

TOPIC:

RETIREMENT PLANS: COMPLIANCE WITH THE NEW 403(b) REGULATIONS

INTRODUCTION:

Unlike other types of qualified retirement plans, 403(b) plans have been only loosely regulated since they first came into existence in 1963, with Internal Revenue Service ("IRS") guidance consisting of various uncoordinated regulations, revenue and private letter rulings, notices, and audit guidelines. On July 26, 2007, the IRS issued the first comprehensive regulations governing 403(b) plans in over forty-three years. The new regulations reflect a Congressional mandate that 403(b) plans be subject to the same or similar rules as 401(k) and 457(b) plans, the most important implication of which is that responsibility for compliance will now be focused on the employer sponsoring a 403(b) plan and not on the individual employee participant as in the past. The new 403(b) regulations generally are effective January 1, 2009 [1]. In conjunction with the new 403(b) regulations, the IRS also issued regulations regarding how the controlled group rules apply to tax-exempt employers, also effective January 1, 2009.

Failure to comply with these new regulations will result in severe penalties, such as the immediate taxation of all assets held under the 403(b) plan. Therefore, it is critically important that all institutional 403(b) plans be reviewed to ensure compliance by the effective date of the regulations. This Note addresses the key changes and clarifications under the new 403(b) regulations as they apply to both public and private colleges and universities.

DISCUSSION:

Some of the key changes and clarifications under the new 403(b) regulations of which institutions should be aware include: (1) the plan document requirement; (2) nondiscrimination requirements; (3) post-retirement contributions; (4) in-service withdrawals; (5) transfers and exchanges; (6) timely remittance; (7) plan terminations; and (8) controlled group rules.

1. The Plan Document Requirement

What is the plan document requirement?

Private colleges and universities sponsoring 403(b) plans subject to the Employee Retirement Income Security Act of 1976 (“ERISA”) are already required to maintain plan documents that contain all material terms of their 403(b) plans. These institutions are unlikely to be significantly impacted by the plan document requirement. However, because Code Section 403(b) has not previously required a written plan document, many public institutions and private institutions sponsoring church plans not subject to ERISA have not had a written plan document for their 403(b) plan. Additionally, private institutions sponsoring 403(b) plans that allow only voluntary salary deferral have frequently taken advantage of an exception to ERISA’s rules for these types of plans and not maintained written plan documents.

The new regulations require all employers – both public and private – to adopt written plan documents for all 403(b) programs, regardless of whether the plan is exempt from ERISA. The 403(b) plan sponsor – generally, the institution – is responsible for ensuring that the terms and conditions of the 403(b) plan are set forth in a written plan document that satisfies 403(b) and its underlying regulations both in form and in operation. Under the new regulations, the plan document will be central to plan compliance going forward.

The plan document must contain all material terms regarding eligibility, entry dates, benefits, approved vendors under the plan, contribution limits, and distribution rules. The plan document must also contain information regarding any optional terms, rights, or benefits, such as the availability of hardship distributions, loans, or transfers. To the extent that the institution chooses to delegate administrative and/or compliance responsibilities to a vendor or other third party, the plan document must contain provisions allocating and coordinating such responsibilities, including responsibilities that apply on a “plan level,” such as loans and hardship withdrawals. No compliance responsibility can be allocated to plan participants.

The written plan document requirement may be satisfied by compiling various documents (e.g., state statutes, annuity contracts, institution policies, and salary reduction agreements) or by incorporating other documents by reference [2]. However, there cannot be any conflict or inconsistency among the documents, and the documents must contain all material terms describing the plan. The new regulations state that the plan document will control over the underlying annuity contracts or custodial account agreements in the event of inconsistencies. Because the plan’s vendors will operate under the terms of their contracts and/or agreements, it will be important to review the underlying annuity contracts and/or custodial account agreements for consistency with the plan document to avoid potential operational errors.

The written plan document must be adopted by no later than December 31, 2008. Institutions that already have written plan documents for their 403(b) plan will also need to review their documents (as well as their related administrative forms, such as salary reduction agreements and service or vendor agreements) for compliance with the new rules, including the delegation of responsibility, and make any necessary amendments by

January 1, 2009 [3]. Failure to adopt a written plan document that satisfies the new regulations by that deadline will result in the taxation of all participant contracts under the 403(b) plan, including all amounts contributed before and after January 1, 2009.

