Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document promulgates final regulations under section 403(b) of the Internal Revenue Code and under related provisions of sections 402(b), 402(g), 402A, and 414(c). The regulations provide updated guidance on section 403(b) contracts of public schools and tax-exempt organizations described in section 501(c)(3). These regulations will affect sponsors of section 403(b) contracts, administrators, participants, and beneficiaries.

DATES: Effective Date: [INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

Applicability Date: These regulations generally apply for taxable years beginning after December 31, 2008. However, see the “Applicability date” section in this preamble for additional information regarding the applicability of these regulations.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, John Tolleris, (202) 622-6060; concerning the regulations as applied to church-related entities, Robert Architect (202) 283-9634 (not toll-free numbers).
SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in § 1.403(b)-10(b)(2)(i)(C) of these final regulations has been approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2068. Responses to this collection of information are required in order to provide certain benefits.

The estimated burden per respondent varies among the plan administrator/payor/recordkeeper, depending upon individual respondents' circumstances, with an estimated average of 4.1 hours. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

The collection of information in §1.403(b)-10(b)(2)(i)(C) of these final regulations was not contained in the prior notice of proposed rulemaking. For this reason, this additional collection of information has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2068. Comments concerning this additional collection of information should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the Office of
Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503. Comments on the collection of information should be received by [INSERT DATE THAT IS 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see above);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The estimated burden per respondent varies among the plan administrator/payor/recordkeeper, depending upon individual respondents' circumstances, with an estimated average of 4.1 hours.
Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 USC 6103.

Background

Regulations (TD 6783) under section 403(b) of the Internal Revenue Code (Code) were originally published in the Federal Register (29 FR 18356) on December 24, 1964 (1965-1 CB 180). Those regulations provided guidance for complying with section 403(b), which had been enacted in 1958 in section 23(a) of the Technical Amendments Act of 1958, Public Law 85-866 (1958), relating to tax-sheltered annuity arrangements established for employees by public schools and tax-exempt organizations described in section 501(c)(3). Since 1964, additional regulations were issued under section 403(b) to reflect rules relating to certain eligible rollover distributions' and required minimum distributions under section 401(a)(9). See §601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin.

On November 16, 2004, a notice of proposed rulemaking (REG-155608-02) was published in the Federal Register (69 FR 67075) that proposed a comprehensive update of the regulations under section 403(b) (2004 proposed regulations), including: amending the 1964 and subsequent regulations to conform them to the numerous amendments made to section 403(b) by subsequent legislation, including section 1022(e) of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat.

1 See TD 8619, September 22, 1995 (60 FR 49199).
2 See TD 8987, April 17, 2002 (67 FR 18987).

Following publication of the 2004 proposed regulations, comments were received and a public hearing was held on February 15, 2005. After consideration of the comments received, the 2004 proposed regulations are adopted by this Treasury decision, subject to a number of changes, some of which are summarized below in this preamble.

Section 403(b) was also amended by sections 811, 821, 822, 824, 826, and 829 of the Pension Protection Act of 2006 (PPA '06) (120 Stat. 780), Public Law 109-280. These final regulations reflect these amendments.

Sections 403(b) and 414(c) Statutory Provisions

Section 403(b) provides an exclusion from gross income for certain contributions made by specific types of employers for their employees and by certain ministers to specified types of funding arrangements. The employers are limited to public schools and section 501(c)(3) organizations. There are three categories of funding arrangements to which section 403(b) applies: (1) annuity contracts (as defined in section 401(g)) issued by an insurance company; (2) custodial accounts that are
invested solely in mutual funds; and (3) retirement income accounts, which are only permitted for church employees and certain ministers. Except as otherwise indicated, an annuity contract, for purposes of these final regulations, includes a custodial account that is invested solely in mutual funds.

The exclusion applies to employer nonelective contributions (including matching contributions) and elective deferrals (other than designated Roth contributions) within the meaning of section 402(g)(3)(C) (which applies to section 403(b) contributions made pursuant to a salary reduction agreement). The exclusion applies only if certain requirements relating to availability, nondiscrimination, and distribution are satisfied. Section 403(b) arrangements may also include after-tax employee contributions.

Section 403(b)(1)(C) requires that the contract be nonforfeitable (except for the failure to pay future premiums), regardless of the type of contribution used to purchase the contract. Section 403(b)(1)(E) requires a section 403(b) contract purchased under a salary reduction agreement to satisfy the requirements of section 401(a)(30) relating to limitations on elective deferrals under section 402(g)(1). In addition, all contributions to a section 403(b) arrangement, when expressed as annual additions under section 415(c)(2), must not exceed the applicable limit of section 415.

Section 403(b)(5) provides that all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract for purposes of the requirements of section 403(b). Other aggregation rules apply both on an individual and aggregate basis. For example, the section 402(g) limitations on elective deferrals apply to all elective deferrals during the year with respect to an individual and the limitations of section 401(a)(30) apply to all elective deferrals made by an employer
to that employer's plans with respect to an individual during the year. The contribution limitations of section 415 generally apply on an employer-by-employer basis.

Section 403(b)(12) requires a section 403(b) contract that provides for elective deferrals to make elective deferrals available to all employees (the universal availability rule) and requires other contributions to satisfy the general nondiscrimination requirements applicable to qualified plans. These rules are discussed further in this preamble under the heading "Section 403(b) Nondiscrimination and Universal Availability Rules."

A section 403(b) contract is also required to provide that it will satisfy the required minimum distribution requirements of section 401(a)(9), the incidental benefit requirements of section 401(a), and the rollover distribution rules of section 402(c).

Many section 403(b) arrangements of employers that are section 501(c)(3) organizations are subject to the Employee Retirement Income Security Act of 1974 (ERISA), which includes rules substantially identical to the rules for qualified plans, including rules parallel to the section 414(l) transfer rules, the section 401(a)(11) qualified joint and survivor annuity (QJSA) transferee plan rules, and the anti-cutback rules of section 411(d)(6) (which apply to transfers). See sections 204(g), 205, and 208 of ERISA. However, as discussed in this preamble under the heading "Interaction Between Title I of ERISA and Section 403(b) of the Code," Title I of ERISA does not apply to governmental plans, certain church plans, or a tax-exempt employer's section 403(b) program that is not considered to constitute the establishment or maintenance of an "employee pension benefit plan" under Title I of ERISA.
Section 414(c) authorizes the Secretary of the Treasury to issue regulations treating all employees of trades or businesses which are under common control as employed by a single employer.

