

403(b)



Perspectives

Insights into the Administration of §403(b) Tax-Sheltered Arrangements

WINTER 2010

RAP for 403(b) Plans

In IRS Announcement 2009-89, issued in early December 2009, the IRS reiterated that it expects to publish a revenue procedure for obtaining an opinion letter that the form of a prototype or other "preapproved plan" meets the requirements of §403(b) of the Internal Revenue Code and the regulations thereunder. The Rev. Proc. will reflect the Service's consideration of comments it received on the draft Rev. Proc. included in IRS Ann. 2009-34.

Subsequently, there will be a revenue procedure for obtaining an individual determination letter for a §403(b) plan.

This announcement provides for a remedial amendment period and reliance for employers that, pursuant to the upcoming revenue procedures, either adopt a preapproved plan with a favorable opinion letter or apply for an individual determination letter when available.

Notice 2009-3 provides relief during 2009 with respect to the requirement in the regulations to have a written §403(b) plan in place by January 1, 2009. The Service will not treat a §403(b) plan as failing to satisfy the requirements of §403(b) and the regulations during the 2009 calendar year, provided that the employer satisfies the conditions of Notice 2009-3.

As one of the conditions for relief under Notice 2009-3, a written §403(b) plan that is intended to satisfy the requirements of §403(b) and the regulations must be adopted on or before December 31, 2009. If this condition is met and, pursuant to the upcoming revenue procedures, the employer sponsoring the plan either adopts a preapproved plan that has received a favorable opinion letter from the Service or applies for an individual determination letter when available, the employer will have a remedial amendment period in which to amend the plan to correct any form defects retroactive to January 1, 2010. Further, such an employer will have reliance, beginning January 1, 2010, that the form of its written plan satisfies the requirements of §403(b) and the regulations, provided that, during the remedial amendment period, the preapproved plan is adopted retroactive to January 1, 2010 or the plan is amended to correct any defects in the form of the plan retroactive to January 1, 2010.

An employer that first establishes a §403(b) plan after December 31, 2009, by adopting a written plan intended to satisfy the requirements of §403(b) and the regulations will also have reliance beginning on the effective date of the plan, provided the employer either adopts a preapproved plan with a favorable opinion letter or applies for an individual determination letter and corrects any defects in the form of the plan retroactive to the plan's effective date. ■

ERISA V. Non-ERISA

At its DOL Speaks Conference earlier in 2009, the DOL offered soft guidance. The DOL stated its speakers will be speaking on behalf of the DOL and thus, their positions will actually represent the DOL and not be just the opinion of the speaker. Two items of particular note in determining whether a plan is exempt from ERISA were addressed. One was if a plan has only one vendor for investments, it will not satisfy the “reasonable choice” exemption from being an ERISA

plan under ERISA regulation 2510.3-2(f). The second had to do with a 403(b) plan where the deferrals were made into a 403(b) plan, but the match on the deferrals is being made into a 401(k) plan. This also was seen as being an ERISA arrangement and not able to satisfy exemption from being an ERISA plan as employer contributions are being made. We await actual written guidance from the DOL on these points. ■

Tax-exempt Common Control Rules

Section 1.414(c)-5 was added at the back of the final 403(b) regulations of July 26, 2007. These regulations address control group rules for tax-exempt entities. There are four new tax-exempt common control rules. They generally do not apply to church or church-controlled organizations.

Mandatory Aggregation

In the case of an organization that is exempt from tax under Section 501(a) (an exempt organization) whose employees participate in a plan, the employer with respect to that plan includes the exempt organization whose employees participate in the plan and any other organization that is under common control with that exempt organization. For this purpose, common control exists between an exempt organization and another organization if at least 80% of the directors or trustees of one organization are either representatives of, or directly or indirectly controlled by, the other organization. A trustee or director is treated as a representative of another exempt organization if he or she also is a trustee, director, agent, or employee of the other exempt organization. A trustee or director is controlled by another organization if the other organization has the general power to remove such trustee or director and designate a new trustee or director. Whether a person has the power to remove or designate a trustee or director is based on facts and circumstances:

Example

Exempt organization A has the power to appoint at least 80% of trustees of exempt organization B. Organization B is the owner of all the outstanding

shares of corporation C, which is not an exempt organization. Organization A has the power to control at least 80% of directors of exempt organization D. Then, A, B, C, and D are the same employer for the purposes of any plan maintained by A, B, C, and D.

