Comments to the Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts

March 14, 2006

Department of Labor
EBSA
26 CFR Parts 1 and 31
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On November 19, 2004, the Treasury Department (Treasury) and Internal Revenue Service (Service) issued temporary and proposed regulations (Proposed Regulations) under Internal Revenue Code (Code) §403(b) and related Code provisions (Reg. 155608-02). The Proposed Regulations would update the current Code §403(b) regulations to conform to numerous legislative changes made to 403(b) plans since the current regulations were issued in 1964—including §1022(e) of the Employee Retirement Income Security Act of 1974 (ERISA) —and would incorporate other interpretive guidance.

The preamble to the Proposed Regulations states that Treasury and the Service have consulted with the Department of Labor (Department) on the interaction between Title I of ERISA (Title I) and Code §403(b). Treasury and the Service expressly requested comments on the extent to which the Proposed Regulations raise questions for employers concerning the scope and application of the Department's regulation at 29 CFR §2510.3-2(f) [DOL Regulation §2510.3-2(f)]. This section relates to when a program for the purchase of an annuity contract or the establishment of a custodial account described in Code §403(b) is "established or maintained by an employer" and therefore becomes a pension plan subject to Title I coverage.

On March 7, 2005, the American Society of Pension Professionals & Actuaries (ASPPA) submitted its letter to the Service commenting on the Proposed Regulations (attached). ASPPA herein comments to the Department on the need for Department (1) guidance on those questions and (2) coordination with Treasury and the Service before their issuance of final §403(b) regulations.

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of almost 6,000 actuaries, plan administrators, attorneys, CPAs, and other retirement plan experts who design, implement and provide other services in connection with tax-qualified retirement plans, §403(b) and §457 plans covering tens of millions of American workers.

The issuance of the first set of comprehensive Code §403(b) regulations in over 40 years provides the ideal opportunity for the Department to coordinate efforts with Treasury and the Service to resolve questions regarding the interaction of Code §403(b) and Title I.

ASPPA asks the Department to provide guidance on the topics outlined below.

Summary of Recommendations

The following is a summary of ASPPA's recommendations. These are described in greater detail in the Discussion of Recommendations section.

I. Confirm that a §403(b) plan will not be subject to Title I solely because the sponsoring employer complies with the Proposed Regulations. Specifically, the guidance should provide that a plan will not be subject to Title I solely because of the following activities:

A. Complying with a written plan document requirement;

B. Ensuring that a §403(b) plan's annuity contracts and custodial agreements contain required provisions (and rejecting contracts and agreements that do not contain these provisions);

C. Monitoring a §403(b) plan's operational compliance;

D. Correcting a §403(b) plan's errors under the Service's Employee Plans Compliance Resolution System (EPCRS) correction program for 403(b) plans;

E. Overseeing distributions, loans and similar transactions as required by the regulations; and

F. Authorizing transfers among plans and contracts.

II. Provide more specific guidance about the degree of employer involvement in selecting investment vendors, including the imposition of a limit on the number of vendors, that will subject a §403(b) plan to Title I;

III. Provide guidance concerning the circumstances under which Title I coverage of a §403(b) plan ceases; and

IV. Provide guidance about the effect of automatic enrollment for deferral contributions on Title I coverage of a §403(b) plan

Discussion of Recommendations

I. Compliance with Proposed Regulations and Title I Coverage

Public schools and organizations tax-exempt under Code §501(c)(3) are the only employers eligible to offer §403(b) plans to their employees. Public school §403(b) plans and non-electing church §403(b) plans are not subject to Title I. Private sector §403(b) plans are not subject to Title I if employer involvement with the plan is limited in accordance with DOL Regulation §2510.3-2(f). Where employer involvement is not limited, §403(b) plans subject to Title I must satisfy ERISA requirements for reporting and disclosure, eligibility, vesting, benefit accrual, advance notice of contribution reductions, qualified joint and survivor annuities, minimum funding, bonding, fiduciary standards and claims procedures.

