The New 403(b) Regulations

impact on church retirement plans

Article summary. *The IRS issued final regulations in 2007 that address the legal requirements that apply to 403(b) retirement plans. The regulations were enacted because of IRS concern over the massive noncompliance it was observing in field audits of 403(b) plans. The IRS has endeavored to address these concerns, in the final regulations, by making 403(b) plans more like 401(k) plans. One immediate effect will be an increase in the administrative responsibilities of employers that offer 403(b) plans. Whether the regulations ultimately will achieve their purpose remains to be seen. This article has three objectives: review those provisions in the final regulations of most relevance to churches; address what church leaders need to do in order for their 403(b) plan to be in compliance with the final regulations; and, illustrate the application of the final regulations to church-sponsored 403(b) plans with several examples.*

A survey by a national investment firm of religious and other tax-exempt organizations that offer 403(b) plans revealed that less than ten percent of these organizations consider themselves "very familiar" with the new regulations.

Congress enacted section 403(b) of the tax code in 1958 to allow many tax-exempt organizations, including churches, to provide tax-deferred annuities as a retirement program for their employees. The IRS issued regulations in 1964 providing guidance on complying with section 403(b).

In 2004, the IRS published proposed regulations that provided the first comprehensive guidance on the administration of 403(b) plans in 40 years. The IRS was prompted to act as a result of the massive noncompliance it uncovered in field audits of 403(b) plans. Following publication of the 2004 proposed regulations, comments were received and a public hearing was held. The regulations were adopted as final regulations in 2007. The final regulations take effect on January 1, 2009, for most tax-exempt organizations.

What is the relevance of the new 403(b) regulations to churches? Section 403(b) retirement plans are perhaps the most common form of retirement plan for church employees, and so it is essential for church leaders to be familiar with application of the new regulations to their 403(b) plan. Failure to comply with the new regulations will result in adverse tax consequences for church employees.

This article will address the provisions in the final regulations that are of the greatest relevance to churches, and describe the steps churches should take to comply with the regulations.

"As was noted in the preamble to the 2004 proposed regulations, the effect of the various amendments made to section 403(b) within the past 40 years has been to diminish the extent to which the rules governing section 403(b) plans differ from the rules governing other tax-favored employer-based retirement plans, including arrangements that include salary reduction contributions, such as section 401(k) plans and section 457(b) plans for state and local governmental entities." *IRS official summary of the 403(b) final regulations.*

A. The Regulations

The provisions in the final regulations of most relevance to churches are summarized below.

1. Written Plan Requirement

in general

In the past, only those 403(b) plans that were subject to the Employee Retirement Income Security Act of 1974 (ERISA) were required to have a written plan document. The final regulations require all 403(b) providers, including churches, to have a plan document in place no later than December 31, 2008. But merely having a plan document is not enough. The plan document, in both form and operation, must satisfy the requirements of section 403(b) and the regulations. This means that a plan document must address several issues, including the following:

- employee eligibility
- contribution limits
- distributions
- benefits
- salary reductions
- investments (fund providers available under the plan)
- loans
- hardship withdrawals
- allocate compliance responsibilities to employers and fund providers (vendors)

What is the purpose of the written plan requirement? The IRS summary that accompanied the final regulations explains:

> The existence of a written plan facilitates the allocation of plan responsibilities among the employer, the issuer of the contract, and any other parties involved in implementing the plan. Without such a central document for a comprehensive summary of responsibilities, there is a risk that many of the important responsibilities required under the statute and final regulations may not be allocated to any party. . . . The maintenance of a written plan also benefits participants by providing a central document setting forth their rights and enables government agencies to determine whether the arrangements satisfy applicable law and, in particular, for determining which employees are eligible to participate in the plan.

effect of failure to adopt a plan document before January 1, 2009

The final regulations warn a failure to adopt a written plan document before January 1, 2009, will render all subsequent contributions to the plan fully taxable.

allocation of responsibilities

The final regulations note that a 403(b) plan is permitted to allocate to the employer, or to one or more third parties (i.e., investment companies),the responsibility for compliance with section 403(b) and the regulations. Any such allocation must identify who is responsible for compliance with the requirements of section 403(b) including loans and hardship withdrawals.

