

MEMORANDUM TO CLIENTS

April 16, 2009

RE: IRS RELEASES PROPOSED 403(B) PROTOTYPE PLAN PROCEDURES AND MODEL 403(B) PLAN LANGUAGE

In Announcement 2009-43 (April 14, 2009), the IRS issued a draft revenue procedure that would establish a 403(b) prototype plan program. Proposed 403(b) sample plan language (67 pages) has also been posted on the IRS website (http://www.irs.gov/pub/irs-tege/draft_lrm_403b_prototypes.pdf). These long-awaited pieces of proposed guidance establish a proposed framework for a prototype plan design, approval and adoption process that generally parallels the opinion letter program for master and prototype tax-qualified defined benefit and defined contribution plans.

The IRS has requested comments on the draft revenue procedure, the draft sample plan language, or any other aspect of the proposed 403(b) prototype plan program, generally by June 1. In addition, prototype sponsors (*i.e.*, generally sponsors that expect at least 30 eligible employers to adopt its prototype plan) and mass submitters (*i.e.*, a person that expects to file at least 30 opinion letter requests for word-for-word prototype sponsors adopters of the mass submitters' 403(b) plan) are asked to separately report how many opinion letter applications it will submit to ep.prototype.projections@irs.gov.

The 403(b) prototype plan program is not expected to be open for filings until later in 2009. 403(b) prototype plan submissions will be required to be submitted under the program no earlier than March 15, 2010, although a later deadline may apply. The IRS intends to establish an individually designed determination letter plan program for 403(b) plans after the prototype program is implemented.

Meanwhile, we understand that IRS is working on updated 403(b) Audit Guidelines that reflect the final regulations and hopes to have them completed by year-end. The expectation is that IRS agents would use them during audits beginning in 2010. In this regard, it is not clear how IRS audit staff will view non-compliant plan terms during audits of the 2010 and possibly 2011 calendar years.

A. Remedial Amendment Period

The proposed prototype program would establish a remedial amendment period for amending 403(b) plans to bring them into compliance with applicable legal requirements governing the form of a plan document. Notably, although the proposed revenue procedure addresses the 403(b) prototype program, the remedial amendment period provisions also provide for a remedial amendment period for individually designed plans that file under the individually-designed 403(b) plan determination letter program that will be implemented in the future. This 403(b) remedial amendment period is not the same as the remedial amendment for tax-qualified plans because section 401(b) of the Internal Revenue Code (the "Code"), which generally provides for remedial amendment periods, does not apply to 403(b) plans.

The proposed 403(b) remedial amendment period would generally run from January 1, 2010 because the transition relief in Notice 2009-3 requires a plan document be adopted by December 31, 2009. We understand that the remedial amendment period structure is designed to permit a plan to be amended retroactive back to January 1, 2009, to bring it into compliance. Notably, this retroactive amendment ability does not relieve a plan sponsor of its duty to adopt a plan document by December 31, 2009 under Notice 2009-3 or, in the case of ERISA 403(b) plans, to have a written plan document in place at all times. As such, sponsors should not view the remedial amendment period as a further extension of time to amend their documents, but rather as a means to correct failures in documents that are timely adopted in 2009 in reasonable good faith.

B. Key Features of 403(b) Prototype Plans

The proposed prototype program provides that there are two key documents in a prototype plan – a basic plan document and an adoption agreement. The 403(b) prototype plan program will only take into account these two documents – insurance contract and custodial account provisions will not be considered. Multiple adoption agreements (e.g., one for simple elective deferral plans and one for plans with employer contributions) can be used with the same basic plan document.

Key additional features of a 403(b) prototype plan include –

- **Vesting.** A 403(b) prototype plan must not apply a vesting schedule to employer contributions of any kind. This rule applies to all types of 403(b) plans – including governmental and church plans. This restriction will likely limit the appeal of a prototype plan to sponsors who wish to use a vesting schedule.
- **Conflicts Between Plan Documents and Funding Arrangements.** A 403(b) prototype plan must provide that its terms control over the inconsistent terms of any funding arrangement, such as an annuity contract or custodial account. To the extent that a plan sponsor is using a single vendor who has provided a prototype plan, this requirement is likely to be of limited impact. However, where multiple funding arrangement providers are involved, plan sponsors will need to carefully evaluate whether the terms of their 403(b) prototype plan (e.g., loans, hardships, transfers between vendors) are consistent with the terms of funding arrangements to ensure there is not a problem later over which terms govern that could adversely impact a plan sponsor's reliance on a 403(b) prototype plan's opinion letter.
- **Plan Administration.** A 403(b) prototype plan must identify who will fulfill the various plan administrator functions required under the final 403(b) regulations. Sponsors of plans that are designed to use the ERISA safe harbor that permits tax-exempt organization 403(b) plans to be exempt from ERISA will want to carefully evaluate how to allocate plan administrator duties to ensure that they do not inadvertently fall out of the safe harbor rule.