Explanation of Provisions

Overview

Like the 2004 proposed regulations, these final regulations are a comprehensive update of the current regulations under section 403(b). These regulations replace the existing final regulations that were adopted in 1964 and reflect the numerous legal changes that have been made in section 403(b) since then and many of the positions that have been taken in interpretive guidance that has been issued under section 403(b).

As was noted in the preamble to the 2004 proposed regulations, the effect of the various amendments made to section 403(b) within the past 40 years has been to diminish the extent to which the rules governing section 403(b) plans differ from the rules governing other tax-favored employer-based retirement plans, including arrangements that include salary reduction contributions, such as section 401(k) plans and section 457(b) plans for state and local governmental entities. However, there remain significant differences between section 403(b) plans and section 401(a) and governmental section 457(b) plans. For example, section 403(b) is limited to certain specific employers and employees (namely, employees of a public school, employees of a section 501(c)(3) organization, and certain ministers) and to certain funding arrangements (namely, an insurance annuity contract, a custodial account that is limited to mutual fund shares, or a church retirement income account). Also, section 403(b)
contains the universal availability requirement for section 403(b) elective deferrals and
provides consequences for failing to satisfy certain of the section 403(b) rules
(described in this preamble under the heading “Effect of a Failure to Satisfy Section
403(b)”\(^3\) that differ in significant respects from the consequences applicable to qualified
plans.

The final regulations, as did the 2004 proposed regulations, require the section
403(b) contract to satisfy both in form and operation the applicable requirements for
exclusion. The final regulations also require that the contract be maintained pursuant to
a written plan as described in the next section.

The final regulations, like the proposed regulations, provide rules under which
tax-exempt entities are aggregated and treated as a single employer under section
414(c). These rules apply to plans referenced in section 414(b), (c), (m), (o), and (t),
such as plans qualified under section 401(a) or 403(a), as well as section 403(b) plans.

Comments on the 2004 proposed regulations raised a number of questions and
concerns about:

- The requirement in the 2004 proposed regulations under which a section
  403(b) contract would be required to be maintained pursuant to a written
  plan;
- The elimination of certain non-statutory exclusions that a section 403(b)
  plan was permitted to have under Notice 89-23 (1989-1 CB 654) for

\(^3\) Other differences between the rules applicable to section 403(b) plans and qualified plans include the following:
the definition of compensation (including the five-year rule) in section 403(b)(3); the special section 403(b) catch-up
elective deferral in section 402(g)(7); and the section 415 aggregation rules. An additional difference relates to
when a severance from employment occurs for purposes of section 403(b) plans maintained by State and local
government employers. See §1.403(b)-6(h) of these regulations.
purposes of the universal availability rule;

- The elimination of Rev. Rul. 90-24 (1990-1 CB 97), which allowed a section 403(b) contract to be exchanged for another contract; and
- The controlled group rules under section 414(c) for entities that are tax-exempt under section 501(a).

These final regulations include a number of revisions to reflect the comments received, as described further in this preamble.

**Written Plan Requirement**

These regulations retain the requirement from the 2004 proposed regulations that a section 403(b) contract be issued pursuant to a written plan which, in both form and operation, satisfies the requirements of section 403(b) and these regulations. This requirement implements the statutory requirements of section 403(b)(1)(D), which provides that the contract must be purchased “under a plan” that satisfies the nondiscrimination requirements delineated in section 403(b)(12).

The existence of a written plan facilitates the allocation of plan responsibilities among the employer, the issuer of the contract, and any other parties involved in implementing the plan. Without such a central document for a comprehensive summary of responsibilities, there is a risk that many of the important responsibilities required under the statute and final regulations may not be allocated to any party. While a section 403(b) contract issued to an employee can provide for the issuer to perform many of these functions by itself, the contract cannot satisfy the function of setting forth the eligibility criteria for other employees, nor can the issuer by itself coordinate those Code requirements that depend on other contracts, such as the loan limitations under
section 72(p). The issuer must rely on information or representations provided by either the employer or the employee for employment-based information that is essential for compliance with section 403(b) provisions, such as the limitations on elective deferrals in section 402(g) and the requirements of section 72(p)(2) for a plan loan that is not a taxable deemed distribution. In addition to providing a central locus to coordinate those functions, the maintenance of a written plan also benefits participants by providing a central document setting forth their rights and enables government agencies to determine whether the arrangements satisfy applicable law and, in particular, for determining which employees are eligible to participate in the plan.

The 2004 proposed regulations would have required that the section 403(b) plan include all of the material provisions regarding eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made. The proposed regulations would not have required that there be a single plan document. However, under the proposed regulations, the written plan requirement would be satisfied by complying with the plan document rules applicable to qualified plans.

Some comments raised concerns that the written plan requirement would impose additional administrative burdens. In response, the final regulations make a number of clarifications, including that the plan is permitted to allocate to the employer or another person the responsibility for performing functions to administer the plan, including functions to comply with section 403(b). Any such allocation must identify who is responsible for compliance with the requirements of the Code that apply based on the aggregated contracts issued to a participant, including loans under section 72(p) and
the requirements for obtaining a hardship withdrawal under §1.403(b)-6 of these regulations.

Additional comments recommended that certain responsibilities be permitted to be allocated to employees. The IRS and Treasury Department have concluded that it is generally inappropriate to allocate these responsibilities to employees for a number of reasons. First, employees often lack the expertise to systematically meet these responsibilities and may not recognize the importance of performing these actions (including not fully appreciating the tax consequences of failing to perform the responsibility). Second, an individual employee may have a self-interest in a particular transaction. In addition, while there are various factors that will often cause an employer or issuer to have an interest in procedures that ensure that the requirements of section 403(b) are satisfied (including income tax withholding requirements), an employee generally bears the income tax exposure and other risks of failing to comply with rules set forth in the plan. The IRS and Treasury Department believe it is important to prevent failures in advance so as to minimize the cases in which the adverse effects of a failure fall on the employee. See the discussion in this preamble under the heading "Contract Exchanges."

In response to comments, the final regulations clarify the requirement that the plan include all of the material provisions by permitting the plan to incorporate by reference other documents, including the insurance policy or custodial account, which as a result of such reference would become part of the plan. As a result, a plan may include a wide variety of documents, but it is important for the employer that adopts the plan to ensure that there is no conflict with other documents that are incorporated by
reference. If a plan does incorporate other documents by reference, then, in the event of a conflict with another document, except in rare and unusual cases, the plan would govern. In the case of a plan that is funded through multiple issuers, it is expected that an employer would adopt a single plan document to coordinate administration among the issuers, rather than having a separate document for each issuer.