However, the IRS summary of the final regulations asserts that it is generally inappropriate to allocate these responsibilities to employees, for a number of reasons:

> First, employees often lack the expertise to systematically meet these responsibilities and may not recognize the importance of performing these actions (including not fully appreciating the tax consequences of failing to perform the responsibility). Second, an individual employee may have a self-interest in a particular transaction. In addition, while there are various factors that will often cause an employer or issuer to have an interest in procedures that ensure that the requirements of section 403(b) are satisfied (including income tax withholding requirements), an employee generally bears the income tax exposure and other risks of failing to comply with rules set forth in the plan. The IRS and Treasury Department believe it is important to prevent failures in advance so as to minimize the cases in which the adverse effects of a failure fall on the employee.

The IRS summary of the final regulations further specifies: "In the case of a plan that is funded through multiple issuers, it is expected that an employer would adopt a single plan document to coordinate administration among the issuers, rather than having a separate document for each issuer."

The final regulations generally take effect in 2009. However, the effective date is delayed to January 1, 2010, for 403(b) plans maintained by a church-related organization for which the authority to amend the plan is held by a church convention. The IRS special Web site for 403(b) compliance clarifies this special rule as follows: "Churches that sponsor 403(b)s where the obligation to either establish the 403(b) or amend the 403(b) plan itself is an outcome of a church convention [are subject to the delayed effective date]. So merely because a 403(b) is sponsored by a church does not, in and of itself, mean that it's going to experience a delayed effective date but rather, where the authority to amend or establish the plan would be with the church convention."

drafting a plan document

What help is available to churches in complying with the written plan requirement? Consider the following options:

- The IRS has made a sample plan document available to public schools, and in 2009 will be releasing a more generic plan document that can be used by other tax-exempt organizations. While neither document could be used by a church without modifications, they will be helpful in the drafting of an adequate church plan document.
- Many churches use 403(b) plans established by a denominational retirement plan. Most of these denominational plans have created plan documents that can be used by affiliated churches, with minor changes.
- Some churches have established 403(b) plans directly through a mutual fund or other investment company. Most of these third party vendors have created generic plan documents for use by their clients. However, these documents are not designed for churches, and as a result will require far more modification than the sample documents provided by a denominational plan.

The final regulations clarify the requirement that the plan document include all of the material provisions by permitting the plan to incorporate by reference other documents (including salary reduction agreements, contracts, and policies) which as a result of such reference would become part of the plan. As a result, a plan may include a wide variety of documents, but it is important for the employer that adopts the plan to ensure that there is no conflict with other documents that are incorporated by reference. If a plan does incorporate other documents by reference, then, in the event of a conflict with another document, except in rare and unusual cases, the plan would govern.

An IRS website addressing the 403(b) final regulations provides the following additional guidance:

> You'll notice the 403(b) final regulations never used the word plan document because it is the belief that this plan could be a subject of a number of items either stapled together or held together by a big paperclip.
>
> Many organizations may already have these types of programs and not even realize it. For example, the plan can be composed of a salary reduction agreement, the various contracts that fund the plan, as well as administrative procedures regarding who is eligible, how benefits are made available and what the dollar limitations are.
>
> If all those items, including nondiscrimination items for universal availability for salary reductions and non-elective nondiscrimination situations, if you have them, if all that is spelled out, you could just clip those documents together and you've got your plan.
>
> That's not to say that individuals cannot maintain this plan pursuant to a single written document. That would be fine too. To help organizations meet this written plan requirement, a revenue procedure will soon be released that will contain model plan language that would enable a sponsor of a 403(b) to put together a very simple basic 403(b) program based upon the model plan language.

2. Active and Inactive Vendors

Since one of the purposes of a written plan document is the allocation of compliance responsibilities between the employer and fund providers, it is important for the document to identify these parties. However, "frozen" vendors that have not received elective deferrals since January 1, 2005, do not have to be identified in the plan document. Frozen vendors that have received elective deferrals after January 1, 2005 generally must be accounted for in the plan document, pursuant to the following two options: First, the employer can direct the vendor to "freeze" employee accounts, thereby cutting off access to loans and hardship distributions. Second, the employer can allow the vendor to continue making loans and hardship distributions to employees, but this will require an information sharing agreement that requires the vendor to share data with the employer that will enable it to approve such transactions and monitor compliance with section 403(b).