Will adoption of a written plan document cause a non-ERISA plan to become subject to ERISA's requirements?

Public institutions and private institutions sponsoring church plans are not subject to ERISA. All other private institutions are generally subject to ERISA. However, private institutions sponsoring voluntary salary deferral-only plans can treat these plans as exempt from ERISA under a Department of Labor (DOL) safe harbor that provides that 403(b) plans are not subject to ERISA if (i) they are funded through salary deferrals only, (ii) participation is completely voluntary, (iii) all rights under the annuity contract or custodial account are enforceable solely by the employee, (iv) the employer's involvement with the plan is limited, and (v) the employer receives no consideration other than reasonable reimbursement of expenses.

The DOL issued guidance in conjunction with the new 403(b) regulations on the extent to which compliance with the new regulations would result in a 403(b) program falling out of the DOL's exemption from ERISA. The DOL's guidance indicates that compliance with the new 403(b) regulations will not automatically result in a salary deferral-only plan becoming subject to ERISA, and that the DOL will continue to examine this issue on a case-by-case basis. The DOL's guidance recognizes that employers may undertake administrative functions required by the new regulations in order to ensure that their 403(b) plan is tax-compliant without subjecting the plans to ERISA. However, to the extent that an employer has responsibility for discretionary determinations, such as authorizing transfers, processing distributions, satisfying joint and survivor annuity requirements, making qualified domestic relations order (or "QDRO") determinations, and handling loans, these responsibilities would cause the plan to be covered by ERISA [4].

2. The Non-Discrimination Requirements.

Are there any changes to the nondiscrimination rules applicable to employer contributions made to 403(b) plans?

Both public and private institutions sponsoring 403(b) plans (other than certain church plans) must comply with limits on the amount of compensation that can be taken into account in calculating employer contributions under Code Section 401(a)(17) (\$230,000 for 2008). Public institutions may be able to take advantage of the higher OBRA 93 limits in certain circumstances. No other nondiscrimination rules apply to these institutions with respect to employer contributions. However, private institutions sponsoring 403(b) plans (other than certain church plans) must additionally satisfy the Code Section 410(b) coverage test, the Code Section 401(a)(4) general nondiscrimination test for nonelective contributions, and the Code Section 401(m) test for matching and after-tax employee contributions. Private institutions must also use a nondiscriminatory definition of compensation in testing under these Code sections. These are the same rules that apply

to 401(k) and 401(a) plans.

Private institutions, however, have long been able to take advantage of three nondiscrimination safe harbors under IRS Notice 89-23, which generally permit a greater range of permissible discrimination than under the Code nondiscrimination rules. Additionally, Notice 89-23 permitted these institutions to use a good-faith reasonableness standard for satisfying the nondiscrimination rules, which some institutions have relied upon in testing the age- or service-based formulas in their 403(b) plans. The new regulations repeal Notice 89-23 effective January 1, 2009. Any private institution relying on the more permissive nondiscrimination testing rules or under a good-faith reasonableness standard under Notice 89-23 should evaluate whether its 403(b) plan will be able to pass the applicable Code nondiscrimination rules, and, if not, consider changes to its plan design [5].

Have the nondiscrimination rules that apply to employee salary deferral contributions to a 403(b) plan changed?

The 403(b) plans of both private and public colleges and universities (but not certain church plans) must satisfy the "universal availability" rule applicable to salary deferral contributions. Although this requirement is not new, the new regulations clarify the requirements for satisfying this nondiscrimination rule. The universal availability rule states that to the extent an institution permits *one* employee to make salary contributions (either traditional pre-tax or Roth after-tax) to a 403(b) plan, it must permit *all* employees an "effective opportunity" to participate in the 403(b) plan [6]. An institution has, however, historically been able to exclude the following groups of employees from participating in its 403(b) plan without violating this rule:

- Nonresident aliens with no U.S. source income,
- Employees eligible to make elective deferrals to another 403(b), 401(k), or governmental 457(b) plan of the same employer,
- Employees whose contributions to the plan would be \$200 or less annually,
- Student employees exempt from FICA taxation, and
- Employees who normally work less than 20 hours a week.