Finally, comments also indicated that, while section 403(b) contracts that are subject to ERISA are maintained pursuant to written plans, there may be a potential cost associated with satisfying the written plan requirement for those employers that do not have existing plan documents, such as public schools. To address this concern, the IRS and Treasury Department expect to publish guidance which includes model plan provisions that may be used by public school employers for this purpose. Because the requirement for a written plan will not go into effect until 2009 (see the discussion under the heading "Applicability date"), employers would be expected to adopt a written plan (including applicable amendments) no later than the applicability date of these regulations.

**Contract Exchanges, Plan-to-Plan Transfers, and Purchases of Permissive Service**

**Credit**

The final regulations, like the 2004 proposed regulations, provide for three specific kinds of non-taxable exchanges or transfers of amounts in section 403(b) contracts. Specifically, under the final regulations, a non-taxable exchange or transfer is permitted for a section 403(b) contract if either: (1) it is a mere change of investment within the same plan (contract exchange); (2) it constitutes a plan-to-plan transfer, so that there is another employer plan receiving the exchange; or (3) it is a transfer to
purchase permissive service credit (or a repayment to a defined benefit governmental plan). If an exchange or transfer does not constitute a change of investment within the plan, a plan-to-plan transfer, or a purchase of permissive service credit, the exchange or transfer would be treated as a taxable distribution of benefits in the form of property if the exchange occurs after a distributable event (assuming the distribution is not rolled over to an eligible retirement plan) or as a taxable conversion to a section 403(c) nonqualified annuity contract if a distributable event has not occurred. See the “Effect of a Failure to Satisfy Section 403(b)” section in this preamble for discussion of section 403(c) nonqualified annuity contracts. In any case in which a distributable event has occurred, a participant in a section 403(b) plan can always change the investment through a distribution and non-taxable rollover from a section 403(b) contract to an IRA annuity, as long as the distribution is an eligible rollover distribution. Note, however, that an IRA annuity cannot include provisions permitting participant loans. See section 408(e)(3) and (4) and §§1.408-1(c)(5) and 1.408-3(c).

Any contract exchange, plan-to-plan transfer, or purchase of permissive service credit that is permitted under the final regulations is not treated as a distribution for purposes of the section 403(b) distribution restrictions (so that such an exchange or transfer may be made before severance from employment or another distribution event).

Contract Exchanges

Rev. Rul. 73-124 (1973-1 CB 200) and Rev. Rul. 90-24 (1990-1 CB 97) dealt with contract exchanges. Rev. Rul. 73-124 had allowed section 403(b) contracts to be exchanged, without income inclusion, if, pursuant to an agreement with the employer,
the employee cashed in the first contract and immediately transmitted the cash proceeds for contribution to the successor contract to which all subsequent employer contributions would be made. This ruling was replaced by Rev. Rul. 90-24 which does not provide for the first contract to be cashed in but allows section 403(b) contracts to be exchanged, without income inclusion, so long as the successor contract includes distribution restrictions that are the same or more stringent than the distribution restrictions in the contract that is being exchanged.

The 2004 proposed regulations would have imposed additional restrictions on contract exchanges by limiting tax-free contract exchanges to situations in which the new contract is provided under the plan. The proposal was intended to improve compliance with the Code requirements that apply on an aggregated basis because, without coordination, it is difficult, if not impossible, for a plan to comply with those tax requirements. These requirements include certain distribution restrictions, including the rule that requires the suspension of deferrals for a plan that uses the hardship withdrawal suspension safe harbor rules for elective deferrals, and the section 72(p) rules for loans. In addition, these changes make it easier for employers to respond to an IRS inquiry or audit. For example, where assets have been transferred to an insurance carrier or mutual fund that has no subsequent connection to the plan or the employer, IRS audits and related investigations have revealed that employers encounter substantial difficulty in demonstrating compliance with hardship withdrawal and loan rules. These problems are particularly acute when an individual’s benefits are held by numerous carriers. Such multiple contract issuers are commonly associated with plans in which Rev. Rul. 90-24 exchanges have occurred.
Commentators generally objected to the proposal to limit exchanges allowed under Rev. Rul. 90-24. They argued that such exchanges enable participants to change funding arrangements and claimed that these exchanges have generally been responsible for improved efficiency and lower cost in the section 403(b) market. Comments often included specific suggestions, such as limiting any restrictions on exchanges to active employees and effectuating compliance with loan restrictions by alternative methods, such as having the issuer report loans on, for example, a Form 1099–R (Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA, Insurance Contracts), or notify the employer about loans. Other comments included a recommendation that the employer be involved to ensure that the exchange is within the plan. Comments also suggested that a grandfather may be necessary for exchanges made before the applicability date of the restrictions imposed by the final regulations.

These final regulations include a number of changes to reflect these comments. The regulations allow contract exchanges with certain characteristics associated with Rev. Rul. 90-24, but under rules that are generally similar to those applicable to qualified plans.

Unlike the 2004 proposed regulations, these regulations permit an exchange of one contract for another to constitute a mere change of investment within the same plan, but only if certain conditions are satisfied in order to facilitate compliance with tax requirements. Specifically, the other contract must include distribution restrictions that are not less stringent than those imposed on the contract being exchanged and the employer must enter into an agreement with the issuer of the other contract under which
the employer and the issuer will from time to time in the future provide each other with
certain information. This includes information concerning the participant's employment
and information that takes into account other section 403(b) contracts or qualified
employer plans, such as whether a severance from employment has occurred for
purposes of the distribution restrictions and whether the hardship withdrawal rules in the
regulations are satisfied. Additional information that is required is information necessary
for the resulting contract or any other contract to which contributions have been made
by the employer to satisfy other tax requirements, such as whether a plan loan
constitutes a deemed distribution under section 72(p).

These regulations also authorize the IRS to issue guidance of general
applicability allowing exchanges in other cases. This authority is limited to cases in
which the resulting contract has procedures that the IRS determines are reasonably
designed to ensure compliance with those requirements of section 403(b) or other tax
provisions that depend on either information concerning the participant's employment or
information that takes into account other section 403(b) contracts or qualified employer
plans. For example, the procedures must be reasonably designed to determine
whether a severance from employment has occurred for purposes of the distribution
restrictions, whether the hardship withdrawal rules are satisfied, and whether a plan
loan constitutes a deemed distribution under section 72(p). By contrast, procedures
that rely on an employee certification, such as whether a severance from employment
has occurred or whether the participant has other outstanding loans, would generally
not be adequate to meet this standard, because such a certification is not disinterested,
and also because of the lack of employer oversight in the certification process to ensure
accuracy.

