

A 403(b) Plan Sponsor's Guide to the New Final 403(b) Regulations

When the IRS issued proposed regulations for 403(b) plans in November 2004, many of the proposed provisions, which were intended to replace over 40 years of piecemeal and often outdated guidance, were quite controversial among plan sponsors and providers of annuity contracts and 403(b) mutual fund custody accounts. But since such regulatory proposals tend to change before being finalized, most plan sponsors decided to wait for the final regulations to be published before making major changes to their plans.

That wait is now over. The final regulations were published in the July 26, 2007, edition of the Federal Register. As a result, many 403(b) plan sponsors will need to make significant changes to their plans and how they manage them in order to comply. Though generally not effective until 2009 (and with some rules effective as early as September 24, 2007), the changes are numerous and important, so there is not much time for delay in implementing them. Failure to comply could result in additional taxable income to participants. Employers could be charged with failure to withhold and pay income and Federal Insurance Contributions Act (FICA) taxes. Both could carry costly penalties.

While a discussion of the nuances of each rule in the final regulations is beyond the scope of this paper, this guide is offered as an introduction to the major changes and their impact on plan sponsors.

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Overview of the Regulations

The main theme of the proposed regulations still echoes strongly through the final version and is consistent with changes in the statute over time. It is that 403(b) plans have become very much like 401(k) plans, and they must be run in a very consistent manner. And that means many plan sponsors will need to make a number of changes in how they currently manage their plans.

The biggest change is that the IRS requires plan sponsors to put the plan in writing. Previously, plans not subject to the Employee Retirement Income Security Act (ERISA), particularly school district plans, faced no such requirement. Fortunately, plan sponsors have until 2009 to comply with this new requirement (though in some circumstances, which are detailed in the next section, that deadline is extended). Also, the IRS has indicated it will issue a sample document that should make complying a bit easier, though it is also expected to be specific to school district plans.

Because plan sponsors will have much more responsibility for the plan under the new regulations, as a practical matter, they will also need to designate a “point” person for the plan. This will be someone, either in-house or an outside professional, who will have the ongoing responsibility for monitoring the plan’s compliance with 403(b) requirements. These requirements include monitoring distribution restrictions, including plan loans and hardship distributions.

Some employers (other than governmental and church employers) have relied on Department of Labor (DOL) regulations, which exempt from ERISA certain 403(b) plans where only voluntary salary reduction contributions are being made and employer involvement is minimal. Sponsors of these plans will want to reconsider whether they can — or if it is desirable to — continue maintaining their plans outside of ERISA.

Also, as of September 24, 2007, “Revenue Ruling 90-24 transfers” will be substantially curtailed. These transfers were typically made from one 403(b) annuity or mutual fund custodial account to another, outside of the current employer’s 403(b) plan. Some transfers will continue to be permitted, but they are subject to substantial restrictions intended to ensure continued 403(b) compliance. As of September 24, 2007, the purchase of separate life insurance contracts as incidental benefits under 403(b) plans will also be barred, though contracts purchased before that date will be “grandfathered” and considered valid.

Nondiscrimination rules are also being tightened. At the same time, the IRS plans to step up its examination of compliance with those rules. Additionally, some valuable safe harbors for employer contributions to 403(b) plans under a longstanding IRS Notice will disappear.

Valuable guidance is provided on how the limitations on contributions to 403(b) plans operate — and the consequences of violations. Many of these remain different from the 401(k) rules.

Though the regulations will also require changes to many 403(b) annuity contracts and to the custodial accounts in which plans invest, this paper will focus on the employer's responsibilities. Providers can be expected to contact their plan sponsor clients directly about the changes they are making to their products in light of the IRS's adoption of its final regulations.

With such sweeping changes in how 403(b) plans will need to operate in the future, it is natural for questions to arise. For example:

- When will the **final regulations** take effect?
- Will our plan need a **plan document**?
- Is there a **model 403(b) plan** document available?
- Are **transfers and exchanges** still permitted?
- Can **separate life insurance contracts** or the other incidental benefits previously provided be purchased with 403(b) monies?
- What changes are needed to meet **nondiscrimination** requirements?
- Will complying with the final regulations subject the plan to **ERISA**?
- Where does **FICA** fit into all of this?
- When do **contributions** have to be made?