For the last two of these exclusions to apply, all employees covered by that exclusion must be prohibited from participating in the plan by the plan's terms. Institutions have additionally been able to exclude the following groups of employees under Notice 89-23's guidance:

- Employees who make a one-time election to participate in a governmental plan instead of a 403(b) plan,
- Visiting professors for up to one year,
- Employees affiliated with a religious order who have taken a vow of poverty, and
- Employees covered by a collective bargaining agreement.

The new regulations repeal these exclusions under Notice 89-23, generally effective

January 1, 2010, for any plan that excluded any such employees as of July 26, 2007. There may be later effective dates for plans maintained pursuant to collective bargaining agreements and by governmental employers [7].

One of the more significant exclusions from the nondiscrimination rules for colleges and universities is the one for employees who normally work less than 20 hours a week. The new regulations interpret this as a 1,000 hour a year requirement. The new regulations provide that an institution may exclude an employee from participating in the 403(b) plan during his or her first twelve months of employment if the institution reasonably expects the employee to work less than 1,000 hours during that period. However, for subsequent years, the employee can be excluded from the 403(b) plan only if he or she did in fact work less than 1,000 hours during the prior twelve-month period. Private institutions sponsoring 403(b) plans subject to ERISA, however, are already subject to stricter rules. Such institutions can exclude employees from participating in the 403(b) plan only if they actually work less than 1,000 hours that year [8].

An institution will not be treated as giving all employees an effective opportunity to participate in its 403(b) plan unless it notifies all eligible employees at least once a year of their ability to make or change an election to contribute to the 403(b) plan. Additionally, although an institution may condition matching contributions to the 403(b) plan (or to a 401(a) plan) on a participant making elective deferrals under the 403(b) plan, no other rights or benefits may be conditioned on participation in the 403(b) plan.

If a college or university fails to give all employees (except those permissibly excluded) an effective opportunity to participate in the 403(b) plan, all participant contracts under the 403(b) plan become taxable. Although the IRS does permit employers to correct for universal availability failures short of taxing the entire plan, the correction method requires an employer contribution made on behalf of all impermissibly excluded employees. Because of the draconian penalties for noncompliance with the universal availability rule, institutions may want to consider permitting all employees to participate in the 403(b) plan immediately for purposes of making salary deferrals (not necessarily employer contributions) and providing meaningful notice rather than attempting to track hours.

3. Clarifications Regarding Salary Deferral and Post-Employment Plan Contributions.

How do the new regulations impact salary deferral contributions to a 403(b) plan?

The new 403(b) regulations clarify that a salary deferral under Code Section 402(g) does not include a contribution made as a condition of employment or a contribution made pursuant to a one-time irrevocable election made on or before an employee's first becoming eligible to participate in the plan. Nonetheless, under a new regulation issued November 1, 2007, FICA taxes *do apply* to salary deferral contributions regardless of whether mandatory or elective.

The new regulations confirm that 403(b) plans can allow *after-tax* Roth contributions

beginning in 2007. Roth contributions are treated the same as traditional pre-tax salary deferral contributions for most purposes under the 403(b) plan, and are counted toward the salary deferral contribution limits. Roth contributions are required to be held at least five years from the date that the first Roth contribution is made to the 403(b) plan in order to be tax-free at distribution.

The new regulations also set forth an “ordering rule” for application of catch-up contributions. There are two types of catch-ups available under 403(b) plans: the age 50 catch-up (\$5,000 for 2008) and the 15 years of service catch-up (up to \$3,000 per year, with a \$15,000 maximum). The new regulations confirm that the age 50 catch-up applies only *after* the employee has contributed an amount equal to both the basic salary deferral limit (\$15,500 for 2008) and the 15 years of service catch-up limit, if any. This rule is important in that employees can inadvertently use up their 15 years of service catch-up without realizing it. Additionally, the new regulations provide that part-time employment or full-time employment for less than the entire work period (e.g. academic year for faculty) must be aggregated, under a specific but complicated formula, to determine years of service under the 15 years of service catch-up.