What rules are impacted if there is a controlled group?

Watch out for coverage (universal availability) and nondiscrimination testing if there is a controlled group. Section 415 contribution limits could be impacted. The special catch-up rules could be affected. Lastly, the 401(a)(9) minimum distribution rules could be impacted.

Permissive Aggregation

Two tax-exempt entities are a single employer if they maintain a joint retirement plan and they coordinate their daily activities. They can essentially choose between a multiple employer plan and a single employer plan. The IRS can expand the list.

For example, an entity that provides a type of emergency relief within one geographic region and another exempt organization that provides that type of emergency relief within another geographic region may treat themselves as under common control if they have a single plan covering employees of both entities and regularly coordinate their day-to-day exempt activities. Similarly, a hospital that is an exempt organization and another exempt organization with which it coordinates the delivery of medical services or medical research may treat themselves as under common control if there is a single plan covering employees

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of the hospital and employees of the other exempt organization and the coordination is a regular part of their day-to-day exempt activities.

Commissioner May Issue Additional Rules to Permit Aggregation

The Commissioner of the IRS may issue rules of general applicability in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin permitting other types of combinations of entities that include exempt organizations to elect to be treated as under common control for one or more specified purposes if—

- (A) There are substantial business reasons for maintaining each entity in a separate trust, corporation, or other form; and
- (B) Such treatment would be consistent with the anti-abuse standards below.

For example, this authority might be exercised in any situation in which the organizations are so integrated in their operations as to effectively constitute a single coordinated employer for purposes of Sections 414(b), (c), (m), and (o), including common employee benefit plans.

Permissive Disaggregation

In case of a church plan under Section 414(e) to which contributions are made by more than one common law entity, any employer may choose to treat “church” organizations as separate from “non-church” organizations. Example: where there is a church, church school, and several nursing homes. Each nursing home gets more than 25% of support from fees paid by residents, and thus, each nursing home is a “non-church” entity (i.e., none of them are qualified church controlled organizations). The nursing homes may treat themselves as under common control with each other, but not as being under common control with the church and the church school, a separate entity.

Anti-abuse Catch-all

If the IRS determines that the structure or positions of one or more tax-exempts (or tax-exempts and nonexempt) has the effect of avoiding nondiscrimination rules, the IRS may treat the entities as under common control.

Governmental Plans and Common Control

There are no common control rules for governmental plans. These entities remain under a reasonable, good-faith standard. It would be relevant for Section 415 purposes, even though governmental

plans are not subject to most nondiscrimination rules.

More Examples to Illustrate This Article

Example 1

Facts. Organization A is a tax-exempt organization under Section 501(c)(3) which owns 80% or more of the total value of all classes of stock of corporation B, which is a for-profit organization.

Conclusion. Under these rules, this section does not alter the rules of Section 414(b) and (c), so that organization A and corporation B are under common control under §1.414(c)-2(b).

Example 2

Facts. Organization M is a hospital, which is a tax-exempt organization under Section 501(c)(3). Organization N is a medical clinic that is also a tax-exempt organization under Section 501(c)(3). N is located in a city and M is located in a nearby suburb.

There is a history of regular coordination of day-to-day activities between M and N, including periodic transfers of staff, coordination of staff training, common sources of income, and coordination of budget and operational goals.

A single Section 403(b) plan covers professional and staff employees of both the hospital and the medical clinic. While a number of members of the board of directors of M are also on the board of directors of N, there is less than 80% overlap in board membership.