3. Nontaxable Exchanges and Transfers

In the past, some employees who participated in their employer's 403(b) plan were not satisfied with the investment options or performance. To illustrate, take a church that offered employees the opportunity to invest their 403(b) account with three different fund providers (vendors). But, an employee wanted to invest her funds with a different provider. If the church refused to add a fourth provider to its approved list, the employee could take her accumulated funds in the existing 403(b) plan and transfer them to another vendor of her choice. This was called a "90-24 transfer," based on a 1990 IRS ruling (Revenue Ruling 90-24) that authorized such transfers.

The problem with these transfers was that they were not a reportable event on a Form 1099, so no one, including the IRS, knew they had occurred. The employer would not know where the employee's money was either. How, then, could the employer determine if the requirements for a 403(b) plan were being satisfied? For example, were the limitations on loans from a 403(b) plan exceeded? Or, was an employee's financial hardship sufficient to warrant a hardship withdrawal? Clearly, such 90-24 exchanges were not working, and this was contributing to an unknown degree of noncompliance with section 403(b).

The final regulations addressed this problem by eliminating 90-24 exchanges, and replacing them with two options for transferring funds out of an existing 403(b) account while the employee is still working for the same employer, without any of the funds being currently taxable: (1) contract exchanges (a change of investment within the same plan), and (2) fund transfers (a plan-to-plan transfer, so that another employer plan receives the exchange). Contract exchanges and fund transfers are explained below.

The discussion of contract exchanges in this section is based on the language in the final regulations. Some IRS officials have made public statements indicating that the concept of contract exchanges only applies to transfers of funds to a vendor that is not approved by an employer's 403(b) plan to receive contributions, and not to employees' transfers of funds between vendors who are approved under the plan. As a result, the definition of contract exchanges may change based on future IRS guidance.

4.Contract Exchanges

Revenue Ruling 90-24 allowed employees to "exchange" their 403(b) contract with a contract from another provider without the balance being included in taxable income, so long as the successor contract included distribution restrictions that were the same or more stringent than the distribution restrictions in the contract that was being exchanged.

The final regulations allow an exchange of one contract for another to constitute a nontaxable change of investment within the same plan, but only if certain conditions are satisfied in order to facilitate compliance with tax requirements. The IRS summary that accompanies the final regulations explains:

> Specifically, the other contract must include distribution restrictions that are not less stringent than those imposed on the contract being exchanged and the employer must enter into an agreement with the issuer of the other contract under which the employer and the issuer will from time to time in the future provide each other with certain information. This includes information concerning the participant's employment and information that takes into account other section 403(b) contracts or qualified employer plans, such as whether a severance from employment has occurred for purposes of the distribution restrictions and whether the hardship withdrawal rules in the regulations are satisfied. Additional information that is required is information necessary for the resulting contract or any other contract to which contributions have been made by the employer to satisfy other tax requirements, such as whether a plan loan constitutes a deemed distribution under section 72(p). . . .

A 403(b) plan document must specifically allow contract exchanges for them to be a permissible option for employee participants. If a plan document does not provide for contract exchanges, employees may not utilize them.

Clearly, churches that allow employees to invest their 403(b) contract with more than one authorized vendor will be incurring significant additional paperwork and administrative responsibilities. The same is true for any tax-exempt entity that offers multiple investment providers to its employees. An "information sharing agreement" (ISA) will need to be executed with each investment provider to ensure that it is sharing enough information with the employer to enable it to ensure compliance with section 403(b). To illustrate, some of the issues that each ISA must address include the following:

loans

A 403(b) plan can authorize employees to obtain loans. Such loans will not be deemed to be a taxable distribution so long as the requirements imposed by section 72(p) of the tax code are satisfied. These requirements include:

- a written, enforceable agreement;
- a reasonable rate of interest;
- a loan term of not more than five years;
- an amortization schedule providing for repayments no less frequently than quarterly;
- a principal loan amount not to exceed the lesser of (1) $50,000, or (2) the lesser of 50 percent of the vested account balance or $10,000.