What contributions are permitted to a 403(b) plan after termination of employment?

Post-retirement contributions to a 403(b) plan can generally take two forms. First, effective January 1, 2007, former employees can electively defer compensation that they receive from their employing institution up to the later of 2 ½ months after severance from employment or the end of the year in which they sever employment, but *only to the extent* that the compensation is either regular pay or accumulated unused sick or vacation pay and that the compensation has not been paid or made available to the employee at the time of the election. Any deferrals made under these provisions cannot exceed the contribution limits when aggregated with all other contributions to the 403(b) plan. Salary deferrals cannot be made from severance pay received after separation from service.

Second, employer contributions can be made for the five-year period beginning at the end of the taxable year of an employee’s severance from employment. Contributions can be made each year up to the total contribution limit of the lesser either of 100% of compensation or \$46,000 for 2008. The new regulations clarify that any contribution to a 403(b) plan under this rule on behalf of a former employee must be an *employer contribution* [9].

403(b) plans are unique in that they are the only type of retirement plan to which employer post-retirement contributions can be made. This can be a very valuable feature for institutions (particularly public institutions) that want to restructure existing unfunded-benefit promises, establish early-retirement incentives, or reward long service. Post-retirement contributions are subject to non-discrimination rules to the extent applicable, however, and private institutions should, therefore, exercise caution in designing a plan with post-retirement contributions.

4. In-Service Loans and Hardship Withdrawals from Plan Funds.

What changes have been made to the loan and hardship withdrawal provisions?

The new regulations require that plan loans and hardship distributions follow the same rules applicable to 401(k) plans. For example, hardship withdrawals can be made only if the institution (or the vendor, if appropriately delegated) verifies that there is a financial hardship and the amount of that hardship, the hardship withdrawal does not exceed certain amounts, and, if the safe harbor rules apply, salary deferrals are suspended for six months following the withdrawal [10]. Note that in order to verify a financial hardship, the institution or vendor, as applicable, will need to request substantiation of the need – employee self-certification is no longer permissible. Likewise, loans cannot be made if the participant has a previous loan in default with a vendor or if the participant has an existing loan with a vendor that if combined with the second loan request would exceed certain dollar limits. Similarly, the new regulations do not permit employees to self-certify that the loan requirements are satisfied.

What distribution rules apply to employer contributions?

Salary deferral contributions to 403(b) annuity contracts generally cannot be distributed prior to age 59 ½, death, disability, severance from employment, and financial hardship. Employer and salary deferral contributions to 403(b) custodial accounts are subject to similar rules. However, employer contributions made to an annuity contract under a 403(b) plan have historically not been subject to any distribution restrictions. Under the new regulations, employer contributions to an annuity contract cannot be distributed prior to a fixed number of years (such as five years of participation), attainment of a stated age, or the occurrence of certain events (such as severance from employment or disability) [11]. The regulations provide that a timely amendment to a 403(b) plan to comply with this new rule will not violate ERISA's anti-cut-back rule to the extent the amendment reduces a right to receive in-service distributions. This change applies to all 403(b) annuity contracts issued on or after January 1, 2009.

5. Non-Taxable Transfers and Exchanges.

What transfers are available under a 403(b) plan?

The new regulations recognize three types of transfers under a 403(b) plan that will not be treated as a taxable distribution:

- Contract exchanges within the same 403(b) plan. (e.g., from one vendor to another).
- Transfers from one 403(b) plan to another 403(b) plan if the participant whose assets are being transferred is an employee or former employee of the employer maintaining the receiving plan.
- Transfers to a governmental defined-benefit 401(a) plan to purchase permissive service credit.

The new contract exchange rules are the most significant of these transfer rules for most colleges and universities. In the past, unless prohibited by the plan document or contract, 403(b) plan participants have had the ability to transfer their account or contract held by the employer's "approved" vendors under the 403(b) plan to any other vendor they wanted, without any employer involvement. This was the so-called "90-24 transfer," named after the IRS Revenue Ruling that provided that such transfers did not result in a taxable distribution. Private institutions sponsoring 403(b) plans subject to ERISA have typically had provisions in their 403(b) plan documents prohibiting such transfers, but public institutions sponsoring salary deferral-only plans with multiple vendors frequently did not address or regulate transfers. The IRS has stated its belief that it is impossible for an employer to comply with the 403(b) rules if plan assets are transferred to vendors over which the employer has no control. Therefore, the 403(b) regulations prohibit "90-24 transfers" after September 24, 2007.