This paper will first address these questions, and then explore some of the other changes that may have a significant impact for plan sponsors. Once the changes and their impact are better understood, a plan of action will be presented.

Executive Summary

In recent years, by deliberate statutory changes, defined contribution plans such as 403(b) plans and 401(k) plans have grown more similar. As a result, it is understandable that the Internal Revenue Service (IRS) and Treasury Department would want to bring the rules for these two different types of employer plans more in line with one another, and that is what they have done in issuing new regulations for 403(b) plans.

With much of the prior guidance allowing wide differences in how 403(b) plans and 401(k) plans work, the new regulations narrowing those differences are controversial. While many 403(b) plan sponsors have taken active roles regarding their 403(b) plans, others have attempted to remain strictly "hands-off." While all 403(b) plans must be reviewed and satisfy the regulations, these hands-off plan sponsors will be required to make substantial changes in how they operate and manage their plans. As burdensome as making these changes will be, compliance is not optional, nor, barring further changes, is the pace at which it must occur.

Therefore, the first step to incorporating the changes into current 403(b) plans and bringing those plans into compliance is to understand what the key changes involve, as well as which types of plans and investments are impacted and to what extent.

The second step is to create a plan of action for implementing changes in accordance with the IRS's deadline schedule.

Guiding plan sponsors through the final regulations and to their respective action items is this paper's objective.

When will the final regulations take effect?

In general, the effective date for the new regulations, including having a written plan document, begins with tax years starting after December 31, 2008. This gives plan sponsors more than a year to bring their plans into compliance. However, those dates have been extended for church plans, plans maintained under collective bargaining agreements and some governmental plan provisions. Their deadlines are as follows:

- **Church plans** — Church plans, as defined in Internal Revenue Code section 414(e), are not subject to the new regulations until the first day of the first plan year beginning after December 31, 2009.
- **Collective bargaining agreements (CBAs)** — In the case of a 403(b) plan maintained pursuant to a CBA, the regulations do not apply before the earlier of (1) the date on which the CBA terminates (determined without regard to any extension after July 26, 2007), or (2) July 26, 2010.
- **Governmental plans** — Governmental plans did not receive a broad delayed effective date of their own. This is particularly unfortunate because the most common type of governmental 403(b) plan is a plan of a public school district. These are the plans that are least likely to be close to compliance with the final regulations and will require the greatest number of changes. However, for many school districts, the CBA exemption, described above, may apply. Separately, the effective date for phasing out some of the exemptions related to the universal availability rule is delayed for governmental plans. This will be explained later, when that rule is discussed in greater detail.

Will our plan need a plan document?

In short: yes. Though many employers complained about the IRS instituting a written plan document requirement for non-ERISA plans, the IRS held firm. Demonstrating its resolve to bringing the operation of 403(b) plans more in line with that of 401(k) plans, the IRS kept the written plan document requirement in the final regulations. As a result, *all* 403(b) plans will be required to have a written plan document by 2009, unless a church plan, CBA or certain type of governmental plan is involved. In these situations, plans may gain the benefit of extra time to comply.

The final regulations do not necessarily require a single, traditional 401(k)-style plan document. The written plan may still include a number of documents, including insurance policies, custodial accounts and agreements. However, the final regulations also provide additional rules that will be difficult to satisfy without a fairly complete, traditional-style plan document referencing the various annuities and custodial accounts in which the plan has invested.

The written plan must contain all the material terms and conditions regarding:

- **Eligibility**
- **Contributions**
- **Applicable limitations**
- **Contracts available**
- **Time and form of distributions**

Also to be included are any optional provisions, including those for loans; hardship distributions; plan-to-plan or annuity contract transfers or exchange provisions; acceptance of rollovers; and any delegation of responsibility for administrative functions. Such a delegation may be to someone besides the employer, but not to a participant.

Consequently, employers will need a written plan document that is fairly comprehensive, though it may cross-reference distribution options, loans and hardship withdrawals available under different annuities and custodial account investments.

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Is a model 403(b) plan document available?

The IRS has indicated it will issue a model plan soon. It is not currently clear how “plain vanilla” it will be, but the language is expected to primarily be of application to public school district plans. When the model language is issued, it will undoubtedly be helpful to those drafting plans, but it remains to be seen if it can be used without modification.

