section 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)(ii) 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.

(ii) **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)(B) 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)(B) 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