

IRS Issues Guidance for 403(b) Plan Sponsors: Model Language for Public Schools and Transition Relief for Contract Exchanges and Frozen Plans

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Practice Area: Nonprofit and Tax Exemption & Compensation and Benefits/ERISA & School Law

Final Regulations: Plan Document Requirement

Last July, the Internal Revenue Service (“IRS”) released final regulations under section 403(b) of the Internal Revenue Code (“Code”) that are generally effective for tax years beginning after December 31, 2008. The final regulations make 403(b) plans more like other defined contribution retirement plans such as 401(k) or 457(b) plans.

One of the most significant provisions of the regulations is the requirement that sponsoring organizations maintain written plan documents for their 403(b) plans. Another important requirement is that 403(b) plans comply in both form and operation with the requirements of the regulations. The written plan documents must contain all of the material terms and conditions for eligibility, benefits, and applicable limitations. In addition, plans must specify the contracts available under the plan and the time and form under which benefit distributions will be made.

Model Language for Plans Sponsored by Public Schools

The IRS recognizes that many public schools do not have existing plan documents and may incur significant costs in developing a written plan to satisfy the 403(b) regulations. To address this concern, the IRS released Revenue Procedure 2007-71, which provides model plan language that public schools may use to create new plan documents or amend existing plan documents to comply with the new 403(b) regulations. Public school employers may rely on the model language as compliant with the requirements of Code section 403(b) as long as the language of the Revenue Procedure is adopted on a word-for-word basis or the employer’s plan is “substantially similar in all material respects.”

Public school employers may use the model language for a basic plan that only allows pretax elective deferrals with no Roth, employer matching, or other employer nonelective contributions. The Revenue Procedure also includes model language for optional provisions that public schools may wish to include in their written plan documents. The optional provisions include features such as in-service distributions from rollover accounts, distributions for financial hardships, loans, contract exchanges, and plan to plan transfers.

501(c)(3) Organizations

In addition to public schools, organizations that are exempt from tax under Code section 501(c)(3) may also sponsor 403(b) plans. Because the IRS model plan language has been designed for plans maintained by public schools, a 501(c)(3) organization must determine the extent to which the model language is appropriate for its 403(b) plan. Also, a 501(c)(3) organization may need to add language to its plan that is not in the IRS model.

Contract Exchanges

Participants in a 403(b) plan may exchange an annuity contract issued by one carrier for a contract issued by a different carrier pursuant to Revenue Ruling 90-24 (a "90-24 exchange"). For a 90-24 exchange occurring after September 24, 2007, the regulations require that the plan document provide for the exchange, that the sponsoring employer enter into an information-sharing agreement with the issuer of the new contract and that certain other requirements be met. Revenue Procedure 2007-71 provides that if the contract was issued after December 31, 2004 and before January 1, 2009, the 90-24 exchange occurred after September 24, 2007 and the affected employees still work for the employer, then, generally, the employer must make a reasonable, good faith effort to include the contract as part of the employer's plan that satisfies the final regulations. For this purpose, a reasonable, good faith effort includes collecting information regarding the contract issuers, and notifying the issuers of the name and contact information of the person in charge of administering the employer's 403(b) plan. Alternatively, the issuer may make a good faith effort to contact the employer and exchange the required information to satisfy these requirements. Generally, for a 90-24 exchange that occurs after September 24, 2007, if these requirements are not met, the exchange will not occur tax-free and will be treated as a distribution from the 403(b) plan. Revenue Procedure 2007-71 provides relief, however, if, prior to July 1, 2009, the contract is exchanged under another 90-24 exchange for either a contract that is receiving current contributions under the employer's 403(b) plan or a contract with a carrier that has an information sharing agreement in place with the employer and otherwise satisfies the regulations.

Frozen Plans

In some cases, an employer is not making current contributions to a 403(b) contract. For example, the employer may have "frozen" the plan by discontinuing contributions to all 403(b) contracts, or the employer may have changed carriers and frozen contributions to the prior carrier. If the frozen contract was issued after December 31, 2004 and before January 1, 2009 and the affected employees still work for the employer, then the employer must make a reasonable, good faith effort (as defined above) to include the contract as part of the employer's plan. If a frozen contract issued before January 1, 2009 only covers an employer's former employees or beneficiaries, the employer's 403(b) plan will not be treated as failing to satisfy the written plan document requirement if the plan does not include terms relating to that contract.

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