

Qualified Retirement Plans
Practice Alert
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The Deadline is Approaching – 403(b)/TSA Plans – Part I

After more than forty years the IRS has issued updates to the original regulations issued in 1964 for 403(b) plans (Tax Sheltered Annuities/TSAs) covering employees of public schools, churches and tax-exempt 501(c)(3) organizations. These regulations are effective beginning January 1, 2009. The most prominent issue in the new regulations is the requirement that all plans adopt a “plan document.” In the past plans that were considered “conduits” for employee deferrals only, i.e. there was no employer involvement in the plan administration other than remittance of employee deferrals, were not required to establish a written plan. Typically financial vendors, those companies offering the investment products, either insurance companies for annuities or mutual funds for custodial accounts, prepared a custodial agreement covering such issues as loans and hardship distributions. Effective on January 1st those plans must adopt a written plan document addressing eligibility, benefits, limitations, e.g. deferral limits, funding options and distribution options. Plans that already have a written plan in place because they are considered Title I plans, i.e. they are covered by ERISA, must update those plans to comply with the new regulations. A Title I plan is any plan in which the employer does participate in the administration, e.g. determination of eligibility for hardships withdrawals, or participates in the funding of the plan, e.g. a matching contribution. To avoid ERISA coverage participation in the plan must be voluntary, all rights under the annuity contract or custodial agreement must be enforceable only by the employee or the employee’s beneficiary, the involvement of the employer must be limited and the employer cannot receive any direct or indirect compensation other than reimbursement for proper expenses incurred in performing the employer’s duties.

Many plans offer multiple product vendors. The final regulations require the employer to review the varied annuity contracts and/or custodial agreements to be sure there is consistency between the provisions of those agreements and the written plan document. It is the written plan document that guides the operation of the plan. In addition the written document must list the approved product vendors.

The document must assign specific responsibility for monitoring the administrative functions including loan limits, deferral limits, requirements for hardship distributions, among others. The Department of Labor has indicated that the employer’s involvement in the required administrative functions set forth in the final regulations would not cause the plan to be considered a Title I plan covered by ERISA. If the written document requirement is not satisfied by the effective date of the final regulations every investment contract issued to a participant and every custodial account opened for a participant would become immediately taxable. It is anticipated that most employers will choose a single organization to provide recordkeeping and administrative services allowing them to coordinate and monitor the provisions of the written plan document with the annuity contracts and/or custodial agreements of the investment providers. Once the new rules are in place it is likely that the IRS will offer a determination letter program similar to the program available for qualified plans.

Stephen Abramson, CPC, CLU, ChFC
APS Pension & Financial Services Inc.
(516) 228-8444 E-mail steve@apspension.com