



403(b) Final Regulations Guide

Find out how a historic update to regulations might affect you!

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On July 26, 2007, the United States Treasury Department released final regulations for tax sheltered retirement plans under Internal Revenue Code (IRC) §403(b). The regulations consolidate, update and supersede much of the prior Internal Revenue Service (IRS) guidance for 403(b) plans. This prior guidance had remained largely unchanged since 1964. Though significant differences remain, the final rules diminish the extent to which 403(b) plans differ from 401(a) qualified plans.

This special 403(b) final regulations guide outlines many of the clarified or modified provisions and summarizes how they may affect your organization and employees.

While many of the changes are effective with tax years beginning in 2009*, please use this guide to learn more about the impact on your 403(b) plan(s) and how you can best prepare to incorporate future requirements and optional designs into your strategy.

As with past legislation, we're ready to discuss implications for you and your plan participants. We're here to work with you and help you understand the impact of these changes.

*Note: You may apply the final regulation provisions earlier than the 2009 effective date as long as they are applied on a consistent and reasonable basis.

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Plan Document				
Written Plan	January 1, 2009*	<p>Under current law only 403(b) plans that are subject to the Employee Retirement Income Security Act (ERISA) are required to be in writing. Non-ERISA 403(b) plans are not currently required to have a written plan document.</p>	<p>The IRS will require 403(b) plans be maintained pursuant to a plan document regardless of ERISA status by January 1, 2009. The regulations outline a plan document as a written defined contribution plan which satisfies the following provisions in form and operation:</p> <ul style="list-style-type: none"> • Terms and conditions for eligibility, contributions and applicable limitations • Form and timing of distributions • Contracts available under the plan • Responsible party for administration and compliance of the plan • Optional plan provisions, such as loans or hardship withdrawals <p>The IRS is expected to publish a model plan document.</p>	<p>ERISA plans are already required to have a written plan document and therefore, should already meet the plan documents' requirements. If the Principal® prepares your plan document, we will assist you to help ensure your plan document is updated as appropriate.</p> <p>For plans with multiple service providers, the plan document must now cross-reference the custodial agreement or annuity contract for purposes of distributions, loans and hardship withdrawals.</p> <p>The administrative and compliance responsibilities may be assigned to someone other than the employer, but may not generally be assigned to participants.</p> <p>There is not currently a determination letter process for 403(b) plans. However, the IRS is considering implementing such a process for 403(b) plans.</p>
Contribution Limitations				
Catch-up Contributions	January 1, 2009*	<p>Two types of catch-up contributions are allowed:</p> <ul style="list-style-type: none"> • Special section 403(b) catch-up — A participant with 15 years of service with a hospital, educational organization, church related organization or a health and welfare service agency is eligible for the special catch-up contribution. A year of service is defined as a full-time year of service. Part-time years of service are added together until 15 full-time years of service are completed. <p>Employees who are eligible may increase their elective deferrals by the lesser of —</p> <ul style="list-style-type: none"> • \$3,000; • The excess of — <ul style="list-style-type: none"> a) \$15,000; over b) Any special catch-up contributions made in prior tax years; or • The excess of — <ul style="list-style-type: none"> a) \$5,000 x years of service; over b) The total elective deferrals made in prior years with the organization. • Age 50 catch-up contributions (\$5,000 in 2007) 	<p>The final regulations clarify that if an employee is eligible for both types of catch-up contributions, contributions are first classified as special 403(b) catch-up to the extent permitted and then any remaining elective deferral contributions are classified as age 50 catch-up.</p> <p>The final regulations expanded the definition of health and welfare service agency to include organizations whose primary activity is to provide medical care, organizations whose primary activity is the prevention of cruelty to individuals or animals, adoption agencies, and agencies which provide home health services, provide meals to the needy, substance abuse assistance or help the disabled.</p>	<p>If your organization is a health or welfare service agency that was not previously allowed to offer the special catch-up contribution, you may want to consider evaluating if the extension of these definitions now includes your organization.</p> <p>If applicable, care will be needed to ensure the special catch-up is utilized before the age 50 catch-up.</p>

