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## ERISA and Nonprofit Update: IRC 403(b) Tax-Sheltered Annuity Plans Must Adopt a Written Plan Document by December 31, 2009

By Erwin D. Kratz

On July 26, 2007, the IRS issued final regulations that significantly impact employers who sponsor 403(b) plans. A 403(b) plan is a retirement plan for employees of public schools and certain tax-exempt organizations including churches, hospitals, foundations, private schools, and other types of charitable organizations.

### Sweeping Change

The new regulations represent the most extensive change in the rules governing 403(b) plans in over 40 years. The most significant change is that for the first time employers must adopt a written plan document that demonstrates compliance with the Internal Revenue Code qualification requirements applicable to 403(b) plans. In Notice 2009-03 the IRS extended the deadline to comply with the written document requirement to December 31, 2009. Accordingly, employers who have not yet reviewed their 403(b) plans to determine compliance with the new regulations will need to act quickly to bring their plans into compliance before the end of 2009.

### Reallocation of Responsibility

Traditionally, insurance companies and financial institutions have marketed the annuity contracts, custodial account agreements, and services agreements that make up employees' 403(b) plans directly to employees. Accordingly, many nonprofit employers have considered these arrangements to be a contract between the employee and the contract issuer and have deferred to the contract issuer to handle administration and legal compliance. This approach is no longer viable under the new regulations.

While the IRS recognizes that 403(b) plans have historically consisted of multiple annuity contracts, custodial accounts and services plans, the new regulations now require that all such contracts be issued "pursuant to a written plan which, in both form and operation, satisfies the requirements of section 403(b)" of the Internal Revenue Code. The IRS believes the plan document requirement will facilitate the allocation of plan responsibilities among the employer, the issuer of the contract, and any other parties involved in implementing the plan. Nevertheless, the IRS has placed the burden of coordinating compliance squarely on the employer's shoulders.

While a plan may consist of one document or many separate documents, the documentation taken as a whole must provide all the material terms and conditions for eligibility, benefits, applicable limitations, and the contracts available under the plan, and the time and form in which benefits will be paid. In addition, if the plan has optional features such as hardship withdrawals, loans, and acceptance of rollovers, those optional features must be described in the written plan document. The employer also must ensure that there is no conflict between the central plan document and any other documents that are incorporated by reference and if there is a conflict to resolve it in writing.

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## ERISA Compliance

The increased employer involvement in 403(b) plans required by the IRS regulations may also subject a 403(b) plan to the Employee Retirement Income Security Act ("ERISA") for the first time. The application of ERISA brings further compliance issues for employers with respect to their 403(b) plans. For example, a plan that is subject to ERISA is required to file an annual form 5500 return with the Department of Labor ("DOL"), to make certain financial disclosures to participants, and to have and periodically issue a summary plan description ("SPD") to plan participants.

There is a long-standing DOL regulation that exempts certain 403(b) arrangements from ERISA if (1) employee participation is completely voluntary, (2) the plan is funded solely by employee contributions, (3) the employer's involvement is limited (generally to selecting annuity contract providers and collecting and forwarding employee contributions), and (4) the employer receives no compensation other than reasonable compensation for expenses actually incurred in implementing employee salary reduction agreements.

The DOL has issued guidance to assist employers to determine whether the steps they take to comply with the IRS regulations will cause them to be subject to ERISA. With careful planning, an employer can either structure its involvement with the plan to comply with the IRS regulations while remaining exempt from ERISA, or choose to operate the 403(b) plan in compliance with ERISA.

## Action Items

To ensure that their 403(b) arrangements comply with the IRS regulations and, if applicable, ERISA requirements, employers should:

1. Identify the current plan documents, including all of the applicable annuity contracts, custodial account agreements, and services agreements.
2. Review the current plan documents and determine what additional documentation is required to comply with the IRS regulations and how to structure that documentation. In some cases, a simple unifying "umbrella" document to coordinate all of the existing documentation will be sufficient.
3. Determine whether the plan can be structured to avoid ERISA compliance and, if ERISA applies, what to do to comply. Further, if it is determined that ERISA does apply, determine whether there are now any late form 5500 filings to be corrected.
4. Adopt a compliant written plan document by December 31, 2009. While the IRS has issued model plan language that can be modified to suit many plans and should reduce the expense of getting into compliance, the better approach for many employers may be to simply adopt an umbrella document to unify and coordinate existing documentation. In addition, 403(b) service providers may offer a new plan document and administrative support for complying with the regulations. However, form documents provided by service providers should also be reviewed by the employer's legal counsel to work through the issues outlined in this alert.

Fennemore Craig's Employee Benefits and Non-Profit Practice groups are ready to assist you in this process. Please feel free to address any questions you may have to Erwin Kratz at 602-916-5098 in Phoenix or at 520-879-6401 in Tucson, or to your regular Fennemore Craig attorney contact.

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