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Are transfers and exchanges still permitted?

Despite the many complaints, the final regulations effectively eliminate open-ended contract-to-contract transfers. Under Revenue Ruling 90-24, the requirement for a transfer from one 403(b) contract to another essentially consisted of the transferee contract needing to impose withdrawal restrictions no less stringent than those under the transferor contract.

Apparently, the IRS believes that transferee contracts under the current rule were prone to not complying with 403(b) requirements because there was typically no plan sponsor involvement with them. By limiting such transfers, the IRS expects to both improve compliance and, again, make 403(b) plans more like 401(k) plans.

The final regulations differentiate between transfers within a plan (which are now generally referred to as “exchanges” rather than transfers) and plan-to-plan transfers. Plan-to-plan transfers are generally permitted, provided the plans allow them, though the amount is subject to distribution restrictions under the transferee plan and those restrictions must be no less stringent than those applied under the transferor plan. Any transfer that is less than a complete plan-to-plan transfer will need to include a pro rata portion of any employee after-tax contributions. In addition, transfers to purchase permissive service credit and to make repayments under governmental defined benefit plans are also permitted.

For exchanges within a plan, however, the basic requirements will now require that the contract allows the exchange and that the participant's or beneficiary's accumulated benefit after the exchange be at least equal to the accumulated benefit before the exchange. (It is understood this does not mean that surrender charges and other investment fees do not apply.) Most importantly, the employer and the issuer of the new contract will have to agree to provide each other with the information necessary to ensure the new contract complies with the new regulations. This includes information regarding the participant's employment and participation in other qualified employer plans in order to ensure compliance with the distribution, hardship and loan rules of section 403(b). See the discussion below of the impact of this rule before 2009.

In another significant change from prior guidance, but consistent with cutting back on 90-24 transfers, transfers by employees and beneficiaries may be made only to 403(b) contracts of the individual's employer. The regulations also expand this provision to include a former employer. This addresses instances when a participant — or decedent, in the case of a beneficiary transfer — is an employee or former employee of the employer sponsoring the receiving plan.

Consequently, what participants had been able to do under 90-24 transfers will now have to meet these rules for exchanges within a plan or to another 403(b) plan, if one exists. Of course, if the employee has terminated employment or is otherwise eligible for a distribution, the employee may still elect a rollover, directly or indirectly, to another eligible plan in which he or she participates or to an IRA.

It remains to be seen whether financial institutions or employers will be willing to enter into agreements to satisfy the transfer rules for individual contracts, which have previously been treated as effectively being made outside of the plan. If not, transfers among investments lacking an employer's approval as part of the plan, and which had been permissible under 90-24, will dry up.

These new exchange rules are essentially effective for exchanges on or after September 24, 2007. As a result, any 90-24 transfers that are desired under the prior rules should be completed prior to that date. There remains some uncertainty as to how the rules will apply on and after September 24, 2007, for those contracts, which, due to a prior 90-24 transfer or transfers, or just because of the passage of years since contributions were made, may not be known to the employer and the contract owner may no longer be an employee, but more guidance is expected. Currently, Revenue Ruling 90-24 has not been formally revoked, though its revocation is expected when the new regulations become effective. Presumably, once revoked, the owner of such a contract can perform another transfer to another contract only if the transfer rules in the final regulation are followed. The IRS appears to treat the new exchange and transfer rules as though they may be relied upon even though the regulation does not technically become effective before 2009. Again, it is hoped that the IRS will clarify what has to be done with contracts during this transition period before 2009.

Can separate life insurance contracts be purchased with 403(b) monies?

A short answer: no. As of September 24, 2007, any new death benefit that is purchased must be a part of the annuity contract. Separate life insurance contracts acquired before September 24, 2007, however, will be grandfathered in and left intact. Under both the prior and proposed regulations, any life insurance benefit must still be incidental to the retirement benefits under the plan. This applies under rules which limit the amount of plan assets that can be used to purchase death benefits. Also, as under the prior law, for a grandfathered life insurance contract to be part of a 403(b) plan, it must carry a rider or endorsement including the provisions required for 403(b) contracts.