Many Code §501(c)(3) employers, especially smaller ones, have very limited resources and cannot offer a SEP, SIMPLE IRA or qualified plan that requires employer contributions. A §403(b) plan may be the only retirement savings program an eligible employer can offer its employees. It is an inexpensive plan requiring no employer contributions. Section 403(b) plans that are not covered by Title I are not subject to the administrative burdens, obligations and expenses associated with plans subject to Title I.

Under Department Regulation §2510.3-2(f), Title I coverage of a §403(b) plan depends on the degree of employer involvement with the plan. Section 403(b) plans of non-church private sector employers will not be considered to be "established or maintained by an employer" and subject to Title I if:

- Employee participation in the plan is completely voluntary;
- All rights under the §403(b) plan or arrangement are enforceable solely by the employee, his or her beneficiary or by an authorized representative of the employee or beneficiary;
- The sole involvement of the employer is limited to:
  - Permitting product providers (annuity issuers or custodial account providers) to publicize their products to employees;
  - Requesting information about the funding products or product providers;
  - Summarizing or compiling information provided with respect to §403(b) proposed products or §403(b) product providers to help employees review and analyze available products;

  - Collecting and remitting salary reduction contributions to product providers and maintaining records of such contributions;
  - Holding §403(b) group annuity contracts in the employer's name; and
  - Limiting products available to employees to a number and selection that is designed to offer employees a "reasonable" choice in light of all relevant circumstances that could include number of employees affected, number of contractors who have indicated an interest in approaching employees, the terms of the available arrangements, the administrative costs and burdens to the employer.

The plan document requirement and other duties placed on employers under the Proposed Regulations make it imperative for the Department to provide specific guidance about the types and degree of employer involvement that subject a §403(b) plan to Title I. Existing guidance under DOL Regulation §2510.3-2(f) does not specifically identify those employer activities that will trigger Title I coverage. For example, the following employer activities appear to be anticipated by the Proposed Regulations, but are not addressed in any current Department guidance:

- Adopting and maintaining a plan document;
- Ensuring that annuity contracts and custodial agreements contain required provisions (and rejecting contracts and agreements that do not contain such provisions);
- Monitoring operational compliance;
- Overseeing distributions, loans and similar transactions; and
- Authorizing transfers among plans and contracts.

ASPPA recommends that, in coordination with Treasury's and the Service's issuance of §403(b) final regulations, the Department provide clear and specific guidance describing the activities that, undertaken in accordance with the final regulations, will or will not cause a §403(b) plan to be covered by Title I.

A. Adopting and Maintaining a Written Plan Document

The Proposed Regulations require that a §403(b) plan be maintained pursuant to a written plan document. ASPPA recommended to the Service that it consider providing a model §403(b) plan document, similar to those provided for SEPs and SIMPLE IRAs, that would satisfy the plan document requirement in form, but would not result in Title I coverage. The preamble to the Proposed Regulations states that plan document rules do not require that there be a single plan document. In many cases, a §403(b) program with multiple investment product contracts may not be easily covered under a single document.

Department guidance is needed confirming that a §403(b) plan is not subject to Title I merely because the terms of the plan are in writing, whether in a single document or pursuant to multiple investment contracts.

ASPPA recommends that the Department, before the effective date of the final regulations, issue guidance clarifying that adopting and maintaining a written plan document (including any model document made available by the Service) or a group of documents that constitute a plan will not subject a §403(b) plan to Title I.

B. Ensuring that Annuity Contracts and Custodial Agreements Contain Required Provisions (and Rejecting Contracts or Agreements that Do Not Contain Such Provisions)

The Proposed Regulations require that §403(b) plan annuity contracts and custodial agreements be maintained pursuant to a plan. Section 403(b) contracts are required to:

- Limit employee elective deferral contributions;
- Impose withdrawal restrictions;
- Provide for minimum required distributions; and
- Allow rollovers to other eligible plans and IRAs under specified conditions.

Annuity contracts and custodial agreements that do not contain these requirements may cause the entire plan to lose its §403(b) status, subjecting participants to adverse tax consequences.

