

## **IRS Issues 403(b) Proposed Regulations**

On November 16, 2004, the IRS issued proposed regulations for 403(b) tax-sheltered annuity plans. These proposed rules provide the first comprehensive guidance issued for 403(b) arrangements in more than 40 years. 403(b) plans may be offered by employers who are public schools and 501(c)(3) tax-exempt organizations.

The 403(b) proposed rules consolidate statutory changes, previous IRS rulings and administrative practice into one set of guidance. The 403(b) proposed rules include both clarifications of these prior rules and new guidance. For example, some issues addressed in the 403(b) proposed rules are as follows:

- (1) no single plan document is required, but the rules require that written documents must be maintained that set out plan eligibility, benefits, applicable limitations, contract provisions and time and form of benefit distributions;
- (2) governmental plans are subject to the non-discrimination rules regarding universal availability and compensation limitation;
- (3) tax-exempt entity plans are subject to general non-discrimination and coverage rules, compensation limitations and the average contribution percentage rules;
- (4) employers must give employees an “effective opportunity” on at least an annual basis to elect to contribute to the 403(b) plan under the universal availability rules;
- (5) employees normally working 20 hours or less per week who are excepted from the universal availability rule are defined to include employees who actually worked less than 1,000 hours in the last 12-month period;
- (6) a severance from employment occurs and a 403(b) distribution may be made if an employee ceases to work for a public school, but continues to be employed by the same state;
- (7) qualified domestic relations order (QDRO) rules apply to 403(b) plans, thus permitting distributions to a former spouse pursuant to a QDRO;
- (8) 20% mandatory withholding applies to 403(b) distributions that are not directly rolled over to an eligible employer plan or an individual retirement account (IRA);

- (9) 403(b) contributions must be transferred to the annuity contract or custodial account within a reasonable period of time, such as within 15 business days following the end of the month in which the elective deferral occurred;
- (10) 403(b) plan termination and subsequent plan distributions are permitted if the employer (and its related entities) does not make contributions to a 403(b) plan during the 12 months before and after the date of plan termination, subject to certain exceptions and limitations; and
- (11) controlled group rules for tax-exempt entities aggregate with the employer any other tax-exempt entity that has at least 80% of its directors or trustees in common with or directly or indirectly controlled by the employer. Controlled group rules for public schools may be considered by the IRS during the comment period and in the final regulations.

These rules are proposed to be effective as of January 1, 2006. However, at this time, these rules are proposed only and cannot be relied upon until adopted as final regulations.

The IRS also issued a companion temporary regulation that clarifies that FICA tax is applicable to contributions made under the following types of 403(b) salary reduction agreements:

- (1) elective deferrals made by the employee;
- (2) one-time irrevocable elections made by the employee at the time of initial plan eligibility; and
- (3) mandatory employee deferral contributions.

This rule is effective as of November 16, 2004.

The Citizens Bank & Trust 403(b) “Gatekeeper” Services<sup>SM</sup> Division will be submitting comments on the proposed regulations by the comment due date of February 14, 2005. Please provide us with any comments or questions that you have before that date and we will include them in our submitted comments.

For further information, please visit our website at [www.cbt403b.com](http://www.cbt403b.com) for the associated press release regarding the proposed 403(b) rules and the accompanying temporary rule regarding FICA tax.

For questions or comments regarding the 403(b) proposed rules, please contact Tamara Vaughn of the 403(b) “Gatekeeper” Services<sup>SM</sup> Division at 800-399-3023 or [cbt403b@cbcfamily.com](mailto:cbt403b@cbcfamily.com).