The final rules allow death benefits under annuity contracts as long as other applicable rules, such as the incidental benefit rules, are satisfied.

The final regulations will put an end to the employer safe harbors involving the nondiscrimination requirements for nonelective and matching contributions, which had been available under existing guidance found in IRS Notice 89-23. They will also change the rule for elective contributions. As a result, plan changes may be required.

What changes are needed to meet nondiscrimination requirements?

First, 403(b) plans are subject to a special nondiscrimination rule on salary reduction amounts. Generally, this means that if any employee can make salary reduction contributions, then every employee who normally works 20 or more hours per week must be allowed to make salary reduction contributions. A \$200 annual minimum can be imposed. This has been known as the “universal availability” rule. That 403(b) plans are subject to this simple rule, rather than the complex numerical testing under the “actual deferral percentage” or ADP rule that applies to 401(k) plans, has been and remains one of the 403(b) plan’s most attractive advantages over 401(k) plans. However, because compliance with the rule is perceived as being spotty, the IRS recently began auditing employers on this particular issue. Governmental plans, mainly school districts, while exempt from most of the other nondiscrimination rules of the Code, are subject to the universal availability rule. The new audit focus hits them particularly hard.

One of the past uncertainties regarding the application of the rule, however, is largely resolved by the new regulations. This involves defining what is meant by the phrase: “normally” working fewer than 20 hours a week. The uncertainty arises, for example, when seasonal and temporary employees are involved. The final regulations state that an employee normally works fewer than 20 hours a week if:

- The employer “reasonably expects” the employee to **work fewer than 1,000 hours in the 12-month period** beginning on the employee’s commencement of service, and
- For each plan year ending after the close of the 12-month period beginning on the date the employee’s employment commenced — or, if the plan provides, each subsequent 12-month period after such commencement date — the employee actually **worked fewer than 1,000 hours in the preceding 12-month period.**

Effectively, this allows the exclusion of seasonal and temporary employees who will work less than 1,000 hours in a year. Employers will also be able to include or exclude employees from making salary reduction contributions based upon their reasonable expectations at the time of hire. However, the employer must then track hours of service. If an employee works 1,000 or more hours in a subsequent plan year — or in a subsequent year based on the anniversary of date of hire, depending upon what the plan provides — the employee must be permitted to enter the plan and make salary reduction contributions the following plan year. Thus, the test becomes more objective.

By simply allowing most employees to participate in the plan and make salary reduction contributions even though they are not required to do so under the universal availability rule, the employer may avoid having to track such hours. It may also keep them from having to correct errors regarding improperly excluded employees — which can be expensive — by being overly inclusive. A plan that does so may still be able to exclude such employees from eligibility for employer nonelective or matching contributions, which are subject to different eligibility rules.

In addition to the 20 hours per week rule, there are also a number of exceptions to the universal availability rule (see list at far right). Among these is the allowance to exclude employees eligible to make salary reduction contributions under another section 403(b) plan, governmental section 457(b) plan or 401(k) plan; certain nonresident aliens; and certain employees performing services as students.

Though these will remain in force, a few other exclusions are being dropped from the list of exceptions to the universal availability requirement under current rules.

For nongovernmental employers, employees described by exceptions (1) through (3) may no longer be excluded from the plan in taxable years after December 31, 2009.

Where governmental employers are concerned, if the authority to amend the plan is held by a legislative body that meets in legislative session, the plan does not have to remove universal availability exceptions (1) through (3) before the earlier of either the close of the first legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2009; or January 1, 2011.

With regard to exception (4), if a collective bargaining agreement was in effect on July 26, 2007, the plan does not have to allow those employees to make salary reduction contributions before the *later* of the first day of the first taxable year after December 31, 2008; or the earlier of either the date on which the collective bargaining agreement terminates (without any extensions after July 26, 2007), or July 26, 2010.

Also, a helpful “common payroll” rule now applies to the universal availability rule allowing governmental employers within the same state to be treated as separate employers for the purpose of the universal availability rule if they do not use a common payroll.