The new regulations continue to permit participants to transfer their account or contract to another vendor (which the IRS refers to as "contract exchange") after September 24, 2007, however, so long as the following rules are satisfied:

- The contract exchange is not prohibited by the 403(b) plan document (note that the document is not required to permit contract exchanges expressly).
- The participant's benefit is not reduced.
- The distribution restrictions under the new contract or account are at least as stringent as those imposed on the old contract or account.
- The institution and vendor either (i) enter into an "information sharing" agreement to ensure that the school and vendor each have the information they need to comply with the 403(b) regulations (e.g. information regarding the participant's employment status, hardship withdrawals, and plan loans), or (ii) the vendor is an approved vendor under the plan document. For contract exchanges before January 1, 2009, this requirement must be satisfied by no later than January 1, 2009.

If contract exchanges are permitted only between vendors approved under the plan document, information-sharing agreements are not necessary, because the employer and vendor should already have agreed to share this type of information via the plan document and vendor agreements. If exchanges are permitted with vendors that are not approved under the plan, however, the information-sharing agreement serves to bring the vendor into the plan as a "deemed" approved vendor. If a contract exchange is made after September 24, 2007, and the contract exchange rules are not satisfied, all amounts under all of the affected participant's contracts and/or accounts under the 403(b) plan become taxable [12].

What happens if the institution makes a mistake?

If an institution fails to timely adopt a written 403(b) plan document, the plan does not satisfy the applicable nondiscrimination rules, or the plan is not operated in accordance with its coverage provisions, all amounts under all participants' contracts under the 403(b) plan become taxable. However, most operational failures that occur within a participant's

account or contract will result in the disqualification only of the contracts or accounts of that participant held under the 403(b) plan, and will not impact other participant accounts under the plan [13].

There is a special rule that applies if the contribution limits are exceeded. Any excess contribution must be held in a separate account that is not treated as covered by Code Section 403(b) in the year of the excess and each year thereafter, and is immediately taxable to the extent vested. If the excess is not timely held in a separate account, all of the affected participant's contracts or accounts under the 403(b) plan become taxable. Excess elective deferrals plus allocable net income should be distributed by April 15 of the year following the year the excess was made to avoid double taxation of the excess.

6. Timely Remittance of Plan Contributions.

When must contributions be paid to vendors?

The new 403(b) regulations require that both public and private institutions sponsoring 403(b) plans remit contributions to vendors within a period that is no longer than reasonable for proper plan administration. The new regulations give an example of a reasonable period for employee salary deferrals being within 15 business days following the end of the month in which the amounts would otherwise have been paid to the participants. However, private institutions sponsoring ERISA-covered 403(b) plans are already subject to a stricter remittance rule; they are required to transfer salary deferral contributions to the vendor within a period that is no longer than reasonable for the proper administration of the plan, but no longer than 15 business days following the month in which the amounts would otherwise have been paid to the participant. The DOL has interpreted the “no longer than reasonable” requirement as being significantly shorter than the 15 day standard. Employer contributions generally must be made in accordance with the plan document and the Code Section 415 rules.

7. Annuity Contract and Custodial Account Agreement Requirements.

What must be in the annuity contracts and/or custodial account agreements to comply with the new regulations?

Annuity contracts or custodial account agreements with vendors are required to contain specific provisions in order to comply with the 403(b) rules, including the nonforfeitability (for annuities) and nontransferability of accounts, the salary deferral contribution limits, and the direct rollover provisions. The new regulations also require that the annuity contracts and custodial account agreements contain the minimum distribution requirements and the limits on incidental benefits. Finally, the new regulations require that an annuity contract and/or custodial account agreement be issued under an employer 403(b) plan.

8. Rules Concerning Plan Terminations.

Can an institution terminate its 403(b) plan and establish another type of retirement plan?

