



GROOM LAW GROUP

403(b) Multiple Employer Plans: ERISA and Tax Considerations



A Memorandum Prepared by The Groom Law Group.

MEMORANDUM

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RE: ERISA and Tax Considerations Applicable to 403(b) Plan Closed Multiple
Employer Plans

This memorandum outlines the Internal Revenue Code of 1986, as amended (the “Code”) and the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) considerations a tax-exempt organization or an association of tax-exempt organizations might evaluate when considering establishing a “closed” multiple employer plan (a “MEP”) that is intended to be treated as a “403(b) plan” under the Code and ERISA.

Summary

Numerous leaders in Congress, at the Department of Labor, and the Department of the Treasury have expressed support for the expanded utilization of MEPs. Widely accepted benefits of a MEP include:

- Simplification of administrative burdens imposed on plan sponsors and their employees.
- More “professional” management of retirement plans by retirement plan experts.
- Economies of scale in administrative and investment pricing.

Many of these benefits have led many organizations to consider a closed Section 403(b) Plan MEP as their method of helping their employees save for retirement.

Code section 403(b) plans are generally subject to less statutory and regulatory guidance and oversight than most Code section 401(a) qualified plans. This discrepancy in the level of

statutory and regulatory guidance also occurs in the closed Section 403(b) Plan MEP context. The effect of this discrepancy is that there is more greyness as to the legal standards that would apply to a closed Code section 403(b) MEP. However, as described in Section IV (Section 403(b) Plans and Closed MEP Rules), there are numerous analogies that an employer could look to in implementing such a MEP. When completing its own individual evaluation as to whether to create or join a closed Section 403(b) Plan MEP, an organization should evaluate with its counsel whether the regulatory uncertainty, and the potential for Department of Labor (“DOL”) or IRS scrutiny¹ may outweigh the benefits a MEP structure can provide.

Structure of Memorandum

This memorandum separates its discussion into several key parts:

- Defining the meaning of the term “closed multiple employer plan”;
- Reviewing how the multiple employer plan rules apply to Code section 401(a) qualified plans;
- Providing a brief overview of Code section 403(b) plans; and
- Reviewing how certain multiple employer plan rules could be applied to a closed Code section 403(b) MEP.

Discussion

I. Defining Closed Multiple Employer Plans

The term “multiple employer plan” or “MEP” generally refers to a plan that (1) is maintained by two or more employers (“MEP Employers”) who are not members of a single controlled group, affiliated service group, or common control relationship and (2) is not maintained pursuant to a collective bargaining agreement. Notably, MEPs are not (1) “single

¹ DOL or IRS scrutiny could potentially lead to a number of changes and or expenses, such as additional reporting requirements or required unbundling of plans for individual employers.

employer plans” (which are maintained by a single employer or a group of employers in a single controlled group, affiliated service group or common control relationship),² (2) “multiemployer plans” (which are maintained pursuant to a collective bargaining agreement),³ and (3) multiple employer welfare arrangements or “MEWAs” that are multiple employer welfare benefit plans subject to special rules under ERISA.

The concept of a closed MEP is that there is an employment based common nexus or organizational relationship among MEP Employers through an association acting for the MEP Employers. ERISA sections 3(2) and 3(5); DOL Advisory Opinions 2012-03A and 2012-04A (May 25, 2012). Examples of closed MEPs (also called association MEPs) include MEPs maintained by associations representing certain types of utilities, such as electrical or telecommunications companies. Factors that an organization considering establishing a closed Code section 403(b) Plan MEP should consider include:

- How members are solicited;
- Who is entitled to participate and who actually participates in the association;
- The process by which the association was formed,
- The purposes for which it was formed, and what, if any, were the preexisting relationships of its members;
- The powers, rights, and privileges of employer members that exist by reason of their status as employers; and

² Code sections 414(b), (c) and (m) provide that employees of employers in a single controlled group or affiliated service group, or who are under common control, are treated as employed by a single employer for qualified plan purposes. (With respect to church-related controlled groups, special considerations apply that are outside the scope of this memorandum. See, e.g., Section 236 of the PATH Act of 2015.)