Exceptions to the Universal Availability Requirement

1

Employees who make a one-time irrevocable election to participate in a governmental plan

2

Professors providing services on a temporary basis to another educational institution and for whom 403(b) contributions are being made at a rate greater than the professor would receive under the home institution's 403(b) plan

3

Employees affiliated with a religious order who are supported in their retirement and who have taken a vow of poverty

4

Employees who are excluded from making salary reduction contributions by a collective bargaining agreement

*DOL Field Assistance
Bulletin 2007-2
indicates certain
discretionary activities
by the employer that
would cause the plan
to be outside of the
ERISA exemption.*

Will complying with the final regulations subject the plan to ERISA?

Those who are governmental or non-electing church plan sponsors remain clearly outside of ERISA. However, those other employers who have relied on the exception under DOL regulations for certain salary-reduction-only arrangements with minimal employer involvement will want to reexamine their compliance in light of the regulation. Even if they are in compliance, employers may want to consider the potential advantages of moving out from under the exception and becoming subject to ERISA.

The DOL regulation (29 C.F.R. § 2510.3-2(f)) provides that programs existing for the purchase of annuity contracts or custodial accounts under section 403(b) of the Code are not “established or maintained” by an employer. Therefore, they are not employer plans subject to ERISA, provided: (1) they are funded solely through salary reduction agreements or agreements to forgo an increase in salary; (2) the participation of employees is completely voluntary; (3) all rights under the annuity contract or custodial account are enforceable solely by the employee or beneficiary of such employee or by an authorized representative of such employee or beneficiary; (4) the involvement of the employer is limited to certain optional specified activities; and (5) the employer receives no direct or indirect consideration or compensation in cash or otherwise, other than reasonable reimbursement to cover expenses properly and actually incurred in performing the employer’s duties pursuant to the salary reduction agreements.

In light of the final IRS 403(b) regulations, which require more employer involvement with the plan, the concern has been whether that involvement will be such that the DOL regulation is no longer met. This has received further clarification in a bulletin issued by the DOL in conjunction with the IRS 403(b) regulations. DOL Field Assistance Bulletin 2007-2, on the one hand, provides that compliance with the new regulations will not necessarily cause a 403(b) program to be covered by ERISA, but it also raises concerns that the “line” for too much involvement may be easier to cross than some employers have thought. The Bulletin clarifies that adopting a written plan to comply with 403(b) does not automatically establish an ERISA plan. However, the Bulletin also indicates that certain discretionary activities by the employer would cause the plan to be outside of the ERISA exemption and would therefore fall under ERISA. These activities would include: authorizing plan-to-plan transfers; processing distributions; satisfying applicable qualified joint and survivor annuity requirements; and making determinations regarding hardship distributions, qualified domestic relations orders (QDROs), and eligibility for or enforcement of loans. If, in order to satisfy the new requirements of the final regulations, an employer undertakes discretionary decision-making authority in one or more of these areas for its 403(b) plan, the plan may fall outside of the exception and become subject to ERISA.

Whereas plans may be designed to delegate all discretion and authority in these areas to the providers, this is likely to require significant coordination of responsibilities amongst the employer and its multiple providers. For example, the Bulletin suggests that the Code-mandated restrictions on transfers of funds may require the employer to allow providers to offer a wider variety of products to afford employees a reasonable choice in light of all relevant circumstances for purposes of the safe harbor. Alternately, an employer may limit the number of providers to which it will forward salary reduction contributions as long as employees may transfer all or a part of their funds to any provider whose annuity contract or custodial account complies with the Code requirements and who agrees to the plan's division of tax compliance responsibilities among the employer, provider and participant.

In other words, it may be difficult for an employer to escape taking additional responsibilities for its plan. That, in turn, raises the question of whether trying to meet the non-ERISA safe harbor will be worth the effort. This is also a call for each plan sponsor currently attempting to meet the safe harbor requirements to reexamine its intended actions, regardless of whether it has truly met the safe harbor in the past.

