

# Which plan type best fits your clients' needs?

## 401(k) and 403(b) comparison chart

There are some important differences between a 401(k) and 403(b) plan design. Use the chart below to compare provisions and pick the one to best suit your clients' needs.

Design considerations and provisions	401(k)	ERISA 403(b) <sup>1</sup>
<b>Eligible organizations</b>	Corporations, partnerships, sole proprietors, tax-exempt employers and Native American Tribal governments. Governmental employers only if established on or before May 6, 1986.	Code Section 501(c)(3) organizations, ministers and public education institutions (or an instrumentality/ agency of a state for public schools).
<b>Qualifications</b>		
ERISA plan compliance	<ul style="list-style-type: none"> <li>• Required, unless governmental or nonelecting church</li> </ul>	<ul style="list-style-type: none"> <li>• Required, unless governmental or nonelecting church</li> </ul>
Form 5500 filing	<ul style="list-style-type: none"> <li>• Required</li> </ul>	<ul style="list-style-type: none"> <li>• Required</li> </ul>
Annual audit	<ul style="list-style-type: none"> <li>• Usually required if greater than 100 lives</li> </ul>	<ul style="list-style-type: none"> <li>• Usually required if greater than 100 lives</li> </ul>
Internal Revenue Service (IRS)	<ul style="list-style-type: none"> <li>• Determination Letter Program* for new plans (may rely on an opinion/advisory letter if using a pre-approved plan document)</li> </ul>	<ul style="list-style-type: none"> <li>• No Determination Letter Program* for 403(b) (may rely on an opinion/advisory letter if using a pre-approved plan document)</li> </ul>
<b>Plan document</b>	<p>Must have a written plan document.</p> <p><b>Options:</b></p> <ul style="list-style-type: none"> <li>• Prototype — standard or non-standard**</li> <li>• Outside drafted</li> <li>• Volume submitter**</li> </ul>	<p>Must have a written plan document.</p> <p><b>Options:</b></p> <ul style="list-style-type: none"> <li>• Prototype — standard or non-standard**</li> <li>• Outside drafted</li> <li>• Volume submitter**</li> </ul>
<b>Funding vehicles</b>	<ul style="list-style-type: none"> <li>• Nonregistered separate accounts</li> <li>• Mutual funds</li> <li>• Self-directed brokerage accounts</li> <li>• Employer securities</li> </ul>	<ul style="list-style-type: none"> <li>• Mutual funds</li> <li>• Self-directed brokerage accounts (limited to mutual funds)</li> <li>• Fixed annuities or registered variable annuities</li> </ul>
<b>ERISA</b>		
404(c) compliance	<ul style="list-style-type: none"> <li>• Yes, but not required</li> </ul>	<ul style="list-style-type: none"> <li>• Yes, but not required</li> </ul>
404(a)(5) disclosure	<ul style="list-style-type: none"> <li>• Required</li> </ul>	<ul style="list-style-type: none"> <li>• Required</li> </ul>

\* Recent 403(b) guidance given closed the first Retirement Annuity Contract for 403(b) plans to March 31, 2020.

\*\* Available with services by Principal®.

## Design considerations and provisions

### 401(k)

### ERISA 403(b)<sup>1</sup>

#### Eligible employees

Employees of the employer. By statute may exclude nonresident aliens without U.S. source income and collectively bargained employees. Other classification exclusions are allowed if coverage testing is satisfied per IRC §410(b).

Most times, salary deferrals must be universally available to all employees of the employer. The final 403(b) regulations may exclude an employee who meets the following criteria:

1. Works less than 20 hours per week
2. Is an enrolled student of a school/college who regularly attends classes and is also an employee at that school/college
3. A nonresident alien with no U.S. source income
4. Is covered under another 401(k), 403(b) or governmental 457(b) plan
5. Is not electing to defer at least \$200 annually

For contributions other than salary deferrals, exclusions are allowed if coverage testing is satisfied per IRC §410(b)

#### Permissible entry requirements

##### Salary deferrals

- Age 21 and 1 year of service

##### Employer contributions (match and non-matching contributions)

- Age 21 and up to 2 years of service (2 years of service requires 100 percent vesting)<sup>2</sup>
- Employees may be automatically enrolled

##### Salary deferrals

- No age or service requirement. Immediate eligibility

##### Employer contributions (match and non-matching contributions)

- Age 21 and up to 2 years of service (2 years of service requires 100 percent vesting)<sup>2</sup>
- Employees may be automatically enrolled

#### Contributions

Pre-tax or Roth salary deferrals (indexed annually)

- Allowed (\$19,000 in 2019)

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Catch-ups (indexed annually)

- Allowed age 50 and above in calendar year (\$6,000 in 2019)

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415 limit (indexed annually)

- Applicable, \$56,000 (in 2019) up to 100 percent of pay

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Compensation (indexed annually)

- \$280,000 in 2019

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Plan may restrict deferrals based on this limit.

#### Plan to plan transfers

Transfers are allowed from one 401(k) plan to another 401(a) plan if certain requirements are met.

Contract exchanges (within the same 403(b) plan) and plan to plan transfers (from one 403(b) plan to another 403(b) plan) are allowed if certain requirements are met.

