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IRS Issues Updated 403(b) Listing of Required Modifications

The IRS recently issued an updated listing of required modifications (“LRMs”), which provide sample language that satisfies certain requirements under Code section 403(b) and the regulations thereunder. Although most of the changes are minor, including updates to reflect cost of living adjustments for purposes of benefit and contribution limitations, there are a few changes that are particularly notable.

In LRM Item 17, the definition of “participant” was clarified to provide that if the plan applies the “normally works fewer than 20 hours per week”/1,000 hours in a year exclusion from the “universal availability” rule, once the employee crosses that threshold (for example, they work more than 1000 hours in a year), the exclusion no longer applies and they can make salary reduction contributions thereafter, even if they later drop back below the threshold. This change confirms the general understanding of the application of this rule.

In LRM Item 24, regarding the definition of “severance from employment,” the example that severance from employment includes where “the Employee ceases to be employed by the Employer and is not an Employee of any other Public School of the same State” was deleted. Regardless, the requirement remains that an employer must make a good faith determination of whether an individual’s movement to employment with a “related employer” as that term is defined in the LRMs constitutes a severance from employment. As such, these determinations must continue to be made on a case-by-case basis.

LRM Item 65 provides that any nonvested amounts under a plan must be treated as a separate contract to which Code section 403(c) applies. However, the changes clarify that the separate account requirement is met so long as separate bookkeeping accounts are maintained, i.e., physically separate accounts are not required.

The updates to the LRMs also make the following changes which may be applicable to your plan:

- The definition of “disabled” was clarified to provide that a separate definition may be provided for annuity accounts distributing amounts that are not attributable to elective deferrals. LRM Item 11.
- The provision regarding the suspension of contributions after receipt of a hardship distribution was modified to specifically include the suspension of after-tax employee contributions. LRM Item 45.
- A note was added, after the language regarding criteria for employer contributions, to provide that a nonstandardized or volume submitter plan may provide (as an option in its adoption

agreement) a threshold minimum hours requirement up to 1,000 hours of service before employer contributions will be made. LRM Item 66.

While these updates may not require changes to all plan documents, changes in operation may be required. Therefore, a review of your plan document and operations now may avoid difficulties in the future.

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