

**MEMO# 18205**

November 18, 2004

## **IRS ISSUES PROPOSED REGULATIONS UNDER CODE SECTION 403(B); CONFERENCE CALL SCHEDULED FOR THURSDAY, DECEMBER 9**

[18205] November 18, 2004 TO: PENSION COMMITTEE No. 55-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 79-04 RE: IRS ISSUES PROPOSED REGULATIONS UNDER CODE SECTION 403(b); CONFERENCE CALL SCHEDULED FOR THURSDAY, DECEMBER 9 The Internal Revenue Service has issued comprehensive proposed regulations under section 403(b) of the Internal Revenue Code, which, among other things, allows employees of public schools and organizations exempt under section 501(c)(3) of the Code to save for retirement through custodial accounts invested in mutual fund shares.<sup>1</sup> According to the preamble, the proposed regulations amend the current regulations to (1) delete provisions that no longer have legal effect due to changes in law; (2) include in the regulations interpretive guidance issued since 1964; and (3) generally reflect numerous legal changes to section 403(b). The relevant provisions are summarized below.

**403(b) Plan Requirement** The proposed regulations would require that a 403(b) annuity contract or custodial account be maintained pursuant to a plan.<sup>2</sup> Under the proposed regulations, the 403(b) plan would be required to be a written defined contribution plan that, in both form and operation, satisfied the relevant requirements of the proposed regulations. Specifically, the plan would be required to contain all the material terms and conditions for 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 also permit the plan to contain optional provisions, such as hardship withdrawals, loans, plan-to-plan or contract-to-contract transfers, and acceptance of rollovers to the plan. The preamble's discussion of this requirement notes that the plan document provision would not require a single plan document. For example, according to the preamble, compliance with the plan document rules applicable to qualified plans would satisfy this requirement. The preamble also notes, however, that the Service has consulted with the Department of Labor on the impact of the proposed regulations on 403(b) plans' status under Title I of ERISA. The Department of Labor advised that, although the proposed regulations would not mandate the

<sup>1</sup> The text of the proposed regulations is available at: <http://www.regulations.gov/fredpdfs/04-25237.pdf>. <sup>2</sup> Prop. Reg. 1.403(b)-3(b)(3). <sup>3</sup> establishment or maintenance of an employee pension benefit plan, an employer might undertake responsibilities that would constitute establishing and maintaining an ERISA covered plan. According to the Department of Labor, a 403(b) plan's ERISA coverage would be analyzed on a case-by-case basis, applying the criteria set forth in regulations under ERISA, including the employer's involvement as contemplated by the plan documents

and in operation. Plan Terminations and Frozen Plans Section 1.403(b)-10(a) of the proposed regulations would permit employers to amend their section 403(b) plans to eliminate future contributions for existing participants, or to limit participation to existing participants and employees (to the extent consistent with applicable nondiscrimination rules). The proposed regulations would also permit a section 403(b) plan to contain provisions that permit plan termination and permit accumulated benefits to be distributed upon termination. In the case of 403(b)(7) custodial accounts and other contracts subject to distribution restrictions, however, termination of the plan and the distribution of accumulated benefits generally would be permitted only if the employer (taking into account all entities treated as the employer) did not make contributions to an "alternative section 403(b) contract" that was not part of the plan. Generally, contributions would be restricted during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. In order for a section 403(b) plan to be considered terminated, all accumulated benefits under the plan would have to be distributed as soon as administratively practicable after termination of the plan.

Other Provisions The proposed regulations also address the following issues:

- The definition of "custodial account" (Prop. Reg. 1.403(b)-8(d)(2));
- Contract exchanges and plan-to-plan transfers (Prop. Reg. 1.403(b)-10(b));
- Coordination of catch-up contributions under Code section 414(v) and special section 403(b) catch-up contributions under Code section 402(g)(7)(A) (Prop. Reg. 1.403(b)-4(c)(2));
- The timeframe within which contributions must be forwarded to an annuity contract or custodial account (Prop. Reg. 1.403(b)-8(b));
- Loans (Prop. Reg. 1.403(b)-6(f));
- 3 Section 403(b) contracts purchased or provided under "governmental plans" or "church plans," as defined in ERISA, are not generally covered by Title I, but a section 403(b) arrangement covering employees of a Code section 501(c)(3) organization potentially may be considered an "employee pension benefit plan" covered by Title I of ERISA. A Department of Labor regulation describes the circumstances under which such an employer's program for the purchase of section 403(b) contracts for its employees will not be considered to constitute the establishment or maintenance of an employee pension benefit plan under Title I of ERISA. 29 C.F.R. 2510.3-2(f).
- 4 The proposed regulations would require that the contributions be forwarded "within a period that is not longer than is reasonable for the proper administration of the plan."
- 3 • Hardship withdrawals (Prop. Reg. 1.403(b)-6(d)(2));
- Qualified domestic relations orders (QDROs) (Prop. Reg. 1.403(b)-10(c)); and
- Required minimum distributions (Prop. Reg. 1.403(b)-6(e)).

5 Effective Date The preamble to the proposed regulations states that the final rules would be effective for taxable years beginning after December 31, 2005, with transition rules for collectively bargained employees and certain church-related organizations. In addition, no reliance upon the proposed regulations will be permitted until they are adopted in final form.

Institute Conference Call The deadline for comments on the proposed regulations is February 14, 2005. The Institute has scheduled a conference call for Thursday, December 9 at 1:30 p.m. Eastern time to discuss the Institute's comments concerning the proposed regulations. If you would like to participate in this call, please complete the attached response form and fax it to Brenda Turner at (202) 326-5841 or e-mail it to bturner@ici.org by Wednesday, December 8. To participate in the call, please dial 888-642-8528 and enter passcode 33131. If you have any questions about the call, please contact the undersigned at (202) 371-5432 or kireland@ici.org.

Kathy D. Ireland Senior Associate Counsel Attachment (in .pdf format)

5 The proposed regulations also include a reserved section for automatic rollovers of certain mandatory distributions. Prop. Reg. 1.403(b)-7(b)(5).

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