ASPPA recommends that the Department, in conjunction with the issuance of the final §403(b) regulations, provide guidance that would specifically permit employers to ensure that the §403(b) annuity contracts and custodial agreements contain the required contract provisions without subjecting the plan to Title I.

C. Monitoring Operational Compliance on a Plan Level or Hiring a Third Party to Do So

The complexity of §403(b) rules can result in their being inadvertently violated. Plan participants, for example, may contribute to the plan in excess of applicable limits, especially if they are participating in other §403(b) or §401(k) plans and/or are eligible to make catch-up contributions. Product vendors in multi-vendor environments cannot adequately track total plan contributions. Many payroll systems, especially those available to smaller employers, are not able to track compliance with annual limits or coordinate the complex forms and ordering rules of catch-up contributions available in a §403(b) plan.

ASPPA recommends that the Department issue guidance clarifying that the monitoring of plan operational compliance by the employer or by a third party hired by the employer will not subject a 403(b) plan to Title I coverage.

D. Correcting Operational and Other Errors Under EPCRS

In a 1996 letter to the Service, the Department confirmed that an employer whose employees participate in a §403(b) plan may take advantage of a correction program offered by the Service without necessarily triggering Title I coverage. Because of the new operational and documentation requirements that would be imposed on §403(b) plans by the Proposed Regulations, additional guidance from the Department is needed to encourage employers to correct errors in compliance.

ASPPA recommends that the Department issue guidance to clarify that correcting errors under EPCRS, or any other correction program available to §403(b) plans, will not subject the plan to Title I. The guidance should also confirm that employers who adopt practices and procedures to ensure compliance, or require their service providers to do so in order to be eligible for EPCRS correction programs, will not subject the §403(b) plan to Title I.

E. Overseeing Distributions, Loans and Similar Transactions

Service audits of §403(b) plans have revealed that participants in non-Title I salary reduction §403(b) plans (especially those with more than one investment provider) have taken loans in excess of applicable loan limits, defaulted on plan loans without their being reported to the Service as deemed distributions, taken serial hardship distributions from various annuity contracts and custodial accounts under the plan without any documentation, and failed to take required minimum distributions.

ASPPA recommends that the Department issue guidance defining the level of control an employer may exercise in overseeing loans, distributions and similar transactions and provide specific examples of employer actions that will or will not trigger Title I coverage.

F. Authorizing Transfers Among Plans and Contracts

The Proposed Regulations do not require a participant to consent to a transfer of assets held for his or her benefit under one §403(b) plan or contract to another §403(b) plan or contract. Thus, it appears that an employer may unilaterally decide to make such transfers. Furthermore, under the Proposed Regulations, it is apparently up to the employer to monitor plan transfers. As discussed above, imposing duties on an employer or granting decision-making authority to an

employer may subject a plan to Title I.

Proposed Regulation §1.403(b)-10(b)(3)(i) also provides that a §403(b) plan may transfer a participant's benefits to another 403(b) plan only if the recipient plan is offered by the participant's employer. The Proposed Regulations do not, however, address the treatment of former employees who have not received a distribution of benefits from the §403(b) plan.

ASPPA recommends that the Department clarify the responsibilities and authority of employers and participants regarding transfers and provide examples of permissible transfers.

II. Selecting Investment Product Providers and Limiting Their Number

Many non-Title I private sector §403(b) plans are salary reduction plans funded through multiple investment product providers. Employers hesitate to restrict the number of investment product providers if enough payroll slots can accommodate all interested investment providers, even if such a restriction would improve plan administration or reduce employee confusion about investment options.

Existing Department regulations do not provide specific guidance to employers, particularly small employers, who wish to impose reasonable limits on the number of investment providers. Such employers are concerned that doing so will subject the §403(b) plan to Title I. The current situation has led to confusion for §403(b) participants, does not necessarily provide better or reasonably-priced investment choices and is not conducive to overall compliance and the protection of participants' benefits.

ASPPA recommends that the Department provide additional guidance on what constitutes a reasonable number of investment options and the circumstances in which an employer's limitation or removal of investment options and providers is permissible in a private sector plan not subject to Title I.