A failure to comply with any of these requirements will cause a loan, or a portion of a loan, to be a "deemed distribution" that is taxed like an actual distribution. Without an ISA, an employer would have no way of knowing if its employees who have selected a third party investment provider were complying with the loan requirements. This illustrates one of the most important objectives of the final regulations.

The final regulations prohibit employees from self-certifying their eligibility for a loan (as was permitted in the past). The employer or plan administrator must approve each employee's loan and ensure compliance with the law.

IRS field audits have revealed widespread noncompliance with the loan requirements, with no portion of the noncompliant loans being reported to the IRS as taxable distributions as required by section 72(p) of the tax code.

hardship distributions

A 403(b) plan may, but it not required to, provide for hardship distributions of 403(b) funds under specified circumstances, as noted previously. In the past, employees could "self-certify" their eligibility for hardship distributions. This is no longer possible under the final regulations. An employee's eligibility for a hardship distribution must be certified by the employer or plan administrator. This illustrates one of the most important objectives of the final regulations.

For a distribution to be on account of hardship, it must be made on account of an immediate and heavy financial need of the employee and the amount must be necessary to satisfy the financial need. The need of the employee includes the need of the employee's spouse or dependent. Whether a need is immediate and heavy depends on the facts and circumstances. Certain expenses are deemed to be immediate and heavy, including: (1) certain medical expenses; (2) costs relating to the purchase of a principal residence; (3) tuition and related educational fees and expenses; (4) payments necessary to prevent eviction from, or foreclosure on, a principal residence; (5) burial or funeral expenses; and (6) certain expenses for the repair of damage to the employee's principal residence.

A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee. A distribution is not considered necessary to satisfy an immediate and heavy financial need of an employee if the employee has other resources available to meet the need, including assets of the employee's spouse and minor children.

A distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if: (1) the employee has obtained all other currently available distributions and loans under the plan and all other plans maintained by the employer; and (2) the employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least six months after receipt of the hardship distribution.

The amount of elective contributions available for a hardship distribution cannot be more than the amount of the employee's total elective contributions as of the date of distribution reduced by the amount of previous distributions of elective contributions. This "maximum distributable amount" generally does not include earnings, qualified nonelective contributions or qualified matching contributions.

Unlike loans, hardship distributions are not repaid to the plan. As a result, a hardship distribution permanently reduces the employee's account balance under the plan. A hardship distribution cannot be rolled over into an IRA or another qualified plan.

The final regulations prohibit employees from self-certifying their eligibility for a hardship distribution. The employer or plan administrator must approve each employee's hardship distributions and ensure compliance with the law.

"Procedures that rely on an employee certification, such as whether a severance from employment has occurred or whether the participant has other outstanding loans, would generally not be adequate to meet this standard, because such a certification is not disinterested, and also because of the lack of employer oversight in the certification process to ensure accuracy." *IRS summary of the final regulations.*

A recent survey of 403(b) providers revealed that most plan on minimizing the administrative burdens associated with the final regulations in the following ways: (1) Permitting employees to invest their 403(b) funds with only one employer-approved vendor (for many religious organizations this will be a denominational plan). Employees can no longer bypass employer approval by engaging in 90-24 transfers, as in the past. (2) Permitting employees to invest their 403(b) funds with multiple vendors, but inserting a provision in the plan document that prohibits loans and hardship distributions.

5. Plan-to-Plan Transfers

Under the final regulations, plan-to-plan transfers are permitted if the participant whose assets are being transferred is an employee or former employee of the employer that maintains the receiving plan and certain additional requirements are met. However, the regulations prohibit a plan-to-plan transfer to a qualified plan, a plan under section 457(b), or any other type of plan that is not a section 403(b) plan. Similarly, a section 403(b) plan is not permitted to accept a transfer from a qualified plan, an eligible plan under section 457(b), or any other type of plan that is not a section 403(b) plan.