³ Under Labor Reg. § 2530.210(c)(3), the term “multiple employer plan” refers both to multiemployer plans and plans described in Code section 413(c). However, the term “MEP” is typically used to refer to multiple employer plans that are *not* multiemployer plans. MEPs are sometimes erroneously referred to as multiemployer plans, which often raises immediate but inapplicable concerns for those who are worried about collective bargaining rules that are not applicable to MEPs.

- Who actually controls and directs the activities and operations of the benefit program.

DOL Advisory Opinion 2012-04A (May 25, 2015). *See also* DOL Advisory Opinions 2012-03A (May 25, 2012), 2003-13A (Sep. 30, 2003), 2001-04A (Mar. 22, 2001), 94-07A (Mar. 14, 1994).

II. Qualified Plan Requirements and Multiple Employer Plans

Qualified plans described in Code section 401(a) (“Qualified Plans”) are subject to numerous rules under the Code and ERISA. Qualified Plan MEPs are subject to many of the same rules as single-employer Qualified Plans. However, Code section 413(c) provides that the “exclusive benefit” rule under Code section 401(a) and the related regulations (the “Exclusive Benefit Rule”) apply differently to MEPs. In addition, both Code section 413(c) and ERISA section 210 provide that the rules set forth in Code section 410(a), ERISA section 202, and the related regulations (the “Minimum Participation Rules”) and the rules set forth in Code section 411, ERISA section 203, and the related regulations (the “Minimum Vesting Rules”) apply differently to Qualified Plan MEPs. Qualified Plan MEPs are also subject to special Code and ERISA rules relating to funding, allocations and limitations on additions and accruals, and employer deductions.

Each of these rules is discussed briefly below in order to illustrate how Code section 401(a) and related guidance apply to Qualified Plan MEPs.

A. *The Exclusive Benefit Rule*

The Exclusive Benefit Rule under Code section 401(a) provides that a Qualified Plan must be maintained by an employer for the exclusive benefit of its employees or their beneficiaries. As a result of the Exclusive Benefit Rule, a plan will generally not be considered a Qualified Plan if the plan benefits individuals who are not considered employees of the employer maintaining the plan (or beneficiaries of such individuals).

Code section 413(c)(2) modifies the Exclusive Benefit Rule as it applies to Qualified Plan MEPs by providing that for purposes of the Exclusive Benefit Rule, all participants in a MEP are considered employed by each MEP Employer. Absent Code section 413(c)(2), each Qualified Plan MEP Employer would be considered to be maintaining a plan that benefits individuals other than its own employees, which would violate the Exclusive Benefit Rule and therefore disqualify the MEP. Code section 413(c)(2) thus allows a Qualified Plan MEP to satisfy the Exclusive Benefit Rule and qualify as a Qualified Plan.

B. Minimum Participation Rules

The Minimum Participation Rules under Code section 410(a) and ERISA section 202 place a number of limits on Qualified Plans relating to how an employee can become eligible to participate. Among other requirements, the Minimum Participation Rules generally prohibit a Qualified Plan from requiring an employee to perform more than 1 “year of service” with the employer(s) maintaining the plan as a condition to participation in the plan. The Minimum Participation Rules also generally require a Qualified Plan to recognize for eligibility purposes a non-vested former employee’s prior service with an employer if the employee is subsequently re-hired and has had fewer than 5 consecutive “1-year breaks in service” between his termination and re-hire.