Plan-to-Plan Transfers

The final regulations expand the rules in the 2004 proposed regulations under which plan-to-plan transfers would have been permitted only if the participant was an employee of the employer maintaining the receiving plan. Under the final regulations, plan-to-plan transfers are permitted if the participant whose assets are being transferred is an employee or former employee of the employer (or business of the employer) that maintains the receiving plan and certain additional requirements are met. However, the final regulations retain the rules that were in the 2004 proposed regulations prohibiting a plan-to-plan transfer to a qualified plan, an eligible plan under section 457(b), or any other type of plan that is not a section 403(b) plan, except as described in the next paragraph. Similarly, a section 403(b) plan is not permitted to accept a transfer from a qualified plan, an eligible plan under section 457(b), or any other type of plan that is not a section 403(b) plan.

Purchases of Permissive Service Credit and Certain Repayments

The final regulations, like the 2004 proposed regulations, include an exception permitting a section 403(b) plan to provide for the transfer of its assets to a qualified plan under section 401(a) to purchase permissive service credit under a defined benefit governmental plan or to make a repayment to a defined benefit governmental plan.

Limitations on Contributions

The final regulations, like the 2004 proposed regulations, provide that the section 403(b) exclusion applies only to the extent that all amounts contributed by the employer for the purchase of an annuity contract for the participant do not exceed the applicable
limits under section 415. The final regulations retain the rule in the 2004 proposed regulations that if an excess annual addition is made to a contract that otherwise satisfies the requirements of section 403(b), then the portion of the contract that includes the excess will fail to be a section 403(b) contract (and instead will be a contract to which section 403(c), relating to nonqualified annuity contracts, applies) and the remaining portion of the contract that includes the contribution that is not in excess of the section 415 limitations is a section 403(b) contract. This rule under which only the excess annual addition is subject to section 403(c) does not apply unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for the portion that includes the excess and for the section 403(b) portion (which is the portion that includes the amount that is not in excess of the section 415 limitations).

With respect to section 403(b) elective deferrals, section 403(b) applies only if the contract is purchased under a plan that includes the elective deferral limits under section 402(g), including aggregation of all plans, contracts, or arrangements of the employer that are subject to the limits of section 402(g). As in the 2004 proposed regulations, the final regulations require a section 403(b) contract to include this limit on section 403(b) elective deferrals, as imposed under sections 401(a)(30) and 402(g). For purposes of the final regulations, the term “elective deferral” includes a designated Roth contribution as well as a pre-tax elective contribution. These rules are generally the same as the rules for qualified cash or deferred arrangements (CODAs) under section 401(k).
Any contribution made for a participant to a section 403(b) contract for a taxable year that exceeds either the section 415 maximum annual contribution limits or the section 402(g) elective deferral limit constitutes an excess contribution that is included in gross income for that taxable year (or, if later, the taxable year in which the contract becomes nonforfeitable). The final regulations, like the 2004 proposed regulations, provide that the section 403(b) plan (including contracts under the plan) may provide that any excess deferral as a result of a failure to comply with the section 402(g) elective deferral limit for the taxable year with respect to any section 403(b) elective deferral made for a participant by the employer will be distributed to the participant, with allocable net income, no later than April 15 or otherwise in accordance with section 402(g).

**Catch-up Contributions**

A section 403(b) plan may provide for additional catch-up contributions for a participant who is age 50 by the end of the year, provided that those age 50 catch-up contributions do not exceed the catch-up limit under section 414(v) for the taxable year ($5,000 for 2007). In addition, a section 403(b) plan may provide that an employee of a qualified organization who has at least 15 years of service (disregarding any period during which an individual is not an employee of the eligible employer) is entitled to a special section 403(b) catch-up limit. Under the special section 403(b) catch-up limit, the section 402(g) limit is increased by the lowest of the following three amounts: (i) $3,000; (ii) the excess of $15,000 over the amount not included in gross income for prior taxable years by reason of the special section 403(b) catch-up rules, plus elective
deferrals that are designated Roth contributions; or (iii) the excess of (A) $5,000 multiplied by the number of years of service of the employee with the qualified organization, over (B) the total elective deferrals made for the employee by the qualified organization for prior taxable years. For this purpose, a qualified organization is an eligible employer that is a school, hospital, health and welfare service agency (including a home health service agency), or a church-related organization.

The 2004 proposed regulations defined a health and welfare service agency as either an organization whose primary activity is to provide medical care as defined in section 213(d)(1) (such as a hospice), or a section 501(c)(3) organization whose primary activity is the prevention of cruelty to individuals or animals or which provides substantial personal services to the needy as part of its primary activity (such as a section 501(c)(3) organization that provides meals to needy individuals). In response to several commentators' requests, the final regulations expand this definition to include an adoption agency and an agency that provides either home health services or assistance to individuals with substance abuse problems or that provides help to the disabled.

Like the 2004 proposed regulations, the final regulations provide that any catch-up contribution for an employee who is eligible for both an age 50 catch-up and the special section 403(b) catch-up is treated first as a special section 403(b) catch-up to the extent a special section 403(b) catch-up is permitted, and then as an amount.

* A technical correction was made to section 402(g)(7)(A)(ii) by section 407(a) the Gulf Opportunity Zone Act of 2005 (119 Stat. 2577), P.L. 109-135, to clarify that the aggregate $15,000 limit on such contributions was reduced not only by pre-tax elective deferrals made pursuant to the special section 403(b) catch-up rules, but also by designated Roth contributions. Treasury has recommended that this language be further changed to reflect the intent that the reduction for designated Roth contributions at section 402(g)(7)(A)(ii)(II) be limited to designated Roth contributions that have been made pursuant to the special section 403(b) catch-up rules.
contributed as an age 50 catch-up (to the extent the age 50 catch-up amount exceeds the maximum special section 403(b) catch-up).

Timing of Distributions and Benefits

The final regulations, like the 2004 proposed regulations, contain provisions reflecting the statutory rules regarding when distributions can be made from a section 403(b) plan. Distributions of amounts attributable to section 403(b) elective deferrals may not be paid to a participant earlier than when the participant has a severance from employment, has a hardship, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½. Hardship is generally defined under regulations issued under section 401(k). In addition, amounts held in a custodial account attributable to employer contributions (that are not section 403(b) elective deferrals) may not be paid to a participant before the participant has a severance from employment, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½. This rule also applies to amounts transferred out of a custodial account to an annuity contract or retirement income account, including earnings thereon.

