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Employee Benefits and Compensation

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IRS Clarifies Benefit Coverage Requirements for Employees of Tax-Exempt Disregarded Entities

The Internal Revenue Service (IRS) recently issued General Counsel Memorandum 201634021 (Memorandum), clarifying benefit coverage requirements for employees of a disregarded LLC wholly owned by a single member tax-exempt organization (referred to as a “disregarded entity”). Specifically, the Memorandum concludes that such employees must be permitted to participate in the member’s 403(b) plan and may be permitted to participate in the member’s 457(b) plan.

The IRS explains that the activities of a disregarded entity are treated in the same manner as a sole proprietorship, branch, or division of the member. Accordingly, the employees of a disregarded entity are treated as employees of the member for purposes of Section 403(b) of the Internal Revenue Code (Code). This means that, if the member sponsors a 403(b) plan that permits elective deferrals, the employees of the disregarded entity must also be eligible to participate in the member’s 403(b) plan to avoid violating the “universal availability” rule. A 457(b) plan sponsored by the member permits the employees of a disregarded entity to participate in the member’s 457(b) plan; however, they are not required to do so because no similar universal availability requirement exists under Section 457 of the Code.

Although not formal guidance, the Memorandum conveys the position of the IRS and therefore merits the attention of any tax-exempt organization that sponsors a 403(b) or 457(b) plan and is a member of a disregarded entity.

If you have any questions about your 403(b) or 457(b) plan in light of the Memorandum, please contact one of the following lawyers in Robinson+Cole's Employee Benefits and Compensation Group:

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