PUBLICATION

Schools, Churches and Other Non-Profits Get Ready: New Rules for Section 403(b) Plans Require Substantial Changes

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January 1, 2009 is the deadline by which employers maintaining Internal Revenue Code §403(b) plans must have formal plan documents in place and satisfy new compliance rules. Participation in §403(b) plans is limited to employees of public schools and charitable organizations, as well as select ministers and employees of churches. Plan assets are held in either annuity contracts issued by an insurance company or in custodial accounts invested solely in mutual funds.

After forty years of laissez faire treatment, the IRS is mandating new requirements that aim to make §403(b) plans more like §401(k) plans. These requirements are set forth in new IRS Regulations under §403(b). The Regulations require that all §403(b) annuity contracts and custodial accounts be issued pursuant to a written plan document which satisfies the applicable requirements in both form and operation, whether subject to ERISA or not. Key items that must be included in a plan document include:

- Contracts and Custodial Agreements. Plan language must identify the contracts and accounts available under the §403(b) plan. Some employers may choose to include language describing the new contract "exchange" and "transfer" rules that apply as of January 1, 2009.
- Coverage and Contribution Rules. Plan language must detail the plan's coverage and contribution provisions.
- Maximum Benefit Limitations. The §415 limits on annual additions must be reflected in the plan terms.
- Optional Plan Provisions. Any optional provisions (e.g., loans, hardships and transfers) must be reflected in the plan document.
- Administration and Compliance. Provisions coordinating and allocating compliance responsibilities must be included in the plan.

Some of the other changes made by these new §403(b) Regulations include the following:

- Universal Availability. The universal availability requirement generally provides that, subject to limited exceptions, all employees of any employer normally working 20 or more hours a week must be permitted to elect to have salary reduction contributions made on their behalf. (Church plans are exempt from this requirement.) The IRS has an ongoing nationwide enforcement initiative in effect dealing with the universal availability requirement.
- Nondiscrimination Rules for Employer Contributions. Most employers will be subject to nondiscrimination rules that apply to employer contributions (e.g., matching contributions) and supersede the current "good faith" compliance standard for tax-exempt employers and the safe harbor guidance provided in 1989 by the IRS.
- Timing of Contributions. Similar to the rules for §401(k) plans, the §403(b) Regulations require an employer to remit contributions within a reasonable period for the administration of the plan. The Regulation suggests that remitting salary reduction contributions within 15 business days after the end of the month in which such amounts would otherwise have been paid is considered reasonable. However, this period may be even shorter if the plan is subject to ERISA.
- Exchanges and Transfers. Today, it is not uncommon for employers that maintain §403(b) arrangements to offer to make contributions to custodial accounts and/or annuity contracts issued by

more than one financial institution. Some arrangements also allow participants to move all or some of their account or contract balances to other financial institutions that offer §403(b) custodial accounts or annuity contracts, regardless of whether the account or contract receives contributions from the employer. These transactions, generally called "90-24 transfers" (referring to the IRS guidance that permitted such investment changes), are excluded from income tax so long as the receiving contract or account includes distribution restrictions at least as stringent as the old contract or account.

The §403(b) Regulations permit investment exchanges between accounts and contracts (called "exchanges") only if the accounts and contracts are part of the employer's plan and certain requirements are satisfied. One of these requirements is the "information sharing requirement." An exchange is permitted only if the plan provides for the exchange and the employer enters into an information sharing agreement with the issuer or custodian of the new contract or account. The information sharing agreement must specify that the employer will share information sufficient for the institution providing the account or contract to satisfy the applicable requirements, including administering loans and hardship distributions and determining whether an employee has had a severance from employment.

- Form 5500 Filing Requirements. Effective for the 2009 plan year, §403(b) plans will be subject to the same Form 5500 (Annual Return/Report of Employee Benefit Plan) filing requirements as §401(k) plans. While non-ERISA plans will not need to file Form 5500 and many §403(b) plans of small employers will file only the small employer Form 5500, §403(b) plans of large employers subject to ERISA will have to file a complete Form 5500, including an independent audit report, although in many cases it may be a limited scope audit.