

Individual and Pre-Approved 403(b) Plan Documents – Evaluating What to Do in 2022

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Background

Back in 2013, the IRS opened its first 6-year cycle of reviewing and issuing opinion letters on 403(b) pre-approved documents. Most of the approval letters for that first set of plans were issued to the pre-approved plan providers in 2017. Employers using them were to have adopted those new documents by June 30, 2020. Also, in 2013 the IRS stated that it would not be issuing determination letters on individual 403(b) plans in the future, though it had initially indicated it would open a program to do so.

The second 6-year filing cycle is now coming around. The IRS has announced in recent Rev. Proc. 2021-37 that it will start accepting filings in the second cycle for pre-approved 403(b) plans on May 2, 2022, with a one-year window to file closing on May 1, 2023. In connection with that, the IRS has also indicated that it is considering opening a determination letter process for individually designed 403(b) plans after all, and has been soliciting comments on doing so.

These developments raise a number of considerations for 403(b) plan providers and employers regarding their plan documents that are worth considering. This article reviews some key considerations.

Should I Continue to Use a Pre-Approved Plan Document?

Certainly, for fairly plain vanilla 403(b) plans, the use of pre-approved plans saves expense. And because a plain vanilla plan will normally fit well with the choices offered in a typical adoption agreement, that adds simplification as well. On the other hand, pre-approved plans allow for little

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variation, and typically include extensive “boilerplate” LRM language that makes them lengthy and sometimes confusing. Complex plans of large nonprofits and church plans in particular have struggled with fitting into LRM-based pre-approved plan language.

Or Should I Switch to an Individually Designed Plan?

For the first filing cycle, the general thinking was that complex plans might stay on individually designed plan documents, because the provisions were more complex. One exception was church plans, which had the benefit of not having to have a minimum of 30 participating employers (presumably because it is difficult to determine the application of the controlled group rules in the church environment so as to be certain of the number of employers), so a large complex church plan, such as for a denomination, could file and obtain the comfort of an IRS opinion letter.

However, the IRS review experience for a number of church plans was not an easy one. The IRS often sought to require restrictive language on qualified church-controlled organizations (QCCOs) and non-qualified church-controlled organizations (NQCCOs), to require longstanding language to be changed to conform to the LRMs, and to require language concerning such matters as related employers, terminations that permitted distributions, and employer participation agreements that were at variance with how the plans had traditionally operated. Consequently, some church employers received the impression that the IRS process was more of a straight-jacket than it should have been. Given that there have not been a lot of changes in the law since the first 403(b) cycle, it is possible that some church plans that were approved in cycle 1 will be updated, but not necessarily re-filed with the IRS in the cycle 2.

Or Should I Consider Keeping My Individually Designed Plan?

One of the main concerns with remaining on individually designed plan documents has been concern that the document has not been approved by the IRS. However, if the IRS were to open a determination letter process for individually designed 403(b) plans, employers with more complex plans and church plans that don't fit as easily into a pre-approved 403(b) document might wish to wait and see if such a program is developed.

Are There Special Document Considerations for a Church Plan?

Yes. First, the SECURE Act clarified retroactively that not just churches (which under IRS definitions essentially means traditional churches) but QCCOs and NQCCOs, such as church hospitals, nursing homes and colleges and universities (those entities generally subject to nondiscrimination requirements), are also able to participate in a church 403(b)(9) plans.

A consideration for 403(b) plan vendors will be whether to expand 403(b)(9) plan offerings. Church retirement income accounts, also known as 403(b)(9) plans, have required special language under the 403(b) LRMs, and such plans are permitted (but not required) to allow investments other than just mutual funds and annuity contracts. Many document vendors have not offered 403(b)(9) plans because

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they only offer mutual fund and annuity contracts as investments. Many church plan sponsors did not want to offer other types of investments, either -- but they did want to have 403(b)(9) plans because they are the only type of 403(b) that allows non-employee chaplains to participate and make contributions directly by check or transfer from a personal account (which they can then deduct on their individual tax return as an above-the-line deduction). In addition, church 403(b)(9) plans can also offer collective investment trusts, which some plans wish to offer in lieu of a money market mutual fund. For this reason, pre-approved plan providers may consider offering more 403(b)(9) plan documents in the future.

What Updates Will Be Needed for a Pre-Approved Plan Document?

The IRS has published its most recent cumulative list of amendments in Notice 2022-8, which lists 403(b) changes that will be considered by the IRS for plan documents submitted in cycle 2 that were not considered during cycle 1. These include:

- permitted mid-year reductions or suspensions of safe harbor nonelective contributions in certain circumstances;
- elimination of certain safe harbor notice requirements for plans that provide for safe harbor nonelective contributions and new provisions for the retroactive adoption of safe harbor status;
- amended definitions of qualified matching contributions (QMACs) and qualified nonelective contributions (QNECs);
- changes regarding in-plan Roth rollovers;
- changes to hardship distribution rules;
- rules regarding 403(b) plan termination and distribution of individual custodial accounts upon plan termination;
- the qualified birth or adoption distribution (QBAD) exception to the 10% early distribution tax; and
- changes to required minimum distribution (RMD) rules.

Of course, these also provide guidance to individually designed plan sponsors for making amendments consistent with the applicable remedial amendment periods for individually designed plans.

Unfortunately, sample language in the form of Lists of Required Modifications (LRMs) has not yet been issued, and many providers and employers will want to see such language before drafting extensive changes to their documents.

Summary

Most pre-approved plan sponsors will be waiting for new LRMs before filing updated 403(b) prototype plans starting as early as May 2, 2022. In the meantime, some pre-approved plan providers may be considering dropping out of the program, including some church plans that may decide to move to individually designed plans, while other providers may be adding to their document offerings, including in 403(b)(9) plans.

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Employers with individually designed plans may be considering whether to move to a pre-approved plan, or to stick with their individually designed plan, continuing to adopt required amendments in accordance with the cumulative list and remedial amendment period rules, particularly if determination letters for individually designed plans become a reality at some point.

403(b) plan providers and employers with questions on their plan documents can call David Powell, David Levine, Lou Mazawey or their regular Groom lawyer.

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