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What to Do Now

Employers should begin to assess their 403(b) plans' compliance with the final regulations now. By 2009, they will need to (i) adjust processes, policies and procedures to comply in operation with the new regulations, (ii) set up administration of any annual testing, and (iii) evaluate the employer's controlled group. In addition, the documentation of every 403(b) plan will need to be reviewed and amended to comply with the final regulations.

For further information on these new regulations, please contact Teri King at 404-888-8847.

Final 403(b) Plan Regulations and Model Language

Last year, the IRS issued final comprehensive regulations that overhaul the rules regarding 403(b) plans for tax-exempt employers. The final regulations contain sweeping changes, many of which were included in proposed regulations issued in 2004. The final regulations generally become applicable for calendar year plans on January 1, 2009.

A few highlights of the changes in the final regulations include:

- **Written Plan Document.** Every 403(b) plan must have a written plan document, even if the plan is not considered an ERISA-covered pension plan (and thus would not otherwise be required to have a plan document).
 - The 403(b) plan may be in more than one document, so it can be a combination of, for example, an underlying annuity contract, the employees' salary reduction agreements, and other documentation as needed.
 - The plan document must contain all of the material terms and conditions for:
 - Eligibility;
 - Benefits;
 - The contracts and/or custodial accounts available under the plan;
 - The time and form under which benefit distributions will be made; and
 - Any optional features such as loans, hardship withdrawals and acceptance of rollovers.
 - The plan document must also contain all of the material terms and conditions for applicable benefit limitations, including:
 - The Internal Revenue Code Section 402(g) limit on participants' elective deferrals (commonly known as voluntary salary reduction contributions) (\$15,500 for 2008);
 - The Internal Revenue Code Section 415 limit on participants' total contributions for the year (\$46,000 for 2008); and
 - The Internal Revenue Code Section 401(a)(17) limit on participants' compensation taken into account under the plan for the year (\$230,000 for 2008).
 - The plan may allocate responsibility for complying with any requirements of 403(b), including the plan document requirement, to a party other than the employer, but not to participants.
 - The Department of Labor issued guidance, providing that an employer that maintains a non-ERISA 403(b) arrangement can have a limited plan document to comply with the final 403(b) regulations, as long as the employer does not have responsibility for any discretionary determinations under the program.

- ***Nondiscrimination Rules.*** 403(b) plans must comply with more stringent rules designed to prevent discrimination in favor of highly compensated employees.
 - Elective deferrals must satisfy the universal availability requirement, but some employees who were previously allowed to be excluded from universal availability can no longer be excluded.
 - Employees who normally work fewer than 20 hours per week may still be excluded if the plan is not covered by ERISA.
 - Employees who are eligible for another 403(b) elective deferral plan or in a 401(k) plan of the employer may be excluded.
 - Transition rules are provided for plans that exclude categories of employees that were previously allowed to be excluded.
 - The group of employees eligible for employer contributions must satisfy the minimum coverage requirements of Internal Revenue Code Section 410(b), which may require annual testing.
 - Matching contributions on employee elective deferrals must satisfy the nondiscrimination requirements of Internal Revenue Code Section 401(m) and must be tested annually.
 - Employer nonelective contributions must satisfy the nondiscrimination requirements of Internal Revenue Code Section 401(a)(4), which may require annual testing;

- ***Controlled Group Rules.*** New rules provide clarification in determining the controlled group of a tax-exempt entity. The controlled group is relevant for purposes of the annual benefit limitations and nondiscrimination testing.
 - Generally, the controlled group includes any for-profit affiliates that would be included under the usual controlled group rules, which generally include any entities in a chain of at least 80% ownership.
 - Any tax-exempt organizations will also be included in the plan sponsor's controlled group if at least 80% of the directors or trustees of one of the organizations are either trustees, directors, agents or employees of, or are controlled by, the other organization.
 - At the employer's discretion, tax-exempt organizations may be included in the controlled group if the organizations regularly coordinate their day-to-day exempt activities.

- ***Correcting Excess Deferrals.*** Employers may correct excess elective deferrals (salary reduction contributions) above the permitted annual limit by distributing the excess amounts, with earnings, by April 15 of the following year.

- ***415 Excesses.*** Amounts in excess of the annual Internal Revenue Code Section 415 limit (\$46,000 for 2008) that are retained in the annuity contract will be taxable. However, if the excess amounts are accounted for separately by the annuity contract or custodial account provider, these amounts will not be considered part of the 403(b) plan and will not cause the remainder of the plan to fail to satisfy 403(b).

- ***Contributions for Former Employees.*** Employers are permitted to make limited contributions to a 403(b) plan for former employees through the end of the fifth calendar year after the year in which the individual terminates employment (*e.g.*, to effectuate an early retirement incentive).

- ***Distribution Restrictions.***

- Distributions from an annuity contract may only occur upon severance from employment or a stated event, such as attainment of a stated age, disability, or after a fixed number of years.
- Distributions from a custodial account may only occur upon severance from employment, death, disability, or attainment of age 59½.
- Distributions of elective deferrals (salary reduction contributions) may only be made upon severance from employment, death, hardship (using the same rules as apply to 401(k) plans), disability, or attainment of age 59½.
- Severance from employment includes transfer to a non-eligible employer in the same controlled group.
- Required minimum distributions generally follow the same rules as an IRA.

- ***Transfers.*** Detailed rules regarding exchanges of contracts, rollovers and plan-to-plan transfers are provided in the final regulations.

- ***Termination.*** Employers are permitted to terminate a 403(b) plan, but generally the employer may not make contributions to another 403(b) plan for 12 months after the plan is terminated.

The IRS has also issued a form 403(b) plan document with language designed to satisfy the requirements of the final regulations. Although the form document is drafted specifically for use by public schools, it should be useful to other employers in preparing a written document to comply with the new requirements.

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