6. Limitations on Contributions

The final regulations provide that the section 403(b) exclusion applies only to the extent that *all amounts contributed by the employer* for the purchase of an annuity contract for the participant do not exceed the applicable limits under section 415 of the tax code (generally, for 2008, the lesser of $46,000 or 100 percent of an employee's includible compensation for the most recent year of service).

If an *employer's excess annual addition* is made to a contract that otherwise satisfies the requirements of section 403(b), then the portion of the contract that includes the excess will fail to be a section 403(b) contract and the remaining portion of the contract that includes the contribution that is not in excess of the section 415 limitations is a section 403(b) contract.

With respect to section 403(b) *elective deferrals* (contributions by means of salary reduction agreements), section 403(b) applies only if the contract is purchased under a plan that includes the elective deferral limits under section 402(g) of the tax code, including aggregation of all plans, contracts, or arrangements of the employer that are subject to the limits of section 402(g). In general, the elective deferral limit for 2008 was $15,500 (some exceptions may apply).

Any contribution made for a participant to a section 403(b) contract for a taxable year that exceeds either the section 415 maximum annual contribution limits or the section 402(g) elective deferral limit constitutes an excess contribution that is included in gross income for that taxable year.

7. Catch-up Contributions

A section 403(b) plan may provide for additional catch-up contributions for a participant who is age 50 by the end of the year, provided that those age 50 catch-up contributions do not exceed the catch-up limit under section 414(v) for the taxable year ($5,000 for 2008). In addition, a section 403(b) plan may provide that an employee who has at least 15 years of service is entitled to a special section 403(b) catch-up limit.

Under the special section 403(b) catch-up limit, the section 402(g) limit is increased by the lowest of the following three amounts: (i)$3,000; (ii) the excess of $15,000 over the amount not included in gross income for prior taxable years by reason of the special section 403(b) catch-up rules, plus elective deferrals that are designated Roth contributions; or (iii) the excess of (A) $5,000 multiplied by the number of years of service of the employee with the qualified organization, over (B) the total elective deferrals made for the employee by the qualified organization for prior taxable years. For this purpose, a qualified organization includes a church-related organization.

The final regulations provide that any catch-up contribution for an employee who is eligible for both an age 50 catch-up and the special section 403(b) catch-up is treated first as a special section 403(b) catch-up to the extent a special section 403(b) catch-up is permitted, and then as an amount contributed as an age 50 catch-up (to the extent the age 50 catch-up amount exceeds the maximum special section 403(b) catch-up).

8. Timing of Distributions and Benefits

The final regulations reflect the section 403(b) rules regarding when distributions can be made. Distributions of amounts attributable to section 403(b) *elective deferrals* (made pursuant to a salary reduction agreement) may not be paid to a participant earlier than when the participant has a severance from employment, has a hardship, becomes disabled, or attains age 59½. Hardship is generally defined under regulations issued under section 401(k).

In addition, amounts held in a custodial account attributable to *employer contributions* (that are not section 403(b) elective deferrals) may not be paid to a participant before the participant has a severance from employment, becomes disabled, or attains age 59½. This rule also applies to amounts transferred out of a custodial account to an annuity contract or retirement income account, including earnings thereon.

The final regulations include a number of exceptions to the timing restrictions. For example, the rule for elective deferrals does not apply to distributions of section 403(b) elective deferrals that were contributed before January 1, 1989.

9. Severance from Employment

The final regulations define severance from employment in a manner that is generally the same as the regulations under section 401(k), but provide that, for purposes of distributions from a section 403(b) plan, a severance from employment occurs on any date on which the employee ceases to be employed by an eligible employer that maintains the section 403(b) plan.

10. Special Rules for Church Plans

The final regulations include a number of special rules for church plans. Under section 403(b)(9), a retirement income account for employees of a church-related organization is treated as an annuity contract for purposes of section 403(b). The regulations define a retirement income account as a defined contribution program established or maintained by a church-related organization under which (i) there is separate accounting for the retirement income account's interest in the underlying assets (namely, it must be possible at all times to determine the retirement income account's interest in the underlying assets and to distinguish that interest from any interest that is not part of the retirement income account), (ii) investment performance is based on gains and losses on those assets, and (iii) the assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. For this purpose, assets are treated as diverted to the employer if the employer borrows assets from the account.