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Contribution Limitations <i>continued</i>				
Elective Deferral Contribution Timing	January 1, 2009*	Employers that sponsor ERISA 403(b) plans are subject to Department of Labor (DOL) rules which require that elective deferrals and loan repayments be remitted to the plan by the earliest date on which those contributions can reasonably be segregated from general business assets, but in no event later than 15 business days following the month in which deferrals were withheld. Non-ERISA plans are not subject to timing requirements.	Elective deferral contributions to 403(b) plans must be submitted within a period that is not longer than is reasonable for the proper administration of the plan. Note: ERISA plans must continue to meet the DOL contribution timing standards noted to the left.	If your plan is not subject to ERISA, you will need to evaluate your current payroll processing to ensure elective deferral contributions are remitted within the new timing standards.
Former Employees — Non-elective Contributions	January 1, 2009*	Under current rules, an employer can contribute non-elective employer contributions to a former employee through the end of the taxable year the employee ceased to be an employee and also for the next five taxable years.	Non-elective employer contributions may be made to a former employee's account for up to five years following a participant's severance from employment. The regulations limit the contribution to the lesser of \$45,000 (415 dollar limit) or 100% of the former employee's pay during the most recent year of service.	As part of an incentive package employers may wish to evaluate the possibility of providing a contribution to former employees. These contributions would be subject to nondiscrimination testing.
Nondiscrimination Rules				
Nondiscrimination Testing for Employer Contributions	January 1, 2009* Note: Not applicable to governmental plans (other than the 401(a)(17) compensation cap) or church plans as defined under §1.403(b)-2.	Good faith compliance with nondiscrimination requirements is required for employer contributions and employee after-tax contributions. Matching and after-tax contributions are required to be tested via the actual contribution percentage test (ACP). For all other contributions, plans can comply by following the same rules as qualified plans or by meeting the safe harbor nondiscrimination provisions outlined in IRS Notice 89-23. Actual deferral percentage (ADP) testing requirements do not apply to elective deferrals because they are subject to universal availability requirements.	Employer contributions and employee after-tax contributions must satisfy the nondiscrimination requirements in the same manner as a qualified plan. The IRS Notice 89-23 good faith reasonable standard regarding nondiscrimination requirements no longer applies. ADP testing requirements do not apply to elective deferrals because they are subject to universal availability requirements.	If your plan currently relies on the safe harbor disparity rules of IRS Notice 89-23, plan design changes may be needed to help ensure compliance. If you have been testing based on nondiscrimination rules applicable to qualified plans, this change should not impact your plan.
Controlled Group Rules	January 1, 2009 Note: These controlled group rules do not apply to certain church entities (other than permissive disaggregation) or governmental entities such as public schools. Churches and governments may continue to rely on the rules in IRS Notice 89-23.	Related tax-exempt organizations or related tax-exempt and for-profit entities may be considered a controlled group if enough common control exists between the organizations. At least 80% of the directors or trustees of the exempt organization must be representatives of, or directly or indirectly controlled by another organization. Good faith compliance with these rules is required.	The final regulations reaffirmed the current controlled group rules. However, good faith compliance no longer applies. In addition to the current rules, tax-exempt organizations are allowed to choose to be aggregated and under common control if they maintain a single plan that covers employees from both organizations and day-to-day exempt activities of the two organizations are regularly coordinated. Permissive disaggregation between qualified church controlled organizations is allowed.	If your organization has a strong affiliation with another tax-exempt organization you may wish to further explore the permissive aggregation rules. The use or disuse of these rules is subject to anti-abuse rules. The anti-abuse rules state that if the Commissioner determines that the structure of one or more exempt organizations, or the positions taken by those organizations has the effect of avoiding or evading any requirements imposed under Section 401(a), Section 403(b), Section 457(b) or any applicable section, the Commissioner may treat an entity as under common control with the exempt organization.