It should be noted that not being subject to ERISA has some advantages. These include not having to file Form 5500 returns annually. Though currently not burdensome, the form is expected to become more complicated for 403(b) plans beginning in 2009 and may also, at some point, require plan audits as with 401(k) plans. Other advantages involve not having to provide summary plan descriptions and not being subject to fiduciary duties under ERISA — though state or common law duties may nevertheless be present. On the other hand, should the employer inadvertently fail the safe harbor, it may be subject to significant penalties for failing to comply with ERISA. Additionally, ERISA-covered plans may have more clearly defined and limited duties than those plans operating under state law, including ERISA section 404(c), which relieves plan fiduciaries of liability for participant investment choices where the participant selects investments. Many 403(b) plans are currently designed and operated in compliance with section 404(c). Increasingly, private tax-exempt employers may decide meeting the ERISA exemption is not worth the uncertainty and risk.

Where does FICA fit into all of this?

The final regulations do not address FICA to a great extent. But it should be noted that, concurrent with the proposed 403(b) regulations, the IRS also issued a temporary regulation, unaffected by the final 403(b) regulations, reiterating its long-held position that salary reduction contributions to 403(b) programs are subject to FICA even when mandatory, made pursuant to a one-time irrevocable election, or made as a condition of employment. There appears to be a perception by the IRS of widespread noncompliance with this rule.

When do contributions have to be made?

The final regulations follow the new rule expressed in the proposed regulations, which is that contributions must be transferred to the insurance company or entity holding assets in a custodial account within a period that is not longer than is reasonable for the proper administration of the plan. Elective deferrals, for example, should be contributed by a specified date, and within 15 business days following the month in which the amounts would otherwise have been paid to the participant. This is roughly consistent with the ERISA contribution rule, though that requires an earlier deposit of salary reduction monies be made if it is administratively reasonable. Employer contributions remain subject to separate existing ERISA requirements, provided the plan is subject to ERISA, as well as separate rules for when an employer contribution is treated as an annual addition for testing under Code section 415.

Other Provisions of Interest

There are several additional provisions that plan sponsors should be aware of as they consider how they will comply with the new regulations.

New distribution rules

The final regulations add a new rule imposing on 403(b) plans funded through annuity contracts some of the 401(a) qualified profit-sharing plan distribution rules contained in various longstanding regulations and rulings under section 401(a) plans. This generally means that the plan must provide a predetermined formula for distributing the funds in the plan after a fixed number of years, generally at least two; the attainment of a stated age (e.g., 59½); or after the occurrence of an event such as a layoff, illness, disability, retirement, death or severance from employment. However, this restriction does not apply to annuity contracts issued before January 1, 2009. A plan amendment adopted before January 1, 2009, to comply with these rules will not violate ERISA's anti-cutback rules if the plan is subject to ERISA.

The final regulations, like the proposed regulations, also generally follow the 401(k) rules for determining whether there is severance from employment, which would permit distributions or omit the ability to make elective deferrals, for example. However, for purposes of distributions from a 403(b) plan, they now provide that a severance occurs when an employee ceases to be employed by an eligible employer that maintains the 403(b) plan.

For example, an employee transferring from a tax-exempt parent to a for-profit subsidiary, an employee of a public school transferring to another agency of the State, or a minister employed by a non-501(c)(3) organization entity ceasing to perform services as a minister but continuing to be employed by the same entity — in all these instances, severed employment will be considered to have taken place. Conversely, the final regulations provide that a severance from employment is not triggered when an employee transfers from one 501(c)(3) entity to another that is treated as the same employer or from one public school to another public school of the same State employer.

New controlled group rules

The final 403(b) regulations are accompanied by final regulations under the controlled group rules of Code section 414. These are important for nondiscrimination testing and contribution limits. The final rules essentially follow the proposed rule that common control exists between a tax-exempt organization and another organization if at least 80 percent of the directors or trustees of one organization are either representatives of, or directly or indirectly controlled by, the other organization. Other organizations may treat themselves as being under common control if each of the organizations regularly coordinates their day-to-day exempt activities.

The new regulations do not apply to churches and governmental entities, which can continue to rely on the controlled group rules of IRS Notice 89-23. The IRS is also granted authority to issue guidance on aggregating entities in other situations not addressed by the regulations where there are “substantial business reasons” for aggregating two entities.

