

## **SUMMARY OF KEY PROVISIONS OF THE FINAL 403(b) REGULATIONS**

On July 23, 2007, the Treasury Department and the Internal Revenue Service (“IRS”) released the much-anticipated final regulations under IRC section 403(b). The final regulations are the first comprehensive re-write of the tax rules affecting 403(b) arrangements since 1964 and will require significant changes to virtually all 403(b) arrangements.

*Effective Date.* The final regulations generally apply beginning in 2009, prior to which taxpayers may comply with either current law or, subject to certain requirements, the final regulations. Special effective dates apply for new rules that restrict contract exchanges, prohibit the purchase of life insurance, and impose new withdrawal restrictions. Also, there are delayed effective dates for certain changes to the nondiscrimination rules, including universal availability.

*Plan Document Requirement.* The final regulations require that all 403(b) custodial accounts and annuity contracts (referred to collectively herein as “403(b) contracts”) be issued pursuant to a written plan that satisfies the applicable requirements. The plan document must set forth all material terms of the arrangement, but need not be a single written instrument and can incorporate other documents by reference. However, the IRS expects a master plan document if the arrangement makes 403(b) contracts from multiple financial institutions available for investment. The final regulations suggest that plans must have their plan documents in place by January 1, 2009, and that the IRS will soon release model plan language for governmental 403(b) plans.

*Administrative Responsibilities.* The final regulations indicate that the employer-maintained plan document should coordinate the responsibilities of the employer and the financial institutions that administer the 403(b) contracts. Also, the employer (or its agent) will have to oversee the arrangement to ensure that it is being operated according to the plan document. Employers will have to provide the financial institutions with adequate information to allow for the administration of loans and hardship distributions and to determine when distributions are permitted as a result of severance from employment.

*Exchanges and Transfers.* The final regulations impose new requirements on investment changes between 403(b) contracts under the same “plan.” Such “exchanges” are permitted only if certain requirements are met, including that the plan provides for the exchange and the employer enters into an information sharing agreement with the issuer of the new 403(b) contract. The information sharing agreement must specify that the employer will share information sufficient for the issuer of the 403(b) contract to satisfy applicable requirements, such as loan limits, hardship distribution requirements, etc. Although the regulations are generally effective on January 1, 2009, it appears that the new exchange rules (including the information sharing agreement requirement) will apply to exchanges occurring after September 24, 2007. The final regulations also impose new requirements with regard to movements of funds outside the employer’s plan, which the regulations refer to as “transfers” and distinguish from “exchanges.”

*Universal Availability Requirement.* The universal availability requirement generally provides that, subject to limited exceptions, all employees of any employer (other than churches) must be permitted to elect to make salary reduction contributions if any employees of the employer have that right. The final regulations include a number of clarifications related to the universal

availability requirement, including repealing a number of prior law administrative exemptions from the requirement and providing guidance on the treatment of part-time employees.

*Nondiscrimination Requirement for Employer Contributions.* Nondiscrimination rules apply to employer contributions to a 403(b) arrangement maintained by a 501(c)(3) organization, although church and governmental plans are entirely or mostly exempt from these rules. The final regulations generally end the current law good faith compliance standard for 501(c)(3) employers as well as certain administrative safe harbors that the IRS had previously provided. In their place, the regulations apply the nondiscrimination rules that otherwise apply to employer contributions for 401(k) plans.

*Plan Termination.* The final regulations officially acknowledge for the first time that an employer may terminate a 403(b) plan. An employer may immediately replace a terminated 403(b) plan with a 401(k) plan or a 457(b) plan, as appropriate.

*Prohibition Against Incidental Benefits.* The final regulations prohibit the purchase of life and other insurance contracts in connection with a 403(b) plan and require that death benefits under the plan be incidental. Life insurance contracts issued before September 24, 2007, are grandfathered, and premium payments may continue to be made.

*Vesting.* The regulations confirm that vesting is permitted with respect to employer contributions but a separate accounting is required for such amounts.

*In-Service Distributions.* The regulations extend restrictions on in-service distributions to amounts attributable to employer contributions to a 403(b) annuity contract issued by an insurance company. Contracts issued before January 1, 2009, are grandfathered.

*Interaction with ERISA.* Governmental and church 403(b) plans continue to be exempt from the Employee Retirement Income Security Act of 1974 (“ERISA”). Plans maintained by tax-exempt employers generally are subject to ERISA, unless a safe harbor exemption requiring limited employer involvement in the plan applies. In connection with final regulations, the Department of Labor (“DOL”) published Field Assistance Bulletin 2007-02, which addresses whether tax-exempt employers will be able to comply with the final 403(b) regulations and remain within the safe harbor exemption from ERISA. The DOL guidance generally provides that a plan of a tax-exempt employer may satisfy the requirements of the final 403(b) regulations and remain exempt from ERISA.