*Plans maintained under a collective bargaining agreement have until the earlier of July 26, 2010, or the date on which the last bargaining agreement terminates. Plans maintained by a church-related organization have until the 2010 plan year if authority to amend the plan is held by a church convention.

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Nondiscrimination Rules <i>continued</i>				
Universal Availability for Elective Deferral Contributions	<p>January 1, 2010</p> <p>Plans maintained by governmental organizations that exclude a category of employees that are no longer allowed to be excluded have until the earlier of:</p> <ul style="list-style-type: none"> the close of the first regular session that begins on or after January 1, 2009, or January 1, 2011, to remove those exclusions. <p>Plans which utilize the collective bargaining exclusion have until the later of:</p> <ul style="list-style-type: none"> the first day of the first taxable year that begins after December 31, 2008; or the earlier of: <ol style="list-style-type: none"> the date on which the related collective bargaining agreement terminates or July 26, 2010, to discontinue use of the exclusion. <p>Note: Universal availability does not apply to churches (as defined by §1.403(b)-2).</p>	<p>In general, salary reduction contributions must be available to any employee who is eligible to defer a minimum of \$200. If an employer offers a 403(b) arrangement, all employees of the employer (with limited exceptions) must be able to defer under the plan. This is often referred to as universal availability. The following are exceptions to the current rule:</p> <ul style="list-style-type: none"> Employees who are eligible to participate in an eligible governmental plan under section 457(b), which permits contributions or deferrals at the election of the employee or a plan of the employer offering a qualified cash or deferred election under section 401(k) or 403(b) Employees who are non-resident aliens Employees who are students performing services described in section 3121(b)(10) Employees who normally work fewer than 20 hours per week Employees who make a one-time election to participate in a governmental plan instead of a section 403(b) plan Employees covered by a collective bargaining agreement Visiting professors for up to one year under certain circumstances Employees affiliated with a religious order that have taken a vow of poverty 	<p>The final regulations do not allow as many exceptions to the universal availability rule. The categories generally are:</p> <ul style="list-style-type: none"> Employees who are eligible to participate in an eligible governmental plan under section 457(b), which permits contributions or deferrals at the election of the employee or a plan of the employer offering a qualified cash or deferred election under section 401(k) Employees who are non-resident aliens Employees who are students performing services described in section 3121(b)(10) Employees who normally work fewer than 20 hours per week if the employer expects the employee to work less than 1,000 hours in a 12-month period and each subsequent 12-month period** <p>In the case of a plan covering employees of more than one 501(c)(3) organization the universal availability rule described above applies to each entity separately.</p> <p>Note: Plans subject to ERISA may have to allow these employees to participate earlier than the beginning of the following plan year in order to meet ERISA requirements.</p>	<p>If your plan does not meet the new universal availability rules, care should be taken to ensure the excludable employees are allowed to participate.</p> <p>If your plan currently provides for the 20-hour per week classification exclusion, records of employees' hours worked will need to be kept to determine if they worked 1,000 hours in a 12-month period.</p>
Effective Opportunity	January 1, 2009*	Effective opportunity was not previously addressed as a requirement of universal availability.	<p>In order to satisfy the universal availability rules, an employee must also be able to start, stop or modify his or her deferral election at least one time during any plan year.</p> <p>Effective opportunity does not exist if there are any rights or benefits (other than matching contributions) that are conditioned upon making a deferral election.</p>	<p>Employees must be given a meaningful notice of their ability to defer. If employees are unaware of their ability to defer, the requirement will not be satisfied. Effective opportunity is determined based on all the relevant facts and circumstances, including notice of the availability of the election, the period of time during which an election may be made and any other conditions on elections</p> <p>If your plan does not allow deferral election modifications on an annual basis or better, you should consider changes to help ensure compliance with the regulations.</p>