A retirement income account must be maintained pursuant to a program which is a plan and the plan document must state (or otherwise evidence in a similarly clear manner) the intent to constitute a retirement income account.

If any asset of a retirement income account is owned or used by a participant or beneficiary, then that ownership or use is treated as a distribution to that participant or beneficiary.

A life annuity can generally only be provided from an individual account by the purchase of an insurance annuity contract. However, in light of the special rules applicable to church retirement income accounts, the final regulations permit a life annuity to be paid from such an account if certain conditions are satisfied. The conditions are that the distribution from the account has an actuarial present value, at the annuity starting date, that is equal to the participant's or beneficiary's accumulated benefit, based on reasonable actuarial assumptions, including assumptions regarding interest and mortality, and that the plan sponsor guarantee benefits in the event that a payment is due that exceeds the participant's or beneficiary's accumulated benefit.

11. Termination of a Section 403(b) Plan

The final regulations allow an employer to amend its section 403(b) plan to eliminate future contributions for existing participants, and to allow plan provisions that permit plan termination and a resulting distribution of accumulated benefits, with the associated right to roll over eligible rollover distributions to an eligible retirement plan, such as an individual retirement account or annuity (IRA).

12. Timing of Contributions

The final regulations specify that contributions to a section 403(b) plan must be transferred to the investment provider (vendor) within a period that is not longer than is reasonable for the proper administration of the plan. For purposes of this requirement, the plan may provide for section 403(b) elective deferrals for a participant under the plan to be transferred to the vendor within a specified period after the date the amounts would otherwise have been paid to the participant. For example, the plan could provide for section 403(b) elective deferrals under the plan to be contributed within 15 business days following the month in which these amounts would otherwise have been paid to the participant.

13. Effect of a Failure to Satisfy Section 403(b)

Section 403(b)(5) of the tax code provides for all of the contracts purchased for an employee by an employer to be treated as a single contract for purposes of section 403(b). As a result, if a contract fails to satisfy any of the section 403(b) requirements, then not only that contract but also any other contract purchased for that individual by that employer would fail to be a contract that qualifies for tax-deferral under section 403(b).

If a contract includes any amount that fails to satisfy the requirements of the regulations, then, except for special rules relating to vesting conditions and excess contributions (under section 415 or section 402(g)), that contract and any other contract purchased for that individual by that employer does not constitute a section 403(b) contract.

In addition, if a contract is not established pursuant to a written plan, then the contract does not satisfy section 403(b). To illustrate, if an employer fails to have a written plan, any contract purchased by that employer would not be a section 403(b) contract. Similarly, if an employer is not an eligible employer for purposes of section 403(b), none of the contracts purchased by that employer is a section 403(b) contract.

Any operational failure, other than those described in this section, that is solely within a specific contract generally will not adversely affect the contracts issued to other employees that comply with section 403(b). For example, if an employee's elective deferrals under a contract, when aggregated with any other contract, plan, or arrangement of the employer for that employee during a calendar year, exceed the maximum deferral amount permitted under section 403(b), the failure would adversely affect the contracts issued to the employee by that employer, but would not adversely affect any other employee's contracts.

14. Former Employees

The final regulations permit employers to make nonelective employer contributions on behalf of a former employee through the fifth year following his or her termination of employment. Nonelective employer contributions for a former employee cannot exceed certain limitations spelled out in the regulations. However, note that nondiscrimination rules that apply to some church affiliated entities prohibit nonelective employer contributions to discriminate in favor of highly compensated former employees (for 2008, those with annual income of $105,000 or more).

B. What Should Churches Do to Comply with the Final Regulations?

Churches that offer a 403(b) plan to their employees should be aware of the following compliance issues:

1. Adopt a written plan

As noted previously in this article, the adoption of a written plan document is essential. And, this task must be completed by December 31, 2008. Keep in mind the following points.