III. Cessation of Title I Coverage

If a non-church private sector employer makes non-elective contributions to a §403(b) plan on behalf of its employees or engages in other activities that go beyond the scope of Department Regulation 2530.302(f)(3), the plan will be considered to be established or maintained by that employer and thus subject to Title I. There is no guidance, however, explaining the extent to which Title I coverage ends if the employer ceases to engage in such activities nor what the effect of cessation of Title I coverage would be. For example, in the case of a §403(b) plan that is subject to Title I solely because the employer makes non-elective contributions, the employer cannot be sure about the extent to which the plan remains subject to Title I if those contributions end.

ASPPA recommends that the Department issue guidance clarifying that a plan subject to Title I ceases to be subject to Title I if the activity that caused that coverage ends. The following are examples of the types of situations, and recommended results, where guidance is requested

> Example I: If an employer that offers a non-Title I §403(b) plan is not eligible to do so or loses its eligibility, termination of the plan should not trigger Title I coverage.
>
> Example 2: If a §403(b) plan subject to Title I is terminated or ceases to be subject to Title I, the Title I fiduciary obligations no longer apply, i.e., there are no fiduciary responsibilities in connection with the participant's individual annuity contract or custodial account.

IV. Automatic Enrollment

In view of the likelihood that legislation will be enacted that encourages automatic enrollment of participants in salary deferral arrangements, questions

about the effect of such enrollment on Title I coverage of §403(b) plans should be anticipated.

ASPPA recommends that the Department issue guidance clarifying that salary deferral contributions to a §403(b) plan may be made according to an automatic enrollment program without triggering Title I coverage provided that such contributions are deemed "voluntary" in accordance with applicable provisions of the Code, regulations and other guidance from Treasury and the Service.

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These comments were prepared by ASPPA's Tax Exempt and Government Plans and DOL subcommittees of the Government Affairs Committee, L. Joann Albrecht, CPC, QPA, and Debra Davis, Esq., respective chairs and were primarily authored by Kathleen M. Meagher, Esq., APM, Vice-chair and Amiram J. Givon, Esq., APM. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration of these comments.

Sincerely,

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Comments to the Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts as revised March 10, 2005

Department of the Treasury
Internal Revenue Service

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The American Society of Pension Professionals and Actuaries (ASPPA) commends the Treasury and Internal Revenue Service (IRS) on its issuance of temporary and proposed regulations (Proposed Regulations) under Internal Revenue Code (IRC) §403(b). ASPPA welcomes the opportunity to provide comments on these Proposed Regulations.

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of more than 5,500 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans and tax-sheltered annuities, especially for small to mid-size employers.

Summary of Issues

These comments address the following issues, which are described in greater detail below.

A. Requirement for a written plan document.

B. Coverage under Title I of ERISA.

C. Non-statutory exceptions to universal availability requirement.

D. Year-by-year exclusion of permissible categories of employees.

E. Transfers of assets among plans and contracts.

F. Definition of compensation.

G. Timing of contributions.

H. Controlled group and employer aggregation rules.

I. Distribution restrictions of amounts attributable to rollover contributions.

J. Effective date of the regulations for governmental employers.

K. Accounting for excess contributions.

L. Nonforfeitability, partial vesting requirements and separate accounts.

M. Distribution restrictions on annuity contract amounts not attributable to IRC §403(b) elective deferrals.

N. Year of service calculations.

O. Definition of health and welfare service agency.

Discussion of Issues

A. Requirement for a written plan document

ASPPA believes that a written plan requirement will promote compliance with IRC §403(b) and increased usage of the IRS Employee Plans Compliance Resolution System (EPCRS). In addition, it is hoped that this requirement will lead the IRS to develop a determination letter program for 403(b) plans. However, the following are concerns with the written plan document requirement.

1. Many 403(b) plans are exempt from Title I of ERISA because there is limited employer involvement with the plan. It is imperative that the written plan requirement be coordinated with Department of Labor (DOL) guidance regarding the application of ERISA Title I to 403(b) plans. In particular, guidance is needed from the DOL to confirm that a 403(b) plan will not be subject to Title I merely because the terms of the plan are in writing (see Section B. below for a further discussion of this issue).