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Distributions and Transfers				
Tax-Free Transfers and Exchanges	<p>The new rules do not apply to a contract received in an exchange that occurred on, or before, September 24, 2007.</p> <p>Various industry groups have asked the IRS for an extension to the September 24, 2007, date. We will keep you informed of any changes to the effective date.</p>	<p>Tax-free transfers and exchanges are allowed from one 403(b) to another. This is commonly referred to as a 90-24 transfer.</p>	<p>Exchanges — Transfers may occur within the same plan if the following conditions are met:</p> <ul style="list-style-type: none"> • The plan allows for the transfer • The benefit before the exchange is the same as the benefit after the exchange • Any distribution restrictions are carried over from the transferred plan • Information is provided to ensure the distribution and tax rules are followed <p>Plan to plan transfers between unrelated plans may occur if the following conditions are met:</p> <ul style="list-style-type: none"> • The participant is an employee or former employee of the employer for the receiving plan, or a beneficiary of a deceased employee or former employee • Both plans provide for the transfer • The benefit immediately preceding the exchange is the same as the benefit immediately after the exchange • Any distribution restrictions are carried over from the transferred plan <p>The transfer of assets from a 403(b) to a governmental defined benefit plan may be allowed to purchase past service credits in certain circumstances.</p>	<p>For transfers after September 24, 2007, you must enter into a written agreement with service providers to share information for compliance purposes. You have until January 1, 2009, to have the agreement in place.</p> <p>For transfers prior to September 24, 2007, existing 90-24 rules will apply. No information sharing agreements are necessary.</p> <p>All contract exchanges after December 31, 2008, will require transfer agreements and must be permitted by the plan document.</p> <p>Non compliance with the regulations could jeopardize the tax status of contracts.</p> <p>You will want to review all contracts established at any time in the past (including any non-ERISA arrangements) to see if information sharing agreements are necessary. You will have until December 31, 2008, to have plan document changes made.</p>
Distributable Events	January 1, 2009*	<p>Distribution of elective deferral contributions are allowed upon:</p> <ul style="list-style-type: none"> • Severance of employment • Death • Disability • Attainment of age 59 ½ • Financial hardship (excluding earnings) <p>Distribution of employer contributions (other than elective deferrals) from custodial accounts are allowed upon:</p> <ul style="list-style-type: none"> • Severance of employment • Death • Disability • Attainment of age 59 ½ <p>Distribution of employer contributions (other than elective deferrals) from an annuity contract may be allowed at anytime.</p>	<p>The final regulations clarify that the distribution of rollover and after-tax contributions may be made at any time.</p> <p>Participants with employer contributions invested in an annuity contract which is issued on or after January 1, 2009, may no longer be able to receive a distribution of their employer contributions at anytime. Instead, they will be restricted to severance of employment or upon the occurrence of some specified event, such as the attainment of a stated age, after a fixed number of years of service, or disability as defined within the plan document.</p>	<p>If you have participants with employer contributions in annuity contracts (other than elective deferrals), you'll want to notify them regarding the change in distribution rules.</p> <p>The plan document should specify when employer contributions invested in annuity contracts may be distributed.</p>

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** Subsequent 12-month periods may be based on employment anniversary or plan year basis. If an employee works 1,000 hours in a 12-month period they must be allowed to participate in the plan by the beginning of the plan year on or after meeting the 1,000 hour requirement.

