

For many years, tax-exempt organizations that sponsored retirement plans for their employees existed in a regulatory void that allowed these plans to operate for years without significant government reporting or oversight. The prior rules encouraged employers to maintain a “hands off” approach to avoid fiduciary liability, and documents governing these plans were often little more than an annuity contract between the investment provider and the employees. Regulations issued in 2007 by the Internal Revenue Service (IRS) profoundly impacted the establishment and operation of traditional retirement plans of nonprofit organizations.

Until the issuance of these regulations, 403(b) plans relied on an assortment of IRS guidance dating back to the 1960's. In an effort to mirror the regulations applicable to 401(k) plans, the IRS proposed a comprehensive set of regulations to consolidate its various guidance in 2004. Those regulations were finalized under Internal Revenue Code (Code) Section 403(b), issued by the IRS on July 26, 2007, and generally become effective for tax years beginning after December 31, 2008.

By January 1, 2009, all 501(c)(3) organizations and public school districts that provide 403(b) tax-sheltered annuities or custodial accounts to their employees were required to bring their 403(b) programs into compliance with the new regulations.

## WHAT IS A 403(b) PLAN?

A 403(b) plan, also known as a tax sheltered annuity (TSA), is a retirement plan for certain employees of public schools, employees of eligible tax-exempt organizations, and qualified ministers. Individual accounts in a 403(b) plan can be any of the following types:

- An annuity contract provided through an insurance company
- A custodial account invested in mutual funds
- A retirement income account set up for church employees (Generally, retirement accounts can invest in either annuities or mutual funds.)

## WHO MAY SPONSOR A 403(b) PLAN?

Only certain types of organizations may sponsor a 403(b) plan. These are tax-exempt organizations, public schools, and other public educational organizations.

### **501(c)(3) Organizations**

Organizations must qualify for tax-exempt status under Code Section 501(c)(3). This Code Section encompasses non-profit and non-political religious, charitable, and other public-interest-oriented organizations. A cooperative hospital service association described in 501(e) is also eligible to sponsor a 403(b) plan.

### **Public Institutions other than Public Schools**

The eligibility of employees of public hospitals and other public institutions depends on whether the employer can qualify as a 501(c)(3) organization.



## WRITTEN PLAN REQUIREMENT

Effective in 2009, all 403(b) plans, including non-ERISA plans, are required to be maintained pursuant to a written plan. The written plan must contain the material terms and conditions regarding:

- Eligibility
- Benefits
- Applicable limitations (e.g., limits on contributions imposed by the Code)
- Contracts that are available under the plan
- Distributions (both timing and form)
- Optional features (such as allowing loan or hardship distributions)
- Administration and Compliance (coordinating and allocating compliance responsibilities)

The original regulations required only a good faith effort in meeting the written document requirement. The IRS has now created pre-approved plan documents for 403(b) programs, similar to the existing 401(k) program. All plan sponsors must amend their existing documents to a pre-approved plan document by March 31, 2020. The IRS will allow retroactive correction of any plan provisions back to 2010 as part of the current amendment cycle.

## CONTRACT REQUIREMENTS

The regulations indicate that certain 403(b) provisions must be in the contract, including:

- Participants' vested benefits must be nonforfeitable
- A 403(b) contract must be nontransferable
- Elective Deferrals must be limited to the maximum elective deferral limit
- A contract must contain the Minimum Required Distribution rules
- A contract must contain the rollover distribution rules
- A contract must limit the incidental benefits paid under the contract

## UNIVERSAL AVAILABILITY REQUIREMENT

In order to satisfy the universal availability rule, the employer is required to permit all employees (including union employees) to make salary reduction contributions to the 403(b) program unless the employees are in an excludable classification of employees (such as part-time employees who work less than 20 hours per week, non-resident aliens, students exempt from FICA taxes, and certain employees eligible to participate in another 403(b), 457, or 401(k) plan).

As before, all employer contributions (other than elective deferrals) and after-tax contributions will be subject to non-discrimination testing.

A tax-exempt employer who is a party to a collective bargaining agreement may not have the option of simply amending its 403(b) plan to include previously ineligible employees subject to such an agreement. These employers should review their 403(b) plan and applicable collective bargaining agreements to determine what changes will be necessary to comply with the new regulations, and determine whether those changes will require new collective bargaining prior to the effective date.

## TIMING OF DEPOSITS

The final 403(b) regulations impose a rule that employee deferral contributions should be transferred to the annuity or custodial account *within a reasonable time* after payroll withholding for the proper administration of the plan, but no later than 15 days following the month in which the amount would otherwise be paid to the employee.

## TERMINATION

The final regulations provide for the first time that 403(b) plans may be terminated and that the benefits can be distributed upon plan termination. Special rules may apply to plans sponsored by members of controlled groups of companies.

With the issuance of new pre-approved documents come increased governmental oversight and the need to monitor plan operation and compliance. We provide complete administrative services for 403(b) plans, including pre-approved documents, non-discrimination testing, and reporting. We would be glad to discuss your specific situation and evaluate your plan in light of these new regulations. If you need assistance with 403(b) plan compliance, please call (562) 435-1191 or contact Therese Cheevers at [tcheevers@windes.com](mailto:tcheevers@windes.com) or Richard Green at [rgreen@windes.com](mailto:rgreen@windes.com).