Code section 413(c)(1) provides that for purposes of the Minimum Participation Rules, all employees of each MEP Employer are generally treated as employed by a single employer. Code section 413(c)(1) thus requires that a Qualified Plan MEP recognize an employee’s eligibility service credit accrued under all MEP Employers. For example, if a Qualified Plan MEP defines a year of service as 1,000 hours of service, an employee who accrues 700 hours of service with one MEP Employer and 300 hours of service with a separate MEP Employer during

the same year will be considered to have accrued a year of service for eligibility purposes under the MEP. Similarly, if an employee terminates employment with one MEP Employer and subsequently commences employment with a separate MEP Employer before he has incurred 5 “1-year breaks in service,” the employee’s service with the prior MEP Employer must usually be taken into account for eligibility purposes under the Qualified Plan MEP.

C. Minimum Vesting Rules

The Minimum Vesting Rules under Code section 411 and ERISA section 203 provide a number of complex requirements relating to vesting and forfeiture of Qualified Plan benefits. Many of the Minimum Vesting Rules require a Qualified Plan to provide specific rights to a participant based on his years of service for the employer maintaining the plan. For example, the Minimum Vesting Rules prohibit a Qualified Plan from requiring an employee to accrue more than a specified number of years of service in order to become vested in certain plan benefits. In addition, the Minimum Vesting Rules generally require a Qualified Plan to recognize for vesting purposes a non-vested former employee’s prior service with an employer if the employee is subsequently re-hired, unless the employee has incurred a number of “1-year breaks in service” between his termination and re-hire equal to the number of years of service prior to termination (but no less than 5).

Code section 413(c)(3) provides that for purposes of the Minimum Vesting Rules, all employees of each MEP Employer are generally treated as employed by a single employer, except that Minimum Vesting Rules with respect to “breaks in service” under Qualified Plan MEPs are to be addressed by DOL regulations.⁴ Code section 413(c)(3) thus generally requires a Qualified Plan MEP to recognize a participant’s vesting service credit accrued under all MEP

⁴ The DOL regulations applicable for “break in service” purposes permit a Qualified Plan MEP to disregard a participant’s “non-contiguous non-covered service” for vesting purposes. Labor Reg. § 2530.210. The rules regarding whether service constitutes “non-contiguous non-covered service” are beyond the scope of this memorandum.

Employers. For example, if a Qualified Plan MEP participant accrues 1 year of service under one MEP Employer, terminates employment, is subsequently hired by a separate MEP Employer (without incurring 5 “1-year breaks in service”), and accrues 2 years of service under the second MEP Employer, the participant will generally be considered to have accrued 3 years of service for vesting purposes under the MEP.

D. Rules Relating to Funding, Allocations, and Employer Deductions

Other areas of Code section 413(c) and ERISA section 210 provide that MEP Employers are generally treated as separate employers for purposes of Code section 412 and ERISA section 302 (regarding how much an employer maintaining a Qualified Plan must contribute annually to the plan), Code section 404(a) (regarding employer deductions for Qualified Plan contributions), and Code section 4971 (regarding excise taxes on delinquent contributions). MEP Employers are also generally treated as maintaining separate plans for certain plan testing purposes, such as the non-discrimination testing rules under Code section 401(a)(4), the coverage testing rules under Code section 410(b), the top-heavy rules under Code section 416, and the highly-compensated employee rules under Code section 414(q).

III. Section 403(b) Plans Generally

Code section 403(b) permits certain types of employers (including Code section 501(c)(3) corporations, churches, and certain state educational organizations) to purchase tax-deferred annuity contracts for their employees. The regulations under Code section 403(b) require such a tax-deferred annuity contract to be maintained pursuant to a defined contribution plan which satisfies various requirements (a “Section 403(b) Plan”). The Section 403(b) Plan rules permit an employer to purchase either individual annuity contracts for each participant or a

group annuity contract that contains individual participant accounts.⁵ In addition, the Section 403(b) Plan rules treat certain custodial accounts invested in registered investment company stock as annuity contracts. A Section 403(b) Plan must be in writing, but can consist of multiple plan documents.