- The plan document must address all aspects of your 403(b) plan, and demonstrate compliance with legal requirements.
- The plan document should allocate the responsibility for compliance with section 403(b) to the employer or third party vendors. Remember, compliance cannot be shifted to employee participants.
- If you have a 403(b) plan that uses a denominational provider, check with your denomination. Many have prepared documents that you can use that will be compliant with the plan document requirement.
- If you have a 403(b) plan that uses a commercial mutual fund or investment company as a fund provider, check to see if it has created a generic document that you can use that will be compliant with the plan document requirement.
- The IRS has made a sample plan document available to public schools, and in 2009 will be releasing a more generic plan document that can be used by other tax-exempt organizations. Both documents will of some assistance to churches in drafting their own plan document. The IRS has noted: "To help organizations meet this written plan requirement, a revenue procedure will soon be released that will contain model plan language that would enable a sponsor of a 403(b) to put together a very simple basic 403(b) program based upon the model plan language."
- Any generic document that you obtain from a denominational plan or commercial investment company likely will need to be modified to account for unique circumstances. While such documents rarely will serve as a church's plan document with such modifications, the fact remains that plan documents prepared by commercial mutual fund and investment companies are not designed for churches, and as a result will require far more modification than the sample documents provided by a denominational plan.
- The plan document may be a single document, or a group of documents including 403(b) contracts, salary reduction agreements, and administrative procedures or policies addressing eligibility and benefits. However, a single comprehensive plan is always superior, since it will avoid the problem of conflicts among several separate documents that may or may not comprise a plan document.
- Remember, in some cases a church may have documents that collectively satisfy the plan document requirement. Obviously, a single document is preferable. Multiple documents require a careful review to eliminate inconsistencies and supply any missing information.

Special rules apply to some churches having a complex legal structure or for-profit subsidiaries, and to some church-affiliated schools, hospitals, and other institutions. Churches and institutions in these categories should contact their denominational plan, or an attorney, regarding compliance issues.

2. Multiple Vendors?

One of the most important decisions for church leaders to make is whether to have one investment provider, or multiple providers. As noted previously, the administrative burden increases significantly for churches that choose to allow employees to invest their elective deferrals (salary reductions) with more than one third party vendor. At a minimum, the church in such a case will need to: (1) enter into an information sharing agreement (ISA) with each vendor obligating the vendor to provide the church with timely information on a number of issues, and (2) continually monitor compliance with section 403(b). This is a significant administrative burden that many churches will not be prepared to meet. And, while employers are permitted to delegate some compliance responsibilities to third party vendors, no vendor will have sufficient information to assess compliance by the entire plan with section 403(b).

Surveys of tax-exempt organizations, including religious organizations, that offer 403(b) plans reveals that many are taking steps to minimize the administrative burdens associated with the new regulations by selecting a single investment provider.

Note, however, that if employees transfer their 403(b) contracts from a commercial investment firm that no longer is approved by their employer, they may face transfer fees or penalties. Some employees will be able to minimize or avoid such fees by keeping their accounts with the third party vendor for the minimum amount of time specified by the vendor agreement.

Some 403(b) plan providers that are switching to a single third party provider are reducing or eliminating the impact of surrender fees by freezing any future elective deferrals (salary reductions) to third party vendors other than the approved vendor, and letting the employees maintain their accounts with these vendors for a sufficient amount of time to avoid surrender fees.

3. For Further Assistance

Churches that are affiliated with denomination that offers a 403(b) plan should check with their denominational plan for compliance related questions. Churches that offer 403(b) plans through one or more commercial mutual fund or investment firms should check with those vendors for assistance. In addition, the IRS Web site contains a section that is devoted to compliance with the new regulations.

The author of the new regulations is IRS employee Bob Architect. Questions regarding the application of the regulations to your church can be directed to him at 202-283-9634.

C. Examples

The following examples illustrate some of the issues addressed in this article.

> ***Example.*** *A church established a 403(b) plan several years ago that allows employees to invest with any one of four mutual fund companies. In the past, some employees who wanted to invest with other investment providers simply transferred their account*

balances from one of the four approved vendors to the vendor of their choice. The final regulations specify that such fund transfers (formerly called "90-24 transfers") will no longer be allowed after December 31, 2008. Recent statements made by some IRS officials indicate that this interpretation of the regulations may be too restrictive, and may only apply to fund providers that are not approved by an employer's plan document. The IRS may clarify this issue in 2009.