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Distributions and Transfers <i>continued</i>				
Severance from Employment	January 1, 2009*	Current law allows a distributable event at severance from employment.	The rules specify that severance from employment occurs on any date an employee ceases to be an employee of an eligible employer. An eligible employer is an entity that is eligible to sponsor a 403(b) plan. If the employee continues to be employed by another employer that is part of a controlled group with the eligible employer, employment is still terminated with his or her eligible employer if the ongoing employer is an entity that can not be an eligible employer (e.g. employee transfers from a 501(c) (3) entity to a for-profit entity of the same controlled group).	This provision is of particular importance for controlled groups which consist of eligible employers and for-profit entities.
Plan Termination	January 1, 2009,* however may apply now if all contracts issued under the plan satisfy all the applicable requirements of the final regulations (other than the written document requirement).	403(b) plans may be amended to eliminate future contributions. However, distributions of accumulated benefits are not allowed until a participant has had a distributable event. Plan termination is not a distributable event.	Plans may provide for termination of the plan and for distribution of accumulated benefits. However, distribution is allowed only if the employer (including controlled group members) did not make contributions to a 403(b) plan within 12 months prior to the date of plan termination and does not make contributions during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. This rule does not apply if fewer than 2% of the employees who were eligible in the terminating 403(b) plan are eligible under the alternative 403(b) plan. 100% vesting is required at plan termination.	In order for a section 403(b) plan to be considered terminated, all accumulated benefits under the plan must be distributed as soon as administratively practicable after termination of the plan. For this purpose, delivery of a fully paid individual annuity contract is treated as distributed.
Qualified Domestic Relations Orders (QDRO)	January 1, 2009	Applicability to all 403(b) plans was unclear.	Much like the rules governing a qualified plan, 403(b) plans may allow for an immediate distribution to an alternate payee in QDRO situations as provided in the plan document.	The plan document should specify if distributions are allowed immediately upon the determination of a QDRO, or if payments are delayed until the participant's earliest retirement age.

Specific Points	Effective Date	Current Rules	Final 403(b) Regulations	What it Means to You
Distributions and Transfers <i>continued</i>				
Minimum Distributions	Effective Immediately	<p>The required minimum distribution (RMD) rules are outlined in section 401(a)(9). In general, required minimum distributions under a 403(b) plan follow IRA rules, however certain provisions follow qualified plan rules. The surviving spouse rules (found in the IRA rules), do not apply — a surviving spouse cannot treat a deceased spouse's interest in the 403(b) plan as their own, even if he/she is considered the sole beneficiary.</p> <p>That portion of a participant account balance, which is valued as of December 31, 1986, shall not be included in the RMD calculation, provided the service provider maintains this portion of an account separately from contributions made after December 31, 1986, ongoing.</p> <p>The required beginning date for most employees is April 1 of the calendar year following the later of:</p> <ul style="list-style-type: none"> • The year the employee attains age 70 1/2, or • The year the employee retires. <p>However, except for governmental or church plans, the required beginning date for a 5% owner is April 1 of the calendar year following the calendar year in which the employee attains age 70 1/2.</p> <p>Additionally, a RMD must be separately determined for each section 403(b) plan an employee participates in. However, distributable RMD amounts may be aggregated and distributed from one or more section 403(b) contracts of the employee.</p>	Final regulations reaffirmed the current rules.	No changes are needed.
Funding				
Applicable Funding Solutions	September 24, 2007	In addition to annuities and custodial accounts, 403(b) plans may currently have life, health or accident insurance, or property, casualty or liability insurance provisions as a source of funding.	The final regulations limit the funding vehicles allowed for 403(b) plans to annuity contracts or custodial accounts.	If your plan provides for insurance benefits, any policies issued prior to September 24, 2007, may remain in force and premium payments may continue. No new policies may be issued after the effective date.
Retirement Income Accounts	For agreements in place before July 26, 2007, steps should be taken to eliminate loans or other extensions of credit before the first day of the first plan year beginning after December 31, 2009, or as promptly as practicable thereafter.	A retirement income account for employees of a church-related organization is treated as an annuity contract.	Final regulations continue to allow retirement income accounts as long as the retirement income account's interest is separately accounted for and as long as the assets in the account are held for the exclusive benefit of participants. The plan document must specify the use of the retirement income account as the funding vehicle. The extension of credit and loans to the church are not allowed.	If you are a church-related organization using a retirement income account, you should review current practices to help ensure you are in compliance with the additional requirements.

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