Electronic Dispatch

Employee Benefits Law Action Memo

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INTERNAL REVENUE SERVICE PUBLISHES FINAL REGULATIONS UNDER CODE SECTIONS 403(b) AND 414(c)

On July 23, 2007, the Internal Revenue Service issued final regulations under Internal Revenue Code ("Code") Section 403(b). The final regulations replace a number of current regulations, conforming the regulations to various statutory changes and Internal Revenue Service guidance issued over more than 40 years. The final regulations will provide consolidated guidance to tax-exempt employers that sponsor Code Section 403(b) plans or that offer employees the opportunity to contribute to tax-sheltered annuity contracts or custodial accounts.

The regulations generally are effective beginning January 1, 2009. Until then, employers may rely on the final regulations, provided that such reliance is on a consistent and reasonable basis.

The final regulations include the following:

Plan Document Requirement

Every Code Section 403(b) plan will have to be set forth in a written plan document that contains all the material provisions of the plan and that satisfies Code Section 403(b) in both form and operation. The plan need not be a single, comprehensive document, but may include a number of documents (e.g., annuity contracts or custodial account agreements) which are incorporated by reference. In the case of a plan under which multiple vendors provide investment vehicles, it is expected that an employer would adopt a single document that coordinates administration among the various vendors, rather than having a separate document for each investment vendor.

For employers that make tax-sheltered annuity products available on a voluntary basis under an arrangement that is treated as exempt from ERISA, the plan document requirement will not necessarily prevent the employer from continuing to rely on the exemption. The U.S. Department of Labor indicated in a recent Field Assistance Bulletin that the existence of a plan document designed solely to comply with the final Code Section 403(b) regulations will not, by itself, void an employer's ability to rely on the exemption. The Department of Labor will analyze each employer's involvement in a tax-sheltered annuity program, and the employer's ability to rely on the ERISA exemption, on a case by case basis.

Restrictions on 90-24 Transfers

Although the final regulations generally are effective January 1, 2009, an earlier effective date applies to restrictions on so-called 90-24 transfers. These are transfers initiated by the individual owner of a tax-sheltered annuity contract or custodial account where accumulations under a contract or account provided by one issuer are transferred to a contract or account of another issuer, all "outside" the scope of an employer-sponsored plan. The final regulations provide that 90-24 transfers that are made after September 24, 2007 will be treated as taxable distributions, unless the "receiving" contract or custodial account is part of a compliant Code Section 403(b) plan.

Non-Discrimination Requirements

The final regulations will replace the safe-harbor non-discrimination guidance provided in Internal Revenue Service Notice 89-23. A tax-sheltered annuity program that provides for employer contributions will be required to satisfy the same non-discrimination rules that generally apply to tax-qualified retirement plans, including non-discrimination rules regarding contributions. For plans that provide for employee elective deferral contributions, the plan must satisfy a so-called universal availability requirement, which generally provides that all employees must be able to make voluntary pre-tax elective deferral contributions, if any employee has the right to make such contributions in excess of $200 per year. Employers also will be obligated to provide meaningful notice of the right to make elective deferral contributions. Certain employees may

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continue to be excluded from consideration when applying the universal availability requirement, provided that all employees in an excludable category are excluded. The final regulations reduce the number of categories of employees that may be excluded for purposes of this requirement.

Plan Terminations

Until now, there was no guidance that authorized the sponsor of a Code Section 403(b) plan to terminate the plan. The final regulations provide explicit authority to terminate a Code Section 403(b) plan. Termination of a Code Section 403(b) plan would permit the distribution of amounts accumulated under the plan.

Ordering Rule For Catch-up Contributions

In Code Section 403(b) plans maintained by educational organizations, hospitals, and certain health agencies, an employee who has completed 15 years of service may be able to make catch-up contributions equal to an aggregate of $15,000 over a period of five or more years. In addition, an employee who is at least age 50 may be able to make catch-up contributions of a specified annual amount ($5,000 in 2007). The final regulations confirm that catch-up contributions by an employee who is eligible to make both types of catch-up contributions will be considered made under the 15-year catch-up rule first and then under the age-50 catch-up rule. Under this ordering rule, an eligible employee might unknowingly use up some or all of the employee's 15-year catch-up contribution maximum earlier than planned.

If you have any questions about the materials summarized in this memorandum, or about the final regulations in general, please contact Steve Daley (315-218-8237, *sdaley@bsk.com)* or any of the other members of our Employee Benefits Law Practice Group listed below.

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Controlled Group Rules

Published together with the final Code Section 403(b) regulations are final regulations under Code Section 414(c) that make official the Internal Revenue Service position on controlled group status for tax-exempt organizations. Under the final regulations, an exempt organization will be combined with another organization, and the two organizations will be considered a single employer for most employee benefit plan purposes, if at least 80 percent of the directors or trustees of one organization are either representatives of, or are directly or indirectly controlled by, the other organization. For this purpose, a trustee or director will be considered a representative of another organization, if he or she also is a trustee, director, agent, or employee of the other organization. Existence of control will be based on the facts and circumstances of each case.

Although published with the final regulations under Code Section 403(b), the controlled group regulations will have broader application than just to tax-sheltered annuity plans of exempt organizations. For example, an exempt organization that has a for-profit subsidiary may be required to take the subsidiary's employees into account when performing non-discrimination tests on the exempt organization's plans. The opposite is also true; employees of the exempt organization may have to be taken into account when performing non-discrimination tests on the subsidiary's plans. Also, because the liability for funding a defined benefit pension plan can be imposed on all controlled group members, if one member of a controlled group that includes one or more tax-exempt entities maintains an under-funded plan, the tax-exempt entities and the other members of the controlled group could now be exposed to funding liabilities for which they were not previously exposed.