ASPPA recommends that the effective date of the written plan requirement be delayed until after the DOL issues guidance providing that adopting and maintaining a written plan document does not, by itself, subject the plan to Title I of ERISA. In addition, once this requirement is effective, ASPPA recommends that the Service provide a model 403(b) plan document, similar to those provided for SEPs and SIMPLE IRAs, that would satisfy the plan document requirement in form and that would not necessarily result in ERISA coverage.

2. The Preamble to the Proposed Regulations provides that the plan document rule does not require that there be a single plan document. This is particularly helpful because many 403(b) programs offer contracts with multiple vendors, which may not be easily covered by a single document. However, the Proposed Regulations do not provide details on the extent to which multiple documents and contracts may be utilized.

ASPPA recommends that the final regulations provide additional guidance regarding the use of multiple documents to satisfy the written plan requirement. For example, the regulations might provide that a group of vendor contracts may comprise a "written defined contribution plan" for purposes of Prop. Reg. §1.403 (b)-3(b)(3) if each contract contains all the provisions required under that section. The final regulations could also provide that an employer may satisfy the plan document requirement by adopting a "wrap" plan that incorporates by reference the provisions of the various vendor contracts.

> 3. Treas. Reg. §1.401(b)-1 sets forth a correction period during which qualified retirement plans may generally be updated for any disqualifying defects (referred to as the "remedial amendment period"). There is no similar provision in the Proposed Regulations addressing a remedial amendment period for 403(b) plans.

ASPPA recommends that, as part of the written plan requirement, the IRS establish a remedial amendment period to permit the retroactive amendment of 403(b) plans to comply with the regulations or with any other statutory or regulatory changes affecting the written plan requirement.
ASPPA also recommends that the final regulations provide that the written plan requirement does not supersede the current rules under which the consequence of an operational failure is limited to the participants affected by that failure.

B. Coverage under Title I of ERISA

The plan document requirement discussed above, and other duties placed on employers under the Proposed Regulations, makes it essential for the DOL to provide specific guidance about what types and degree of employer involvement will subject a plan to Title I of ERISA. Existing guidance provided in DOL Reg. §2510.3-2(f) indicates that Title I coverage of a 403(b) plan is related to the level of employer involvement with the plan. The regulation does not specifically address whether the following activities by the employer (which appear to be anticipated by the Proposed Regulations) will trigger Title I of ERISA coverage:

- Adopting and maintaining a plan document;
- Ensuring that annuity contracts and custodial agreements contain required contract provisions (and rejecting contracts that do not contain such provisions);
- Monitoring operational compliance on a plan level, or hiring a third party to do so;
- Overseeing distributions, loans and similar transactions;
- Authorizing transfers among plans and contracts; and
- Selecting investment vendors and limiting their number.

ASPPA recommends that the Service coordinate issuance of the final regulations with issuance of DOL guidance ensuring private sector employers that they will not cause their plans to be subject to Title I simply because they oversee compliance with the requirements of the 403(b) regulations.
ASPPA also recommends that the IRS encourage the DOL to issue guidance clarifying whether a plan that is subject to Title I of ERISA will cease to be so if the employer activity that led to such coverage ends.

C. Non-statutory exceptions to universal availability requirement

The Proposed Regulations eliminate four non-statutory groups of employees that were permitted, pursuant to IRS Notice 89-23, to be excluded from a 403(b) plan without violating the universal availability requirement of IRC §403(b)(12)(A)(ii). The four groups are: employees who make a one-time election to participate in a governmental plan instead of a 403(b) plan; employees covered by a collective bargaining agreement; visiting professors for up to one year under certain circumstances; and employees affiliated with a religious order who have taken a vow of poverty.

Below are reasons as to why the ability to exclude each of these four categories of employees is important.

Several states (e.g., Texas) allow their employees to choose to participate in either a state retirement plan or a 403(b) plan, but not both. If the exception for employees who make a one-time election to participate in a governmental plan is not retained, such states may be required to change their retirement plan structure to cover employees under both plans.