- **List of Vendors.** A 403(b) prototype plan must either identify the plan's funding arrangements or refer to a list separately maintained by a plan administrator.
- **Prototype Sponsor Rights and Duties.** A prototype sponsor must have the right to amend a 403(b) prototype plan. Further, a prototype sponsor will have an ongoing duty to amend its plan for changes in applicable law and to communicate these changes to plan sponsors that adopt its plan (including procedures to document compliance with these requirements).
- **Types of 403(b) Prototype Plans.** There are two types of 403(b) prototype plan – standardized and non-standardized. Standardized plans are employee deferral only (including Roth 403(b) deferrals) or have employer contributions that satisfy the nondiscrimination rules' uniform coverage and contribution rules. Non-standardized plans are plans with employer contributions that do not satisfy the uniform coverage and contribution rules. Non-standardized plans will need to submit individual determination letters (when available) if they wish to obtain a ruling that they satisfy the contribution and coverage nondiscrimination rules.

C. **Sample Plan Language**

The draft sample plan language provides sample 403(b) plan provisions that address elective deferrals (pre-tax and Roth), employer matching, employer non-elective, and after-tax contributions. This language supplements the model plan language for a salary reduction only 403(b) plan provided in Revenue Procedure 2007-71. Public school employers were permitted to (and may continue to) rely on a word-for-word adoption of (or plan amendment containing) the 2007 language as complying with the applicable 403(b) plan document requirements. Features of the draft sample plan language include the following:

- **Certain Types of Plan Not Addressed.** The IRS does not provide model language addressing the specific rules applicable to grandfathered TEFRA church defined benefit plans, church plans (including qualified church controlled organizations), minister plans, and grandfathered governmental plans not funded with annuity contracts or custodial accounts. These types of plans may not receive 403(b) prototype plan opinion letters.
- **ERISA Provisions.** Part II of the LRMs includes provisions for employer and employee contributions and related ERISA rules (e.g., hours of service and year of service definitions). However, the draft sample plan language is generally silent on ERISA fiduciary duties because the IRS does not have jurisdiction of the fiduciary responsibilities described in Title I of ERISA.
- **Required Minimum Distributions.** The draft sample plan language incorporates model plan language similar to the required minimum distribution model plan language in Revenue Procedure 2002-29. However, several aspects of this language (e.g., annuity payments) do not appear to acknowledge the fact that governmental plans are subject to "reasonable and good faith compliance" with the required minimum distribution rules in Code section 401(a)(9). In addition,

the draft sample language does not contain the rule that allows a required minimum distribution from one 403(b) plan to be taken from any other 403(b) plan account of the employee.

- **Cashout Rules.** The draft sample plan language imposes a \$5,000 cap on cashouts, which does not apply to governmental plans.

D. Other Considerations

While certainly a positive step forward, the proposed 403(b) prototype plan program leaves open a number of questions including –

- **Cutback Issues for ERISA Plans.** ERISA 403(b) plans have always been required to have a written plan document. The Notice 2009-3 transition relief and the proposed 403(b) remedial amendment period does not alter this requirement. To the extent that an existing ERISA 403(b) plan document is amended to cut back benefits in a new plan document designed to be compliant with the final 403(b) regulations, changes reflected in the amendment could still result in violations of the ERISA section 204(g) anti-cutback rules.
- **Timing of Amendments to 403(b) Prototype Plans.** While the proposed remedial amendment period provides guidance on retroactive amendments, it does not address how often interim amendments will be required. Presumably, such amendments will be required for both prototype and individually designed 403(b) plans on a similar basis as for tax-qualified plans (although more clarity would be helpful).
- **IRS Correction Program – Plan Document Failures.** Although the remedial amendment period provides some relief from document failures, it does not provide relief for sponsors who fail to adopt a plan document by December 31, 2009. Hopefully a future update of the Employee Plans Compliance Resolution System will permit correction of this failure.

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If you have any questions, please contact your regular Groom contact or any of the attorneys listed below:

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