

**MEMO# 974**

February 10, 1989

## **IRS PROVIDES SAFE HARBORS FOR SECTION 403(B)(12) NONDISCRIMINATION RULES**

February 10, 1989 TO: PENSION MEMBERS NO. 8-89 RE: IRS PROVIDES SAFE HARBORS FOR  
SECTION 403(b)(12) NONDISCRIMINATION RULES

As you know, the 1986 Tax Reform Act added to the Internal Revenue Code nondiscrimination rules with respect to plans providing annuity contracts and custodial accounts qualifying for favorable tax treatment under section 403(b). These rules are effective for plan years beginning after December 31, 1988. Under section 403(b)(12)(A)(ii), contributions pursuant to a salary reduction agreement will satisfy the nondiscrimination requirements only if each participant who elects to make salary reduction contributions may elect to reduce his or her salary by more than \$200, and the opportunity to make such contributions is available to all employees. Section 403(b)(12)(A)(i) provides that with respect to all non-salary reduction contributions, a section 403(b) annuity plan must satisfy the nondiscrimination requirements of sections 401(a)(4), (5), (17), and (26), 401(m) and 410(b) in the same manner as if the plan were described in section 401(a). Each of these provisions permits certain employees to be excluded from consideration. Attached is a copy of IRS Notice 89-23, which describes what the IRS will consider reasonable, good faith interpretations of these rules pending further guidance. The notice also contains specific guidelines that, although designated as transitional safe harbors, prescribe the circumstances under which the IRS will deem the requirements of section 403(b)(12) satisfied for plan years beginning in the 1989 or 1990 calendar year. The safe harbor for salary reduction contributions under section 403(b)(12)(A)(ii) allows the exclusion of certain employees in addition to those exclusions described in the Code. In addition, this safe harbor allows the employer to consider as separate organizations geographically distinct units that the employer historically has treated as separate for employee benefit purposes and are operated independently on a day-to-day basis. The notice also contains three alternative safe harbors with respect to non-salary reduction contributions. Each of these safe harbors contains a different formula which examines: (1) the disparity between the highest percentage of compensation contributed on behalf of any highly compensated employee and the lowest percentage contributed on behalf of any nonhighly compensated employee; (2) the percentage of nonhighly compensated employees accruing benefits under the plan; and (3) the percentage of those accruing benefits under the plan who are nonhighly compensated employees. We will keep you informed of further developments. Kathy D. Ireland Assistant General Counsel Attachment

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.