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Pension ANALYST

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# Finally, the Final 403(b) Regulations

On July 26, 2007, the IRS published the long-awaited and much-anticipated final 403(b) regulations, which were originally proposed in 2004. At the same time, the Department of Labor (DOL) published Field Assistance Bulletin (FAB) 2007-02, to provide guidance regarding the maintenance of non-ERISA 403(b) programs. This *Compliance Bulletin* will provide an overview of the major provisions contained in these regulations and DOL guidance. Future publications will provide greater detail about many aspects of the rules.

## Effective Date

One of the most welcome provisions contained in the new regulations is their effective date. For most plans, these rules apply for tax years beginning after December 31, 2008 (i.e., generally, January 1, 2009). However, if a 403(b) arrangement is maintained pursuant to one or more collective bargaining agreements that were in effect on July 26, 2007, the rules apply as of the earlier of the date on which the last such collective bargaining agreement expires, or July 26, 2010. If a church convention has the authority to amend a 403(b) plan, the rules do not apply until the first plan year beginning after December 31, 2009.

An important and notable exception to the 2009 effective date is the elimination of Revenue Ruling 90-24 exchanges after September 24, 2007.

## Highlights

The final rules contain many of the provisions that were included in the proposed rules, with some modifications.

**Written plans (but not necessarily a single plan document) are required for all 403(b) arrangements.** However, it will be possible for tax-exempt organizations to comply with this requirement and continue to offer 403(b) programs that are not subject to the ERISA Title I reporting and disclosure requirements. DOL FAB 2007-02 provides guidance for structuring such programs. In addition, the IRS expects to publish model plan provisions that may be used by public school employers to create plan documents in a cost-effective manner.

**Section 403(b) contracts must contain certain provisions.** Contracts must be nontransferable and must provide that the employee's rights are nonforfeitable. In addition, they must limit annual elective deferral contributions, annual additions and incidental benefits. They must also contain minimum required distribution and rollover distribution rules. In general, contracts must be held under a plan that meets nondiscrimination requirements, including the universal availability requirement. However, plans offered by governmental entities are only subject to the universal availability requirement, while plans offered by churches are exempt from both the nondiscrimination and universal availability requirements.

**Qualified plan nondiscrimination rules apply to employer contributions.** With certain exceptions, employer nonelective contributions are subject to the nondiscrimination in amount and availability requirements and minimum coverage requirements, as well as section 401(a)(17) compensation limit. Likewise, employer matching contributions must satisfy the ACP test, as well as the nondiscrimination in availability and minimum coverage rules, and the compensation limit. However, both nonelective and matching contributions made to governmental plans are only subject to the compensation limit. Nonelective and matching contributions made to church plans are exempt from all of these nondiscrimination rules.

**The "universal availability" rule continues to apply to elective deferrals, including Roth deferrals.** This rule applies to all 403(b) arrangements, other than church plans. Under prior IRS guidance, certain classes of employees could be disregarded when applying the universal availability rule. Under the final rules, different classes of employees may be excluded when applying this rule, including: employees who are eligible to make deferral contributions to another 403(b) plan, governmental 457(b) plan, or 401(k) plan sponsored by the employer; certain non-resident aliens; certain student employees; and certain part-time employees. In addition, the final rules clarify that this universal availability requirement applies separately to each section 501(c)(3) organization covered by a 403(b) plan and to each governmental entity that is not part of a common payroll. Special transition rules are provided to allow plans that excluded classes of employees based on prior IRS guidance to come into compliance with these new rules.

**Employers must transfer contributions to 403(b) providers within a "reasonable" time period.** An example of a reasonable time period is within 15 business days following the month in which the amount would otherwise have been paid to the participant.

**Catch-up contributions made by employees who are eligible to make both age 50 catch-up contributions and the special 15-year catch-up contributions are treated first as the special 15-year catch-ups.** Under the final rules, employees of adoption agencies, agencies that provide home health services, agencies that provide assistance to individuals with substance abuse problems, or agencies that help the disabled, are also able to make the special 15-year catch-up contributions.

**New rules apply for making nontaxable exchanges and transfers of 403(b) contracts.** The final regulations eliminate Revenue Ruling 90-24 exchanges after September 24, 2007. Thereafter, three types of nontaxable exchanges or transfers are allowed:

- A change of investment within the same plan (a "contract exchange");
- A plan-to-plan transfer, where a 403(b) arrangement sponsored by another employer receives the assets; and
- A transfer to purchase permissive service credits or to repay a qualified defined benefit governmental plan.

After September 24, 2007, contract exchanges may be made only if they are expressly permitted under the plan, and the contract issuer and employer agree to share sufficient information to ensure compliance with 403(b) distribution rules, loan limits and hardship provisions, to the extent applicable. In addition, the new contract must contain distribution restrictions at least as stringent as the old contract, and the participant's benefit cannot be reduced as a result of the exchange. A post-September 24, 2007 exchange will be valid if plan documentation and information sharing agreements are in place before January 1, 2009.

 

Unfortunately, the IRS guidance has left unanswered many questions regarding operational compliance with the contract exchange rules after September 24, 2007. Many industry insiders are hopeful that the IRS will issue clarifying guidance in the near future.

**Employer contributions are subject to new distribution restrictions.** Employer contributions made to 403(b) annuity contracts (not custodial accounts) may only be distributed upon the participant's severance from employment or the occurrence of a stated event such as completion of a fixed number of years, attainment of a stated age, or occurrence of some other event such as disability or hardship. These new restrictions do not apply to contracts issued before January 1, 2009.

**Section 403(b) arrangements may be terminated.** However, these rules do not allow plan sponsors to merge 403(b) plans with 401(k) or other qualified plans.

## Controlled Group Rules

The IRS has also provided rules for determining when tax-exempt entities are members of a common controlled group. These rules, which are effective for plan years beginning after December 31, 2008, apply for purposes of applying the 403(b) rules, as well as any other situation where rules are applied on a controlled group basis. In general, organizations are considered to be under common control if at least 80% of the directors or trustees of one organization are either representatives of, or are directly or indirectly controlled by, the other organization. Entities that have a common exempt purpose may treat themselves as being under common control if their employees participate in a single plan. These rules do not apply to governmental entities or to certain church entities.

## More Details to Follow

Over the course of the next few months, Prudential Retirement will publish additional newsletters providing more details regarding the specific provisions in these regulations. We will also let you know how we will work with you to bring your 403(b) arrangements into compliance with these new rules.



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