Although Qualified Plans and Section 403(b) Plans offer similar tax advantages to their respective participants, Section 403(b) Plans are not Qualified Plans: Section 403(b) Plans are described under a different section of the Code and must satisfy a separate set of rules. Nevertheless, many of the rules under the Code applicable to Section 403(b) Plans are substantively similar, though not always equivalent, to those applicable to Qualified Plans. In addition, many of the ERISA rules applicable to Qualified Plans are similarly applicable to Section 403(b) Plans. Specific examples of the harmonization of the Section 403(b) Plan and Qualified Plan rules include the following:

- The Economic Growth Tax Relief Reconciliation Act of 2001 (“EGTRRA”). EGTRRA modified a number of Code section 403(b) rules, such as the Code section 403(b) rules governing the definition of “compensation” to more closely align them with the Qualified Plan rules.
- ERISA-covered Code section 403(b) plans are now subject to the same Form 5500 annual reporting requirements as generally applicable to Qualified Plans. Previously, Code section 403(b) Plans were required to file a very short, truncated Form 5500 annual report.
- Final Code section 403(b) regulations issued in 2007 specifically applied a number of Qualified Plan concepts, such as “exclusive benefit” requirements and more precise

⁵ Code section 403(b)(9) church retirement income account plans may invest in other types of investments, but are outside the scope of this memorandum.

linkages to IRS regulations governing Qualified Plans on a number of key compliance areas, such as non-discrimination testing.

IV. Section 403(b) Plans and Closed MEP Rules

Unlike the detailed rules governing Qualified Plans, Section 403(b) Plans are generally subject to the more limited provisions of Code section 403(b) itself, some provisions applicable to Qualified Plans pursuant to Code section 403(b) and/or regulatory cross references, and the tax rules in Title II of ERISA (*i.e.*, the Minimum Participation Rules and the Minimum Vesting Rules). When considering whether to establish a closed Section 403(b) Plan MEP, four key items a tax-exempt organization or an association of tax-exempt organizations might consider are as follows:

- the application of exclusive benefit requirements to a Section 403(b) Plan MEP,
- service crediting requirements under a Section 403(b) Plan MEP,
- annual reporting requirements for a Section 403(b) Plan MEP,
- the potential impact on a participant's distribution rights when an organization moves into a Section 403(b) Plan MEP.

A. *Application of the Exclusive Benefit Rule*

A first item to consider is how the Exclusive Benefit Rule might apply to a Section 403(b) Plan MEP. The Exclusive Benefit Rule in Code section 401(a)(2) does not apply to a Section 403(b) Plan. However, with respect to Section 403(b) Plan custodial accounts described in Code section 403(b)(7), Treasury Regulation section 1.403(b)-8(d)(2)(iii) provides a similar exclusive benefit rule that effectively parallels the Qualified Plan version. However, there is no Code or ERISA provision applicable to a Section 403(b) Plan, such as Code section 413(c)(2), that addresses the concern of how to treat the employees of multiple employers participating in a

plan. Notably, a tax-exempt organization or an association of these organizations may be able to look to the fact that the Treasury Regulation is structured consistent with the historical practice that Section 403(b) Plan accounts are more linked to the participant than the employer, and thus does not impose the exclusive benefit requirement on an employer-by-employer basis. Because 403(b) plans are normally defined contribution plans, so the exclusive benefit concern is not so much with regard to the payment of benefits, but the allocations of earnings and expenses.

B. Service Crediting Requirements

A second area to consider is how the Minimum Participation Rules and Minimum Vesting Rules would operate in a Section 403(b) MEP. At the core of this discussion is ERISA section 210 and how and/or whether it applies to a Section 403(b) Plan MEP. The rules under ERISA section 210 define the term “multiple employer plan” to mean “a multiple employer plan within the meaning of sections 413(b) and (c) of the Code.”⁶ Code section 413(c) in turn applies to “a plan maintained by more than one employer.” Although Code section 413(c) does not state whether it applies exclusively to Qualified Plans, the special rules described in Code section 413(c) all refer generally to Code rules applicable only to Qualified Plans (and not Section 403(b) Plans). As such, to address service crediting requirements, it could be advisable for a Section 403(b) Plan MEP to take the position it is a “multiple employer plan within the meaning of” Code section 413(c) and ERISA section 210 and to apply the Minimum Participation Rules and Minimum Vesting Rules by analogy.⁷ This approach would be consistent with the fact that

⁶ Labor Reg. § 2530.210(c)(3)(i).