Design considerations and provisions	401(k)	ERISA 403(b) <sup>1</sup>
<b>Trust/custodial requirement</b>	Can be either trustee or non-trustee. A trust is required if any retirement funds are held outside a group annuity contract, (i.e., plan loans, mutual funds, etc.).	Trust isn't necessary. However, if not funded with annuities, the retirement funds are to be held in a custodial account.
<b>Plan compliance nondiscrimination testing</b>	<p><b>Salary deferrals</b></p> <ul style="list-style-type: none"> <li>• Actual Deferral Percentage (ADP) testing – can be ADP safe harbor</li> <li>• Subject to 410(b) coverage</li> </ul> <p><b>Match</b></p> <ul style="list-style-type: none"> <li>• Actual Contribution Percentage (ACP) testing – can be ACP safe harbor</li> <li>• Subject to 410(b) coverage</li> </ul> <p><b>Non-matching employer contributions</b></p> <ul style="list-style-type: none"> <li>• 401(a) rules apply, including 410(b)</li> </ul>	<p><b>Salary deferrals</b></p> <ul style="list-style-type: none"> <li>• ADP testing not applicable</li> <li>• Universal availability</li> </ul> <p><b>Match</b></p> <ul style="list-style-type: none"> <li>• ACP testing – can be ACP safe harbor<sup>4</sup></li> <li>• Subject to 410(b) coverage</li> </ul> <p><b>Non-matching employer contributions</b></p> <ul style="list-style-type: none"> <li>• 401(a) rules (e.g., 401(a)(4)) apply, including 410(b)</li> </ul>
<b>Top-heavy rules</b>	Applicable, unless 401(k) safe harbor plan is meeting all the requirements	Not applicable
<b>Vesting</b>	<ul style="list-style-type: none"> <li>• Salary deferrals are 100 percent immediate</li> <li>• Vesting schedules as defined in §411 apply</li> <li>• Maximum of 3-year cliff or 6-year graded for employer contributions</li> </ul>	<ul style="list-style-type: none"> <li>• Salary deferrals are 100 percent immediate</li> <li>• Vesting schedules as defined in §411 apply</li> <li>• Maximum of 3-year cliff or 6-year graded for employer contributions</li> </ul>
<b>Plan loans</b>	Must follow 401(a) rules and requires a trust.	Must follow 401(a) rules, trust isn't required
<b>In-service withdrawals</b>		
Hardship	<ul style="list-style-type: none"> <li>• Allowed, vested account or salary deferrals (including earnings)</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed, but limited to salary deferrals under a custodial account pursuant to IRC §403(b)(7) (excluding earnings)<sup>5,6</sup></li> </ul>
Age 59½ withdrawals	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>
Rollover/voluntary contributions	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>
Seasoned money (5 years of service or 2 years of participation)	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Not allowed for plans funded with mutual funds in a custodial account</li> </ul>
<b>Distributable events</b>		
Severance from service	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>
Death	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>
Disability	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>
Retirement age	<ul style="list-style-type: none"> <li>• Allowed</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed, if normal retirement age is at least 59½</li> </ul>
Plan termination	<ul style="list-style-type: none"> <li>• Allowed, unless successor plan rules apply</li> </ul>	<ul style="list-style-type: none"> <li>• Allowed, unless successor plan rules apply</li> </ul>

## Design considerations and provisions

### 401(k)

### ERISA 403(b)<sup>1</sup>

#### Rollovers

##### Contributions

- May allow from other eligible retirement plans or IRA. Eligible retirement plan means 403(a), 403(b), 401(a) and eligible governmental 457(b).

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##### Direct rollover distributions

- Required to allow participant to rollover to an eligible retirement plan or IRA.

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#### Required minimum distribution

**In general, distributions are required to begin by April 1 of the calendar year following the latter of:**

- The year in which a participant turns age 70½, or
- The year in which the participant retires/terminates

**Exception:** Participants who are 5 percent or more owners must begin receiving distributions by April 1 following the year they turn age 70½. Owners are not allowed to defer distributions until they retire.

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- The year in which a participant turns age 70½,<sup>7</sup> or
- The year in which the participant retires/terminates

<sup>1</sup> Rules and plan provisions of non-ERISA 403(b) programs are different than ERISA 403(b) plans.

<sup>2</sup> ADP/ACP safe harbor plan designs may impose up to 1 year service requirement.

<sup>3</sup> Not all 403(b) plan sponsor employers are eligible for this catch-up.

<sup>4</sup> 403(b) plans sponsored by church or church-controlled organizations: A church as defined in Section 3121(w)(3)(A) or a church-controlled organization that meets the definition of a “qualified church-controlled organization” as defined in Section 3121(w)(3)(B) are exempt from the non-discrimination tests of 403(b)(12). This includes ACP testing, coverage, and 401(a)(4). Church organizations that do not meet the definition, as outlined in 3121 (w)(3)(A) and 3121(w)(3)(B), must follow 403(b)(12) nondiscrimination rules.

<sup>5</sup> Post 1988 contributions: Hardship withdrawal of employer contributions (other than salary deferrals) are only permitted with respect to contributions which are invested in annuities, and are not and have not ever been allocated to any custodial account.

<sup>6</sup> The Bipartisan Budget Act did not extend money sources to 403(b) plans as it did for 401(k) plans.

<sup>7</sup> The plan may permit the receipt of pre-1987 accruals to be delayed until the later of age 75 or retirement.

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Note: References to Prototype and Joinder plan documents and features within are specific to plan documents Principal makes available for plan sponsors to adopt.

This document is intended to be educational in nature and is not intended to be taken as a recommendation.

Principal Life Insurance Company, Des Moines, Iowa 50392-0002, principal.com

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