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Plan termination permissible

The final regulations, like the proposed regulations, provide that 403(b) plans can be terminated and that benefits can be distributed upon plan termination. However, this does not apply if another entity in the same controlled group makes contributions to another 403(b) plan under which 2 percent or more of the employees in the terminated 403(b) plan participate within 12 months before and after the date of plan termination. This does not prohibit the maintenance or establishment of a 401(k) plan. To be considered terminated, all accumulated benefits must be distributed as soon as administratively practicable. This can be satisfied by delivery to participants and beneficiaries of fully paid individual annuity contracts. The final regulations add that the requirement for vesting as of the date of plan termination (i.e., 100 percent vesting) must be satisfied. Taxpayers can rely on this provision starting July 26, 2007, if all of the contracts issued under the plan at that time satisfy all of the applicable requirements of the final regulations — other than the written plan requirement.

A few notes on church plans

Church plans are their own topic — they even have their own paragraph, 403(b)(9). The final regulations generally follow the proposed regulations for church 403(b)(9) plans, which are generally deemed to be 403(b)(1) annuity contracts, even though they are not subject to the requirement that all amounts be invested in annuity contracts or mutual funds. Importantly, 403(b)(9) plans are not subject to nondiscrimination rules, including the universal availability rule and the 401(a)(17) compensation limit, unless the employer is a “non-qualified church controlled organization.” This definition generally includes church hospitals, colleges, universities and nursing homes. Those organizations will be subject to the nondiscrimination rules of other non-governmental, non-church 403(b) plans, and they may be tested separately from any churches if in a combined plan covering multiple church-related entities.

The new regulations under section 403(b) are delayed one year for church plans to taxable years after December 31, 2009. In addition, a loan or extension of other credit to the employer under a church plan from a 403(b)(9) retirement income account that was entered into before July 26, 2007, will not fail to satisfy the exclusive benefit requirement of the regulations if the plan takes reasonable steps to eliminate the loan before the general effective date of the regulations or as promptly as practicable thereafter. Before these final regulations, whether or not church plans were subject to the exclusive benefit requirement was unclear. The requirement was only referenced in legislative history and is not in the statute.

SUMMARY

The new regulations mean that 403(b) plans will have to be operated more like 401(k) plans. Employers will need to provide plan documents and to determine and arrange for someone to be responsible for the administration of the plans and for the coordination of investment vehicles and their compliance with the new 403(b) requirements. Nondiscrimination testing rules will also be changing. And the rules for transfers and exchanges of contracts and custodial accounts will change as well. This will require action on the part of employers.

ACTION ITEMS FOR EMPLOYERS

1. **Determine what your present “plan” is.** Identify all current contracts, custodial accounts, summary plan description-like documents, collective bargaining agreements, enrollment forms, distribution forms, service agreements, etc.
2. **Review these documents** for compliance with the 403(b) regulations.
3. **Consider contacting providers** for availability of plan documents and administrative support to comply with the 403(b) regulations.
4. **Consider use of the IRS model** 403(b) plan document when it becomes available.
5. **If a change in or consolidation of providers is necessary** to obtain documentation and administrative compliance with the 403(b) regulations — or desirable to streamline administration — consider the fiduciary duties involved in selecting providers. Note that this is always true for ERISA plans, but even non-ERISA plans may be subject to common law or state law duties, including request for proposal (“RFP”) requirements.
6. **If relying upon the ERISA safe harbor,** consider whether the plan has satisfied it in the past, whether the plan will continue satisfying it under any changes to meet the final regulations and whether it is desirable to try satisfying it now.
7. **Consider how your plan will satisfy the universal availability rule.**
8. **If your plan relies upon the Notice 89-23 safe harbors,** determine how to satisfy nondiscrimination rules after the final regulations are effective.
9. **Determine the effective date** applicable to your plan — and finalize all documents, service agreements and investment changes before the applicable effective date.
10. **Make certain that contract and custodial account changes on and after September 24, 2007, conform to the new rules.**
11. **Make certain that no separate life insurance contracts are purchased** under the 403(b) plan on or after September 24, 2007.
12. **Stay tuned to further 403(b) guidance from the IRS,** including material posted on the IRS Employee Plans website.

The intent of this paper is to bring a general understanding of the recent regulatory changes to its readers, and it does not provide individual tax or legal advice. Plan sponsors are strongly encouraged to consult their tax and legal advisors to better understand how the changes will impact them specifically. And as always, should you have additional questions, please do not hesitate to contact a representative of the Principal Financial Group®.



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