Example. *A church adopts a 403(b) plan that restricts investments to a denominational plan. An employee wants to invest with a mutual fund company. This investment will not be permitted unless the church's plan document specifically authorizes it.*

Example. *Same facts as the previous example, except that the church modifies its plan document to permit employees to invest in the mutual fund company in addition to the denominational plan. An employee may transfer his or her 403(b) contract from the denominational plan to the mutual fund company in what is now called a "contract exchange." However, the final regulations require in such a case that the church and mutual fund company execute an "information sharing agreement" by which the company agrees to share specified information with the church to enable it to ensure compliance with section 403(b).*

Example. *Same facts as the previous example, except that the church's plan document lists five authorized mutual fund companies with which employees may invest. The church will be required to enter into information sharing agreements with all five companies, and to monitor shared information to ensure compliance with section 403(b). For most churches, this will constitute a significant administrative burden. It is for this reason that many tax-exempt organizations that offer 403(b) plans are moving to a single investment provider.*

Example. *A church adopts a 403(b) plan that allows employees to invest with a denominational pension plan. No other fund providers are authorized. This church has minimal responsibilities in complying with the new regulations. It must adopt a plan document, but in most cases one will be available from the denominational plan that will provide helpful information to assist the church with complying with 403(b) requirements.*

Example. *A church has heard about the new 403(b) regulations, and hastily assembles a written plan that addresses some of the compliance issues. This is not enough to satisfy the written plan document requirement. The final regulations require 403(b) providers, including churches, to have a plan document in place no later than December 31, 2008 that in form and operation satisfies the requirements of section 403(b) and the regulations.*

Example. *A church has adopted a 403(b) plan for its employees. However, it fails to adopt a written plan document by December 31, 2008. Is the church's 403(b) plan noncompliant due to the church's failure to timely adopt a plan document? Not necessarily. The definition of a "plan document" is quite liberal. An IRS website that is devoted to compliance with the final regulations specifies: "You'll notice the 403(b) final regulations never used the word plan document because it is the belief that this plan could be a subject of a number of items either stapled together or held together by a big paperclip. Many organizations may already have these types of programs and not even realize it. For example, the plan can be composed of a salary reduction agreement, the various contracts that fund the plan, as well as administrative* *procedures regarding who is eligible, how benefits are made available and what the dollar limitations are. If [you have] all those items . . . you could just clip those documents together and you've got your plan." Note, however, that the church will be responsible for resolving conflicts among these various documents.*

Example. *A church establishes its own 403(b) plan for its employees, and allows them to invest in a denominational plan and one commercial mutual fund company. The church's plan document does not authorize loans. Employees have no right to obtain a loan under the plan.*

Example. *Same facts as the previous example except that the plan permits loans. The church makes loans to any employee who requests one, and who signs a form certifying that he or she complies with the legal requirements that apply to loans under a 403(b) plan. Under the final 403(b) regulations, employees are no longer allowed to self-certify their eligibility for a loan. The employer is responsible for ensuring that each loan complies with the limitations and requirements specified in section 72(p) of the tax code.*

Example. *A church establishes its own 403(b) plan for its employees, and allows them to invest in a denominational plan and one commercial mutual fund company. The church's plan document does not authorize hardship distributions to employees. Employees have no right to obtain a hardship distribution under the plan.*

Example. *Same facts as the previous example except that the plan permits hardship distributions. The church makes hardship distributions to any employee who requests one, and who signs a form certifying that he or she complies with the legal requirements that apply to such distributions under a 403(b) plan. Under the final 403(b) regulations, employees are no longer allowed to self-certify their eligibility for a hardship distribution. The employer is responsible for ensuring that each hardship distribution complies with the limitations and requirements specified in section 72(p) of the tax code.*

Example. *A church fails to adopt a written plan document by December 31, 2008. The legal effect of this omission is described in the final regulations as follows: "If a contract is not established pursuant to a written plan, then the contract does not satisfy section 403(b). To illustrate, if an employer fails to have a written plan, any contract purchased by that employer would not be a section 403(b) contract."*