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IRS Regulations Provide for Unprecedented Change

403(b) Plans – The New 401(k);

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This past summer, the Internal Revenue Service (the "IRS") released the final regulations for 403(b) plans. These plans allow employees of 501(c)(3) non-profit organizations, public schools, and churches (as well as ministers) to defer money for retirement. These regulations are the first comprehensive amendments in over 40 years. Additionally, the issuance of the final regulations, which incorporated recent significant legislative developments, represents the last installment in the lengthy process that began in December 2004 when the IRS issued the proposed regulations.

The effective date of the final regulations is January 1, 2009. Employers now have less than a year to bring the individual documents and forms they are currently using into compliance with the final regulations.

Written Plan Document

The new regulations will impose several novel requirements and responsibilities, previously more familiar to employers sponsoring 401(k) plans, on employers with 403(b) retirement plans. One major change involves the creation of a written plan document for each 403(b) plan. The individual investment contracts that most employers currently have are not enough. This written plan document must include:

· A definition of eligible employees;

· Vesting provisions for employer contributions, if any;

· Catch-up contribution, loan, and hardship provisions;

Additional Requirements

Universal Availability. In addition to the written plan document requirement, 403(b) plans must now also provide for universal availability thus that all employees, with a few limited exceptions, must have an opportunity to elect to defer amounts into the plan.

Plan Termination. 403(b) Plans may now incorporate plan termination provisions allowing for distributions and rollovers if there is no successor plan in 12 months.

Separation from Service. A separation from service results in a distribution event for the affected employee. However, unlike the regulations governing 401(k) plans, the definition of a separation from service for 403(b) plans are more restrictive. The

IRS Regulations Provide for Unprecedented Change, Continued

employer and its plan advisors should consult the new regulations to ascertain whether a separation from service results in a distribution event.

Do the new final regulations subject 403(b) plans to ERISA?

The Employee Retirement Income Security Act of 1974 (“ERISA”) imposes fiduciary responsibility on employers offering retirement benefits. However, in the past, 403(b) plans were able to bypass ERISA’s requirements if the plan satisfies a safe harbor.

Thus, one of the most defining differences between 401(k) and 403(b) plans, previously, is that some 403(b) plans that satisfy a safe harbor under the Department of Labor are not subject to ERISA requirements. However, under Field Assistance Bulletin 2007-2, the Department of Labor indicated that a 403(b) plan that complies with the new final regulations might still be able to utilize the safe harbor provisions.

Although each plan should determine whether its particular plan satisfies the safe harbor, here is a quick method to determine if your plan meets the safe harbor provisions If the employer contributes to the plan then the plan is subject to ERISA requirements.

Intent and Implication of the Final Regulations

The final regulations bring 403(b) plans into the same framework as 401(k) plans. The requirements increase the responsibility and oversight for 403(b) employers (who will now bear almost the same responsibilities and administrative tasks already borne by their 401(k) sponsoring kin.

The new regulations aim to enhance 403(b) plan compliance while establishing a more structured retirement program for employees in the tax-exempt sector. In addition, the regulations allocate increased responsibility and a more active role on the part of the employer – a stark difference from the past.

This exemplifies a fundamental shift away from a system governed by employee responsibility to one of employer oversight and guidance through the plan document. The failure to abide by the new regulations may result in operational failures and serious adverse tax consequences.

Conclusion

While the January 1, 2009 time limit may appear to allow a good deal of time for compliance, in actuality the deadline is quickly approaching and plan sponsors must act expeditiously to ensure that their plan documents are both in place and in conformity with the regulations by the deadline.

Questions About the New 403(b) Regulations or Their Impact on Your Plan? Or, Considering Switching to a 401(k) Plan?

Contact the Chamberlain Hrdlicka Employee Benefits Group. You may reach us toll-free at 1.800.342.5829, or call Jerome Harris at 713.654.9651; and Stephen Mason at 713.654.9646.