The final regulations, as did the 2004 proposed regulations, include a number of exceptions to the timing restrictions. For example, the rule for elective deferrals does not apply to distributions of section 403(b) elective deferrals (not including earnings thereon) that were contributed before January 1, 1989.

The final regulations, as did the 2004 proposed regulations, reflect the direct rollover rules of section 401(a)(31) and the related requirements of section 402(f) concerning the written explanation requirement for distributions that qualify as eligible rollover distributions, including conforming the timing rule to the rule for qualified plans.
In addition to the restrictions described in this preamble, the final regulations generally retain, with certain modifications, the additional rules from the 2004 proposed regulations relating to when distributions are permitted to be made from a section 403(b) plan, including the restrictions described in this preamble imposed by section 403(b)(7)(A)(ii) and (11) on distribution of amounts held in custodial accounts and elective deferrals, and the tax treatment of distributions from section 403(b) plans. Comments raised no objections to the various rules that were proposed in 2004, other than concerning the general rule requiring the occurrence of a stated event. The 2004 proposed regulations generally would have required the occurrence of a stated event in order to commence distributions of amounts attributable to employer contributions to section 403(b) plans other than elective deferrals or distributions from custodial accounts. The stated event rule is substantially the same as the rule applicable to qualified defined contribution plans that are not money purchase pension plans (under §1.401-1(b)(1)(ii)), so that a plan is permitted to provide for a distribution upon completion of a fixed number of years (such as five years of participation), the attainment of a stated age, or upon the occurrence of some other identified event (such as the occurrence of a financial need, including a need to buy a home).

However, the final regulations make a number of changes relating to distributions. First, the final regulations clarify that after-tax employee contributions are not subject to any in-service distribution restrictions. Second, the regulations address comments that were made regarding certain disability arrangements by clarifying that, if an insurance contract includes provisions under which contributions will be continued in

5 See, for example, Rev. Rul. 56-693 (1956-2 CB 282).
the event a participant becomes disabled, then that benefit is treated as an incidental benefit that must satisfy the incidental benefit requirement applicable to qualified plans (at §1.401-1(b)(1)(ii)). Third, changes were made to reflect elective deferrals that are designated Roth contributions, discussed further later in this preamble under the heading, “Requirement of Certain Separate Accounts Under Section 403(b).” Fourth, §1.403(b)-7(b)(5) has been added referencing the automatic rollover rules of section 401(a)(31), in accordance with section 403(b)(10). See Notice 2005-5, 2005-1 CB 337, for rules interpreting this requirement. Fifth, a cross-reference to certain employment tax rules was added, discussed under the heading “Employment Taxes.” Sixth, in response to comments, the final regulations provide that the general rule requiring the occurrence of a stated event in order for distributions to commence does not apply to insurance contracts issued before January 1, 2009, and a special rule has been added allowing conforming amendments to be adopted by plans that are subject to ERISA. Section 1.403(b)-10(c) has been clarified to indicate that in order to be treated as a distribution under this section, the distribution must be pursuant to a QDRO as described in section 206(d)(3) of ERISA and the Department of Labor’s guidance.

Severance From Employment

The final regulations, like the 2004 proposed regulations, define severance from employment in a manner that is generally the same as the regulations under section 401(k) (see §1.401(k)-1(d)(2)), but provide that, for purposes of distributions from a section 403(b) plan, a severance from employment occurs on any date on which the employee ceases to be employed by an eligible employer that maintains the section 403(b) plan. Thus, a severance from employment would occur when an employee
ceases to be employed by an eligible employer, even though the employee may continue to be employed by an entity that is part of the same controlled group but that is not an eligible employer, or on any date on which the employee works in a capacity that is not employment with an eligible employer. Examples of the situations that constitute a severance from employment include: an employee transferring from a section 501(c)(3) organization to a for-profit subsidiary of the section 501(c)(3) organization; an employee ceasing to work for a public school, but continuing to be employed by the same State; and an individual employed as a minister for an entity that is neither a State nor a section 501(c)(3) organization ceasing to perform services as a minister, but continuing to be employed by the same entity.

Section 401(a)(9)

The final regulations, like the 2004 proposed regulations, require section 403(b) plans to comply with rules similar to those in the existing regulations relating to the required minimum distribution requirements of section 401(a)(9), but with some minor changes (for example, omitting the special rules for 5-percent owners). Thus, section 403(b) contracts must satisfy the incidental benefit rules. Guidance concerning the application of the incidental benefit requirements to permissible nonretirement benefits such as life, accident, or health benefits is contained in revenue rulings.6

Loans

The final regulations adopt the provisions in the 2004 proposed regulations relating to loans to participants from a section 403(b) contract.

QDROs

6 See, for example, Rev. Rul. 61-121 (1961-2 CB 65); Rev. Rul. 68-304 (1968-1 CB 179); Rev. Rul. 72-240 (1972-1 CB 108); Rev. Rul. 72-241 (1972-1 CB 108); Rev. Rul. 73-239 (1973-1 CB 201); and Rev. Rul. 74-115 (1974-1 CB 100).
The final regulations also adopt the 2004 proposed regulations’ limited rules relating to QDROs under section 414(p). Section 414(p)(9) provides that the QDRO rules only apply to plans that are subject to the anti-alienation provisions of section 401(a)(13), except that section 414(p)(9) also provides that the section 414(p) QDRO rules apply to a section 403(b) contract. The final regulations, like the proposed regulations, clarify that the QDRO rules under section 414(p) apply to section 403(b) plans. The Secretary of Labor has authority to interpret the QDRO provisions, section 206(d)(3), and its parallel provision at section 414(p) of the Code, and to issue QDRO regulations in consultation with the Secretary of the Treasury. 29 USC 1056(d)(3)(N).

Under section 401(n) of the Internal Revenue Code, the Secretary of the Treasury has authority to issue rules and regulations necessary to coordinate the requirements of section 414(p) (and the regulations issued by the Secretary of Labor thereunder) with the other provisions of Chapter I of Subtitle A of the Code.