Historically, there has been no statutory basis for terminating a 403(b) plan. The new regulations specifically provide that 403(b) plans can be terminated [14]. Plan assets must be distributed as soon as reasonably practicable after termination and can be rolled over by participants to another retirement plan or an IRA. Distributions can also be made in the form of a deferred but vested annuity. A 403(b) plan can be terminated before January 1, 2009, without having to adopt a plan document, so long as the plan satisfies all other requirements of the new regulations.

The new regulations state that 403(b) plans cannot be merged with, nor can their assets be transferred to, a 401(k), 457(b), or 401(a) plan. Therefore, an institution sponsoring a 403(b) plan cannot establish a new 401(k) plan, terminate the 403(b) plan and transfer all 403(b) assets to the 401(k) plan, nor can it merge the two plans into a single plan. Instead, the assets of the 403(b) plan would have to be distributed to participants at termination, which (unless paid in the form of a deferred vested annuity) the participant could then choose to roll over to the new plan or to another retirement plan or IRA, or take as a taxable distribution.

9. The Controlled Group Rules.

What are the new controlled group rules?

Although the Internal Revenue Code contains controlled group rules for determining when different employer plans should be aggregated for various purposes, these rules do not apply to *tax-exempt* and governmental entities. In conjunction with the new 403(b) regulations, the IRS issued new regulations under Code Section 414(c), effective January 1, 2009, that apply for determining when tax-exempt organizations are treated as a single employer for employee benefit purposes. The new regulations provide that common control exists if 80% or more of the directors or trustees of one entity are either representatives of, or directly or indirectly controlled by, the other organization. The rules can apply so that two tax-exempt entities are treated as a single employer or a tax-exempt entity and another type of entity are treated as a single employer. If common control exists, then the organizations are treated as a single employer for purposes of applying the 403(b) nondiscrimination rules, contribution limits, vesting, 15 years of service catch-up contributions, and minimum distribution rules. The controlled group rules are not limited to 403(b) plans, however, but also apply for many other purposes relating to qualified retirement plans, health plans, cafeteria plans, and fringe benefits.

The new regulations also permit tax-exempt organizations to permissively aggregate if they maintain a single plan covering one or more employees from each organization and the organizations regularly coordinate their day-to-day exempt activities, so long as aggregated for all purposes. However, permissive aggregation is subject to an anti-abuse rule if the purpose of aggregation is to avoid requirements under Code Sections 401(a), 403(b) or 457(b) [15].

10. Steps to Achieve Compliance.

What steps should my institution take to ensure timely compliance with the new regulations?

For most institutions, all requirements under the new 403(b) regulations must be satisfied both in form (*e.g.*, written plan document) and operation (*e.g.*, timely remittance of contributions) no later than January 1, 2009. The institution is legally responsible for its 403(b) plan under the new regulations, so although delegation of responsibility is permitted and anticipated, institutions should ensure that they are partnering with capable vendors and are protected by well-drafted vendor agreements. In order to ensure timely compliance and risk management, institutions should consider undertaking the following steps:

1. Ensure current compliance with the universal availability rule for all eligible employees for salary deferral contributions.
2. Stop 90-24 transfers and determine a strategy for handling contract exchanges from September 24, 2007 to January 1, 2009.
3. For institutions that have relied on the good-faith reasonableness nondiscrimination standard or on a safe harbor under Notice 89-23, evaluate how the 403(b) plan will fare under the new rules and whether any plan design changes are necessary. Also consider how the controlled group rules impact nondiscrimination testing.
4. Consider how to handle salary deferral-only plans treated as exempt from ERISA under the new regulations.
5. Evaluate vendors for ability to comply with the new regulations and the 403(b) plan document, ability to accept delegation of appropriate administrative and compliance responsibilities, and willingness to indemnify the institution for vendor failures. Eliminate any vendors that cannot meet these requirements.
6. Review and/or draft vendor agreements and information-sharing agreements (if contract exchanges will be permitted under the plan).
7. Review the vendor contracts and/or custodial accounts under the 403(b) plan for compliance and consistency with the plan document.
8. Restate your existing written plan document effective January 1, 2009 to comply with new 403(b) regulations, or if you do not currently have a written plan document, draft and adopt a written plan document.
9. Consider operational compliance and how “plan level” functions will be handled, *e.g.*, contribution limits, loans, hardship withdrawals, and distributions.
10. Communicate changes to employees.

