

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

Eligibility requirements for 403(b) plans do not follow the common alternatives available in qualified plans like profit sharing, 401(k) and defined benefit. In the case of 403(b) plans eligibility is defined under a reference to “Universal Availability.” Universal availability requires that a 403(b) plan must provide that any employee must have the right to make elective deferrals and, if they choose and the plan allows, to designate those deferrals as Roth contributions although there are some allowable exclusions including non resident aliens, employees eligible for 457(b) deferrals, students, and employees who normally work less than 20 hours per week. Prior to the final regulations IRS Notice 89-23 also permitted exclusions for employees covered by a collective bargaining agreement, employees who make a one time election to participate in a government plan rather than a 403(b), certain visiting professors and employees of a religious order who have taken a vow of poverty. The final regulations eliminate these exclusions with transition rules that phase in through the year 2010.

In addition to universal availability the concept of “Effective Opportunity” must also be considered. Effective opportunity requires an employee to be able to alter their deferral election at least annually by increasing, decreasing, stopping or starting deferrals. If any rights are withheld from some employees but not others effective opportunity is not satisfied. For example if one group of employees can defer up to 8% and others can defer up to the limit this does not satisfy effective opportunity. This concept can also be applied to the availability of loans, hardship distributions, among other plan benefits. Effective opportunity also does not exist if any other rights or benefits, other than matching contributions, are contingent on making salary deferrals.

Included in the final regulations are several miscellaneous issues:

1. Hardship distribution will mostly follow the same rules as for 401(k) plans including a safe harbor provision.
2. Life insurance will no longer be allowed in a 403(b) plan however life insurance contracts issued up to 60 days after publication of the regulations (July 26, 2007) will be grandfathered.
3. For purposes of distributions severance from employment is defined as a time when an employee no longer works for an eligible employer, e.g. an employee who no longer works for a non profit and works for a for profit organization.
4. Matching contributions are subject to the same non discrimination rules and testing rules as 401(k) plans.
5. A plan participant must be given proper notification of roll over rights to another plan or an IRA including the tax withholding rules.

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