**Taxation of Distributions and Benefits From a Section 403(b) Contract**

The final regulations, like the 2004 proposed regulations, reflect the statutory provisions regarding the taxation of distributions and benefits from section 403(b) contracts, including the provision that generally only amounts actually distributed from a section 403(b) contract are includible in the gross income of the recipient under section 72 for the year in which distributed. The final regulations also reflect the rule that any payment that constitutes an eligible rollover distribution is not taxed in the year distributed to the extent the payment is rolled over to an eligible retirement plan. The payor must withhold 20 percent Federal income tax, however, if an eligible rollover distribution is not rolled over in a direct rollover. Another provision requires the payor to
give proper written notice to the section 403(b) participant or beneficiary concerning the eligible rollover distribution provision.

Section 403(b) Nondiscrimination and Universal Availability Rules

Nondiscrimination

Section 403(b)(12)(A)(i) requires that employer contributions, other than elective deferrals, and after-tax employee contributions made under a section 403(b) contract satisfy a specified series of requirements (the nondiscrimination requirements) in the same manner as a qualified plan under section 401(a). These nondiscrimination requirements include rules relating to nondiscrimination in contributions, benefits, and coverage (sections 401(a)(4) and 410(b)), a limitation on the amount of compensation that can be taken into account (section 401(a)(17)), and the average contribution percentage rules of section 401(m) (relating to matching and after-tax employee contributions).

Notice 89-23 discusses these requirements and provides a good faith reasonable standard for satisfying these requirements. The 2004 proposed regulations would have eliminated the good faith reasonable standard for satisfying the nondiscrimination requirements of section 403(b)(12)(A)(i) for non-governmental plans. Comments acknowledged the need for and the IRS's authority to make this change. Accordingly, these final regulations do not include the Notice 89-23 good faith reasonable standard.

However, as discussed in this preamble under the heading “Treatment of Controlled Groups that Include Certain Entities,” the Notice 89-23 good faith reasonable standard will continue to apply to State and local public schools (and certain church entities) for determining the controlled group. Although the general nondiscrimination
requirements do not apply to governmental plans (within the meaning of section 414(d)), these plans are required to limit the amount of compensation to the amount permitted under section 401(a)(17) for all purposes under the plan, including, for example the amount of compensation taken into account for employer contributions, and are required to satisfy the universal availability rule (described in this preamble under the heading "Universal Availability for Elective Deferrals"). A non-governmental section 403(b) plan that provides for nonelective employer contributions must satisfy the coverage requirements of section 410(b) and the nondiscrimination requirements of section 401(a)(4) with respect to such contributions.

These final regulations, like the 2004 proposed regulations, require a section 403(b) plan to comply with the nondiscrimination requirements for matching contributions in the same manner as a qualified plan. Thus, a non-governmental section 403(b) plan that provides for matching contribution must satisfy the nondiscrimination requirements of section 401(m). The nondiscrimination requirements are generally tested using compensation as defined in section 414(s) and are applied on an aggregated basis taking into account all plans of the employer. See the discussion under the heading "Treatment of Controlled Groups that Include Certain Entities."

The nondiscrimination requirements do not apply to section 403(b) elective deferrals. Instead, a universal availability requirement, discussed further in the next section, applies to all section 403(b) elective deferrals (including elective deferrals made under a governmental section 403(b) plan).

Universal Availability for Elective Deferrals

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The universal availability requirement of section 403(b)(12)(A)(ii) provides that all employees of the eligible employer must be permitted to elect to have section 403(b) elective deferrals contributed on their behalf if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals. Under the 2004 proposed regulations, the universal availability requirement would not have been satisfied unless the contributions were made pursuant to a section 403(b) plan and the plan permitted all employees of an employer an opportunity to make elective deferrals if any employee of that employer has the right to make elective deferrals.

The rules in the final regulations relating to the universal availability requirement are substantially similar to those in the 2004 proposed regulations. The final regulations clarify that the employee's right to make elective deferrals also includes the right to designate section 403(b) elective deferrals as designated Roth contributions (if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals as designated Roth contributions).

The preamble to the 2004 proposed regulations requested comments regarding certain exclusions that have been permitted under transitional guidance issued in 1989. Specifically, Notice 89-23 had allowed, pending issuance of regulatory guidance, the exclusion of the following classes of employees for purposes of the universal availability rule: employees who are covered by a collective bargaining agreement; employees who make a one-time election to participate in a governmental plan described in section 414(d), instead of a section 403(b) plan; professors who are providing services on a temporary basis to another public school for up to one year and for whom section 403(b) contributions are being made at a rate no greater than the rate each such
professor would receive under the section 403(b) plan of the original public school; and employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement.

The comments submitted in response to the request generally requested to have these exclusions continue to be allowed. However, after consideration of the comments received, the IRS and Treasury Department have concluded that these exclusions are inconsistent with the statute and, accordingly, they are not permitted under these regulations. Nonetheless, as described further in the following paragraphs, other rules may provide relief with respect to individuals who are under a vow of poverty and to certain university professors affected.

Rev. Rul. 68-123 (1968-1 CB 35), as clarified by Rev. Rul. 83-127 (1983-2 CB 25), generally excludes from gross income, and from wage withholding, income of an individual working under a vow of poverty for an employer controlled by a church and the individual is treated as working as an agent of the church, not as an employee. While these regulations do not provide an exclusion from the universal availability requirement for individuals working under a vow of poverty, individuals who work for an institution that is controlled by the church organization and whose compensation from the employer is not treated as wages for purposes of income tax withholding under Rev. Rul. 68-123 may be excluded from the section 403(b) plan without violating the universal availability requirement because they are not treated as employees of the entity maintaining the section 403(b) plan.

With respect to an exclusion relating to visiting professors, if an individual is rendering services to a university as a visiting professor, but continues to receive his or
her compensation from his or her home university and elective deferrals on his or her behalf are made under the home university’s section 403(b) plan, the final regulations do not, for purposes of section 403(b) and in any case in which such treatment is appropriate, preclude the plan maintained by the home university from treating the visiting professor as an eligible employee of the home university.

The discussion in this preamble under the heading “Applicability date” describes transition relief for any existing plan that excludes, in accordance with Notice 89-23, collective bargaining employees, visiting professors, government employees who make a one-time election, or employees who work under a vow of poverty.

Rules Relating to Funding Arrangements

These regulations retain, with certain modifications, the rules in the 2004 proposed regulations relating to the permitted investments for a section 403(b) contract. In general, a section 403(b) plan must be funded either by an annuity contract issued by an insurance company qualified to issue annuities in a State or a custodial account held by a bank (or a person who satisfies the conditions in section 401(f)(2)) where all of the amounts in the account are held for the exclusive benefit of plan participants or their beneficiaries in regulated investment companies (mutual funds) and certain other conditions are satisfied (including restrictions on distributions). Additional rules apply with respect to retirement income accounts for plans of a church or a convention or association of churches as discussed in the next section.