CONCLUSION:

The new 403(b) rules include significant new compliance obligations for colleges and universities. Responsibility for compliance is placed upon the employers sponsoring 403(b) plans and not on employees, plan providers, or other third parties. Institutions

should work with their plan providers and tax advisors to ensure that plan documents and procedures conform to the requirements of the new rules. In key instances, non-compliance can result in potentially severe consequences and penalties for both employers and plan participants.

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RESOURCES:

NACUA Resources:

- [Proposed Regulations Under Code Section 403\(b\) of the Internal Revenue Service \(2005 Annual Conference\)](#)

Statutes:

- [Internal Revenue Code Sec. 403](#)

Regulations:

- [Final Section 403\(b\) Regulations](#) (Federal Register, July 26, 2007)
- [Final regulations \(FICA\) \(Treas.Reg. 31.312\(a\)\(5\)-2\)](#) – (Federal Register, November 19, 2007)

Department of Labor Rules and Guidance:

- DOL Safe Harbor from ERISA rules, [29 C.F.R. 2510.3-2\(f\)](#).
- DOL Guidance: [ERISA Coverage of IRC § 403\(b\) Tax-Sheltered Annuity Programs Field Assistance Bulletin No. 2007-02](#)

Internal Revenue Service Rules and Guidance:

- [Internal Revenue Service 403\(b\) Plan Information Page](#)
- [Revenue Procedure 2007-71](#)
- IRS transitional guidance regarding nondiscrimination rules - Notice 89-23, 1989-CB 654

- Transfer rules - [Revenue Ruling 90-24, 1990-1 CB 97](#)
- 403(b) Final Regulations: [Let's Explore the Final 403\(b\) Regulations Powerpoint](#)
- [Publication 571 Tax-Sheltered Annuity Plans](#)
- [IRS 403\(b\) Plan Checklist](#)
- [IRS FAQ on 403\(b\) Plans](#)
- IRS Web Page: [Correcting Plan Errors](#)

Other Resources:

- [Final 403\(b\) Regulations Issued by the IRS](#) (TIAA-CREF)

FOOTNOTES

FN1. Prior to January 1, 2009, plan sponsors may comply with current law or the new regulations, so long as applied reasonably and consistently.

FN2. The IRS expects that a single plan document will be adopted for any 403(b) plan with multiple vendors. This means that any institution that has adopted plan documents from more than one vendor under its plan will need to move to a single plan document covering all vendors. Given the importance of the written plan document under the new regulations, most institutions will want to adopt a single plan document governing their 403(b) program that is controlled by the institution.

FN3. The IRS has issued model language that public institutions may adopt to satisfy the written plan document requirement. The model language addresses elective deferrals only, and most public institutions will still need plan language drafted to cover employer contributions, but it does cover optional plan features such as loans, hardship distributions, and transfers. To the extent that a public institution adopts the model language on a word for word (or substantially similar) basis, and the plan is operated in accordance with its terms, the plan will be treated by the IRS as satisfying Code Section 403(b) and the regulations. The model language may also provide helpful guidance to private institutions reviewing existing plans or drafting new ones.

FN4. It will be difficult for employers to stay within the DOL's safe harbor guidelines, while at the same time ensuring that their 403(b) plans comply with the new regulations, without delegating almost all discretionary determinations to an outside vendor. Additionally, it is important to note that many salary deferral-only plans that have been treated as exempt from ERISA probably do not actually satisfy ERISA's rules for exemption. For example, if the employer approves only a single vendor under its salary deferral-only plan, it will not be exempt. In many cases, it will make sense for private institutions to "merge" their salary

deferral-only programs into their primary 403(b) plans. Although a combined plan is subject to ERISA, the institution's compliance obligations are not increased since the institution is maintaining only a single 403(b) plan (although perhaps with multiple funding vehicles).