Both organizations have approximately the same percentage of employees who are highly compensated and have appropriate business reasons for being maintained in separate entities.

Conclusion. M and N are not under common control under this section, but may chose to treat themselves as under common control, assuming both of them act in a manner that is consistent with that choice for purposes of §1.403(b)-5(a), Sections 401(a), 403(b), and 457(b), and any other applicable section (as defined in Section 414(t)), or any other provision for which Section 414(c) applies.

Example 3

Facts. Organization O and P are each tax-exempt organizations under Section 501(c)(3). Each organization maintains a qualified plan for its employees, but one of the plans would not satisfy Section 410(b) (or Section 401(a)(4)) if the organizations were under common control. The two organizations are

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closely related and, while the organizations have several trustees in common, the common trustees constitute fewer than 80% of the trustees of either organization. Organization O has the power to remove any of the trustees of P and to select the slate of replacement nominees.

Conclusion. Under these facts, the Commissioner treats the entities as under common control.

Applicable date. The common control group rules are effective for plan years beginning after December 31, 2008. ■

QUIZ: Qualified Plan Parity, ERISA v. Non-ERISA Plan Termination

1. **Entities that are always exempt from being subject to ERISA include all of the following except:**
 - A. County hospitals
 - B. State universities
 - C. Churches defined in Code Section 414(e)
 - D. 501(c)(3) organizations
 - E. Public high schools
2. **If a 403(b) is subject to ERISA, all of the following ERISA requirements are necessary except:**
 - A. Fiduciary requirements, such as the prudent person rule
 - B. Prohibited transaction rules preventing self-dealing and not permitting transactions with a party-in-interest
 - C. Protection from creditors
 - D. Summary plan descriptions
 - E. Qualified default investment alternatives
3. **For a non-ERISA plan to be within the safe harbor exemption from being an ERISA plan, the employer must not do any of the following except:**
 - A. Make employer contributions
 - B. Make a determination as to whether a hardship distribution request meets a valid reason
 - C. Transmit to an annuity provider a doctor's certification of an employee's physical condition
 - D. Determine if a DRO is a QDRO
 - E. Authorize transfers
4. **Under FAB 2007-2, the employer is permitted to do all of the following except:**
 - A. Establish a written plan document
 - B. Negotiate with vendors to set the conditions for hardship
 - C. Limit exchanges among vendors who are part of the written plan
 - D. Fashion and propose corrections
 - E. Develop improvements that will prevent future tax defects
5. **True or False: To terminate a 403(b) plan after December 31, 2008, an employer will have to have a written plan that is in compliance with the final 403(b) regulations in place.**
 - A. True
 - B. False
6. **According to DOL Regulation 2510.3-2(f), the employer's involvement in a non-ERISA 403(b) plan is limited to all of the following except:**
 - A. Collecting or remitting employee contributions
 - B. Requesting information about the products
 - C. Allowing product providers to publicize their products or product providers
 - D. Hold group contracts in the employer's name
 - E. Hold the individual annuity contracts in the employer's name
7. **A 403(b) plan termination requires:**
 - A. A written plan document in place in 2008
 - B. Distribution of all the 403(b) assets within 5 years
 - C. Distribution of plan assets within 12 months of the termination date
 - D. For an employer with two 403(b) plans, the termination of one of the 403(b) plans within 12 months
 - E. Following the 20% exception to the successor plan rule
8. **True or False: 403(b) plans for a public school are always exempt from ERISA.**
 - A. True
 - B. False
9. **As of 2009, non-ERISA arrangement requirements include:**
 - A. Voluntary participation
 - B. Mandatory participation
 - C. Employer contributions
 - D. Rights enforceable by only the employer
 - E. 90-24 transfers
10. **True or False: The 403(b) written defined contribution plan adopted in 2008 or 2009 has reliance under the existing 403(b) prototype program.**
 - A. True
 - B. False

Answer Key: 1. D 2. D 3. C 4. B 5. A 6. E 7. C 8. A 9. A 10. B

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