Special Rules for Church Plans’ Retirement Income Accounts

The final regulations, like the 2004 proposed regulations, include a number of special rules for church plans. Under section 403(b)(9), a retirement income account for
employees of a church-related organization is treated as an annuity contract for purposes of section 403(b). Under these regulations, the rules for a retirement income account are based largely on the provisions of section 403(b)(9) and the legislative history of TEFRA. The regulations define a retirement income account as a defined contribution program established or maintained by a church-related organization under which (i) there is separate accounting for the retirement income account’s interest in the underlying assets (namely, it must be possible at all times to determine the retirement income account’s interest in the underlying assets and to distinguish that interest from any interest that is not part of the retirement income account), (ii) investment performance is based on gains and losses on those assets, and (iii) the assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. For this purpose, assets are treated as diverted to the employer if the employer borrows assets from the account. A retirement income account must be maintained pursuant to a program which is a plan and the plan document must state (or otherwise evidence in a similarly clear manner) the intent to constitute a retirement income account.

If any asset of a retirement income account is owned or used by a participant or beneficiary, then that ownership or use is treated as a distribution to that participant or beneficiary. The regulations also provide that a retirement income account that is treated as an annuity contract is not a custodial account (even if it is invested in stock of a regulated investment company).

A life annuity can generally only be provided from an individual account by the purchase of an insurance annuity contract. However, in light of the special rules
applicable to church retirement income accounts, the final regulations, like the 2004 proposed regulations, permit a life annuity to be paid from such an account if certain conditions are satisfied. The conditions are that the distribution from the account has an actuarial present value, at the annuity starting date, that is equal to the participant's or beneficiary's accumulated benefit, based on reasonable actuarial assumptions, including assumptions regarding interest and mortality, and that the plan sponsor guarantee benefits in the event that a payment is due that exceeds the participant's or beneficiary's accumulated benefit.

**Termination of a Section 403(b) Plan**

The final regulations adopt the provisions of the 2004 proposed regulations permitting an employer to amend its section 403(b) plan to eliminate future contributions for existing participants, and allowing plan provisions that permit plan termination and a resulting distribution of accumulated benefits, with the associated right to roll over eligible rollover distributions to an eligible retirement plan, such as an individual retirement account or annuity (IRA). Comments on the rules in the 2004 proposed regulations regarding plan termination were favorable. In general, the distribution of accumulated benefits is permitted under these regulations only if the employer (taking into account all entities that are treated as a single employer under section 414 on the date of the termination) does not make contributions to any section 403(b) contract that is not part of the plan during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. However, if at all times during the period beginning 12 months before the termination and ending 12 months after distribution of all assets from the terminated plan, fewer than 2 percent of
the employees who were eligible under the section 403(b) plan as of the date of plan termination are eligible under the alternative section 403(b) contract, the other section 403(b) contract is disregarded. In order for a section 403(b) plan to be considered terminated, all accumulated benefits under the plan must be distributed to all participants and beneficiaries as soon as administratively practicable after termination of the plan. A distribution for this purpose includes delivery of a fully paid individual insurance annuity contract.

**Effect of a Failure to Satisfy Section 403(b)**

These regulations include revisions to the 2004 proposed regulations that address the effects of a failure to satisfy section 403(b). Section 403(b)(5) provides for all of the contracts purchased for an employee by an employer to be treated as a single contract for purposes of section 403(b). Thus, if a contract fails to satisfy any of the section 403(b) requirements, then not only that contract but also any other contract purchased for that individual by that employer would fail to be a contract that qualifies for tax-deferral under section 403(b).

Under these regulations, as under the 2004 proposed regulations, if a contract includes any amount that fails to satisfy the requirements of these regulations, then, except for special rules relating to vesting conditions and excess contributions (under section 415 or section 402(g)), that contract and any other contract purchased for that individual by that employer does not constitute a section 403(b) contract. In addition, if a contract is not established pursuant to a written plan, then the contract does not satisfy section 403(b). Thus, if an employer fails to have a written plan, any contract purchased by that employer would not be a section 403(b) contract. Similarly, if an
employer is not an eligible employer for purposes of section 403(b), none of the contracts purchased by that employer is a section 403(b) contract. If a plan fails to satisfy the nondiscrimination rules (including a failure to operate the plan in accordance with its coverage provisions or a failure to operate the plan in a manner that satisfies the nondiscrimination rules), none of the contracts issued under the plan would be section 403(b) contracts.

However, under these regulations, any operational failure, other than those described in the preceding paragraph, that is solely within a specific contract generally will not adversely affect the contracts issued to other employees that qualify in form and operation with section 403(b). Thus, for example, if an employee’s elective deferrals under a contract, when aggregated with any other contract, plan, or arrangement of the employer for that employee during a calendar year, exceed the maximum deferral amount permitted under section 402(g)(1)(A) (as made applicable by section 403(b)(1)(E)), the failure would adversely affect the contracts issued to the employee by that employer, but would not adversely affect any other employee’s contracts.

Requirement of Certain Separate Accounts Under Section 403(b)

The final regulations, like the 2004 proposed regulations, include technical provisions addressing certain situations in which a separate account is necessary under section 403(b). For example, a separate bookkeeping account is required for any contract in which only a portion of the employee’s interest is vested because, in such a case, separate accounting for each type of contribution (and earnings thereon) that is subject to a different vesting schedule is necessary to determine which vested contributions, including earnings thereon, are treated as held under a section 403(b)

These rules are not related to segregated asset accounts under section 817(h).
contract. In addition, the final regulations also clarify that if the section 403(b) plan fails to establish a separate account for contributions in excess of the section 415(c) limitation under section 403(c) (relating to nonqualified annuity contracts whose present values are generally subject to current taxation), so that such excess contributions are commingled in a single insurance contract with contributions intended to qualify under section 403(b) without maintaining a separate account for each amount, then none of the amounts held under the insurance contract qualify for tax deferral under section 403(b). Any such separate account must be established by the time the excess contribution is made to the plan. The separate account for excess contributions under section 415(c) is necessary to effectuate differences in the tax treatment of distributions (for example, because of the need to properly allocate basis under section 72 and separately identify amounts that can be rolled over). Similarly, a separate account is required for elective deferrals to be treated as held in a designated Roth account, as described in the following paragraph.