FN5. Those private institutions that have not been regularly testing their 403(b) plans for nondiscrimination testing should begin doing so since the IRS is likely to focus on testing issues now that there is little room for interpretation as to the application of the rules.

FN6. The universal availability rule applies separately to each common law entity, or in the case of a plan that covers the employees of more than one state entity, to each entity that is not part of a common payroll. However, if an employer has historically treated a geographically distinct unit as separate for employee benefit purposes, it may treat each unit as a separate organization if operated independently on a day to day basis.

FN7. There is limited relief under the new regulations for institutions relying on Notice 89-23 to exclude visiting professors and individuals who have taken a vow of poverty.

FN8. Note that a 403(b) plan can set forth an hour limit that is lower than 20 hours a week (1,000 hours a year), e.g. 10 hours a week, so long as all employees who work less than that hour limit are excluded from plan participation.

FN9. The IRS has been concerned that employers are permitting employees to elect whether to have dollars contributed to a 403(b) plan at retirement, or to instead receive the dollars in cash or have them contributed to another type of benefit plan. Any such election with respect to post-retirement contributions, whether direct or indirect, is prohibited by the regulations.

FN10. If there is a single vendor under a 403(b) plan, an institution can choose to delegate administration of financial hardship withdrawals and loans to the vendor, if the vendor will agree to assume the additional responsibilities required under the new regulations. However, if there is more than one vendor under the 403(b) plan, coordination of hardship withdrawals and loans will need to be done at the "plan level." Information regarding loans and hardships will need to be reported by vendors, approved by plan sponsors or third party administrators, and tracked in a database. The IRS has been focusing on improper in-service withdrawals and loans in the for-profit world during its audits, and there is no reason to believe that 403(b) plans sponsored by colleges and universities will not be subject to similar scrutiny.

FN11. Severance from employment is defined under the new regulations to have the same meaning as under Code Section 401(k). However, the new regulations add that severance from employment occurs when an employee no longer works for an eligible employer that maintains the 403(b) plan or works in a capacity that is not employment with an eligible employer. Therefore, for example, an employee who terminates employment with a public university but then is employed by the state department of education is treated as having a severance from employment.

FN12. The IRS has issued transitional relief providing that to the extent that a contract exchange made after September 24, 2007 and prior to January 1, 2009, failed to satisfy the contract exchange rules, the participant's 403(b) contracts and/or accounts will not be taxable if the participant "re-exchanges" the contract and/or account to a vendor approved under the plan (or with whom the institution has an information sharing agreement) prior to January 1, 2009.

Transfers made prior to September 24, 2007 do not have to satisfy the new contract exchange rules, and, therefore, an information sharing agreement is not required between the vendor to whom the transfer was made and the institution. Nonetheless, the IRS has indicated that any vendor that holds 403(b) plan assets of that employer is part of the 403(b) plan, and that vendor and the employer must share any information necessary for compliance with the new regulations. The IRS has issued guidance providing transitional relief relating to annuity contracts or custodial accounts issued or exchanged under 403(b) plans prior to January 1, 2009. The guidance states that to the extent that a vendor issued an annuity contract or custodial account under a plan on or after January 1, 2005 and before January 1, 2009, but the vendor is no longer approved under the plan in a future year (or the vendor was never an approved vendor but became part of the plan due to a contract exchange after September 24, 2007), the contract or account will not fail to satisfy the new regulations if the employer makes a reasonable good-faith effort to include the contract or account as part of its plan. A reasonable good-faith effort means that the employer collects available information from the vendors who received contributions after January 1, 2005, and notifies these vendors of the plan administrator's name and contact information for the purpose of sharing necessary information.

FN13. Many 403(b) plan failures can be corrected under the IRS' voluntary compliance program, which the IRS is updating for consistency with the new regulations and to more comprehensively address corrections of 403(b) plan failures.

FN14. Generally, termination is permitted only if the institution (and its controlled group) does not make contributions to any 403(b) plan for a twelve-month period after distribution of all plan assets; however, an institution can terminate a 403(b) plan and immediately thereafter establish a 401(k) plan.

FN15. Note that the IRS takes the position that public institutions have been and continue to be subject to a good faith reasonable interpretation of the controlled group rules set forth in IRS Notice 89-23.

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