⁷ An approach that could lead to more certainty would be to approach the DOL informally or on a formal basis requesting an Advisory Opinion.

the Minimum Participation Rules and the Minimum Vesting Rules under ERISA also generally apply to Section 403(b) Plans subject to ERISA.⁸

As described above, in order to satisfy the Minimum Participation Rules and Minimum Vesting Rules, a Qualified Plan MEP is required to recognize an employee's prior eligibility and vesting service credit accrued under a MEP Employer if the employee terminates employment with that MEP Employer and commences employment with another MEP Employer. As applied to a Section 403(b) Plan MEP, the MEP would recognize an employee's prior eligibility and vesting service credit accrued under a prior MEP Employer if the employee commences employment with another MEP Employer.

C. Annual Reporting Concerns

A third area to consider is how a Section 403(b) Plan MEP would file annual reports on Form 5500. The Form 5500 instructions permit a "multiple-employer plan" to file a single Form 5500. The Form 5500 instructions define a "multiple-employer plan" as "a plan that is maintained by more than one employer and is not one of the plans already described [*i.e.*, a single-employer plan or a multiemployer plan]." However, the Form 5500 instructions also provide that a separate Form 5500 must be filed "by each employer participating in a plan or program of benefits in which the funds attributable to each employer are available to pay benefits only for that employer's employees."⁹ It is unclear how this instruction should be applied in the case of a Section 403(b) Plan MEP in the absence of guidance in the Code or ERISA designating Section 403(b) Plan MEP Employers as a single employer. A Section 403(b) Plan MEP that adopts ERISA section 210 and Code section 413(c) by analogy might elect to apply the same

⁸ Although Section 403(b) Plans are not technically subject to Code sections 410(a) or 411, they are subject to ERISA sections 202 and 203.

⁹ This instruction is consistent with the IRS ruling in Rev. Rul. 81-137 and the DOL's position in Advisory Opinion 82-17A.

analogy when preparing a Form 5500 for the Section 403(b) Plan MEP, although it should also consider the implications if the DOL disagrees with this position.¹⁰

D. Distribution Rights

A participant in a Code section 403(b) Plan may generally elect to receive a distribution after his or her “severance from employment.” Code sections 403(b)(7)(A)(ii) and Code section 403(b)(11)(A). However, in a multiple employer plan, an individual does not automatically have a “severance from employment” when he or she switches employers. *See generally* Gen. Couns. Mem. 39824 (Aug. 27, 1990). An organization might consider the extent to which distributions after severance from employment apply to employees in a Section 403(b) Plan MEP.

VI. Conclusion

Although no authority specifically bars the creation of a closed Section 403(b) Plan MEP, there are a number of MEP-related areas in which there is limited to no controlling guidance other than analogies to the Code and ERISA rules generally applicable to Qualified Plan MEPs. There are significant business reasons – from cost efficiencies to administrative protections – for a tax-exempt organization to elect to proceed with creating or joining a Section 403(b) Plan MEP. As a result, Section 403(b) Plan MEP sponsors might consider how to design and structure their Section 403(b) Plan MEPs to address these gaps and to take proactive steps to protect against positions that might be subsequently adopted by relevant regulators.

¹⁰ Examples of potential implications of DOL disagreement with a MEP could be a requirement that prior year corrected Form 5500 filings be filed, penalties for late filing of Form 5500s be paid, and/or the Form 5500 matter could lead the DOL to commence one or more formal investigations.



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A Memorandum Prepared by The Groom Law Group.

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