**Designated Roth Accounts**

These regulations also include final regulations relating to elective deferrals that are designated Roth contributions under a section 403(b) plan. These regulations, however, do not address the taxation of a distribution of designated Roth contributions from a section 403(b) plan. See §1.402A-1 for those rules. The final regulations relating to elective deferrals under a section 403(b) plan that are designated Roth contributions are substantially unchanged from the proposed regulations that were issued in January of 2006 regarding designated Roth accounts under a section 403(b)
Interaction Between Title I of ERISA and Section 403(b) of the Code

The Treasury Department and the IRS consulted with the Department of Labor in connection with both the 2004 proposed regulations and these final regulations concerning the interaction between Title I of ERISA and section 403(b) of the Internal Revenue Code. In particular, the consultation focused on whether the requirements imposed on employers in these regulations would exceed the scope of the Department of Labor’s safe harbor regulation at 29 CFR §2510.3-2(f) and result in all section 403(b) programs sponsored by tax-exempt employers (other than governmental plans and certain church plans) falling under the purview of ERISA.

According to the Department of Labor, Title I of ERISA generally applies to “any plan, fund, or program . . . established or maintained by an employer or by an employee organization, or by both, to the extent that . . . such plan, fund, or program . . . provides retirement income to employees, or . . . results in a deferral of income by employees for periods extending to the termination of covered employment or beyond.” ERISA section 3(2)(A). However, governmental plans and church plans are generally excluded from coverage under Title I of ERISA. ERISA section 4(b)(1) and (2). Therefore, contracts purchased or provided under a program that is either a “governmental plan” under section 3(32) of ERISA or a “church plan” under section 3(33) of ERISA are not generally covered under Title I. However, section 403(b) of the Internal Revenue Code is also available with respect to contracts purchased or provided by employers for employees of a section 501(c)(3) organization, and many programs for the purchase of

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section 403(b) contracts offered by such employers are covered under Title I of ERISA as part of an “employee pension benefit plan” within the meaning of section 3(2)(A) of ERISA. The Department of Labor promulgated a regulation in 1975, 29 CFR §2510.3-2(f), describing circumstances under which an employer's program for the purchase of section 403(b) contracts for its employees, which is not otherwise excluded from coverage under Title I, will not be considered to constitute the establishment or maintenance of an “employee pension benefit plan” under Title I of ERISA.

As described in the preamble to the 2004 proposed regulations, the Department of Labor advised the Treasury Department and the IRS that the proposed regulations did not appear to require, but left open the possibility that an employer may undertake, responsibilities in connection with a section 403(b) program that would exceed the limits in the safe harbor and constitute establishing and maintaining an ERISA-covered plan. Comments submitted on the proposal supported the continued availability of non-Title I section 403(b) programs to employees of tax-exempt employers and asked for additional guidance for employers who offer their employees access to such programs.

According to the Department of Labor, review of the final section 403(b) regulations has not led the Department of Labor to change its view on the principles that apply in determining whether any given section 403(b) program is covered by Title I of ERISA. Even though the differences between the tax rules for section 403(b) programs and those governing other ERISA-covered pension plans may have diminished as a result of the final section 403(b) regulations, the Department of Labor continues to be of the view that tax-exempt employers can comply with the requirements in the section 403(b) regulations and remain within the Department of Labor’s safe harbor for tax-
sheltered annuity programs funded solely by salary deferrals. The Department of Labor notes, however, that the new section 403(b) regulations offer employers considerable flexibility in shaping the extent and nature of their involvement. The question of whether any particular employer, in complying with the section 403(b) regulations, has established or maintained a plan covered under Title I of ERISA must be analyzed on a case-by-case basis applying the criteria set forth in 29 CFR §2510.3-2(f) and section 3(2) of ERISA. To assist employers interested in offering their employees access to a tax sheltered annuity program that would not be an ERISA-covered plan, the Department of Labor is issuing, in conjunction with the final publication of this regulation, a Field Assistance Bulletin to provide additional guidance on the interaction of the safe harbor and the requirements in these final regulations. The Field Assistance Bulletin can be found at www.dol.gov/ebsa.

**Treatment of Controlled Groups that Include Tax-Exempt Entities**

The final regulations retain the basic rules in the 2004 proposed regulations regarding controlled groups for entities that are tax-exempt under section 501(a), but with a number of modifications to reflect the comments that were made. As in the 2004 proposed regulations, these rules are not limited to section 403(b) plans, but apply more broadly for purposes of determining when tax-exempt entities are treated as a single employer under section 414(b), (c), (m), and (o). Thus, for example, these rules apply for purposes of plans maintained by a tax-exempt entity that are intended to be qualified under section 401(a). These rules can apply to treat two section 501(c) organizations as a single employer, or a section 501(c) organization and a non-section 501(c) organization as a single employer, if the organizations are under common control. For a
section 501(c)(3) organization that makes contributions to a section 403(b) plan, these rules would be generally relevant for purposes of the nondiscrimination requirements, as well as for the section 415 contribution limitations, the special section 403(b) catch-up contributions, and the section 401(a)(9) minimum distribution rules.

Under the rules in the 2004 proposed regulations, the employer for a plan maintained by a section 501(c) organization would include not only the organization whose employees participate in the plan, but also any other organization that is under common control with the tax-exempt organization. Under the 2004 proposed regulations, the existence of control would be determined based on the facts and circumstances. For this purpose, common control would exist between a tax-exempt organization and another organization if at least 80 percent of the directors or trustees of one organization were either representatives of, or directly or indirectly controlled by, the other organization. The 2004 proposed regulations permitted tax-exempt organizations to choose to be aggregated (permissive aggregation) if they maintained a single plan covering one or more employees from each organization and the organizations regularly coordinated their day-to-day exempt activities. These rules were subject to an overall anti-abuse rule. The final regulations retain the basic rules in the 2004 proposed regulations and the anti-abuse rule, and add an example to illustrate when the anti-abuse rule might apply.

Comments on the 2004 proposed regulations generally approved of the proposed controlled group rules, but some comments argued for expanding the category of entities that can use the permissive aggregation rules. These comments

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9 Treas. Reg. §1.512(b)-1(l)(4)(i)(b) uses a similar test to determine control of a non-stock organization. Note that those regulations do not reflect amendments that were made in section 512(b)(13) by section 1041(a) of the Taxpayer Relief Act of 1997 (111 Stat. 788).