Many sponsors of 403(b) plans employ individuals who are members of a collective bargaining unit under which retirement benefits were the subject of good-faith bargaining. In some cases, unions seek coverage of their members through a separate 403(b) plan or 401(k) plan that includes funding vehicles or other features different from the 403(b) program for other employees of the same employer. Eliminating the exception for collectively bargained employees could require employers to cover union employees under multiple plans, and could limit employers' ability to negotiate with unions about retirement and other benefits. Congress has consistently recognized collectively bargained employees as a separate group by permitting their exclusion from coverage under qualified plans, SEPs and SIMPLE plans and, historically, 403(b) programs.

The exclusions for visiting professors and employees who have taken a vow of poverty are recognition of the categories of employees unique to the public and tax-exempt sector. Extension of eligibility to such employees, who are unlikely to participate for extended periods, if it all, may unnecessarily increase administrative and compliance responsibilities. Moreover, qualified plans under IRC §401(a) may satisfy applicable coverage and nondiscrimination tests if they exclude such employees; under the Proposed Regulations, 403(b) plans would automatically fail IRC §403(b)(12)(A)(ii), absent another basis for exclusion.

ASPPA recommends that the final regulations retain the exclusions permitted under Notice 89-23.

D. Year-by-year exclusion of permissible categories of employees

Prop. Reg. §1.403(b)-5(b)(4)(i) provides that if any employee in an excludable category is given the option to make elective deferrals, then no other employees in that category may be excluded. However, the Proposed Regulations do not address whether an excludable category of employees who have been included in one year may be excluded in a later year. The universal availability rule is a nondiscrimination requirement, and compliance with nondiscrimination requirements in other contexts, such as IRC §§401(a)(4), 410(b) and 401(m), must be applied each year. Presumably, the universal availability rule would be applied on a year-by-year basis.

ASPPA recommends that the final regulations clarify that the universal availability requirement is applied separately to each plan year and that the inclusion of a group that could otherwise have been excluded will not preclude the exclusion of all members of such group in a later plan year.

E. Transfers of assets among plans and contracts

The Proposed Regulations do not require that a participant consent to a transfer of assets held for his or her benefit under one 403(b) plan or contract to another 403(b) plan or contract. Thus, it appears that an employer may unilaterally decide whether to make such transfers. Furthermore, it is apparently up to the employer to monitor transfers at the plan level to ensure they comply with the IRC §403(b) regulations. As discussed in Section B. above, imposing duties on an employer or granting decision-making authority to an employer may subject a plan to coverage under Title I of ERISA.

Prop. Reg. §1.403(b)-10(b)(3)(i) also provides that a participant's benefits under a 403(b) plan may be transferred to another plan only if the receiving plan is provided by the participant's employer. However, the regulation does not address the treatment of former employees who have not received a distribution of benefits from the 403(b) plan.

ASPPA recommends that the following issues relating to transfers among plans and contracts be addressed:

- The final regulations should clarify the responsibilities and authority of employers and participants with respect to transfers and provide examples of permissible transfers.
- The final regulations should permit the transfer of assets held for the benefit of former employees. For example, it should be permissible to transfer a former employee's undistributed benefits from one plan to a second plan that includes different investment options.
- The final regulations should specifically provide that transfers permitted pursuant to Revenue Ruling 90-24 continue to be permitted.
- Furthermore, ASPPA encourages the IRS to request that the DOL issue guidance regarding the level of control an employer may exercise without subjecting a plan to Title I of ERISA.

F. Definition of compensation

The definition of includible compensation in IRC §403(b)(3) creates administrative difficulties. Includible compensation under IRC §403(b)(3) is determined with reference to a five-year look-back period, which creates administrative complexities in monitoring compensation of part-time employees. In addition, using the definition is problematic where an individual participates in both a 403(b) plan and a sole proprietorship defined contribution plan and must aggregate contributions under both plans for IRC §415 testing purposes. Measuring compensation in the same way for both plans would substantially simplify the rules, and thereby promote compliance in these situations.

ASPPA recommends that, to the extent the Treasury and IRS have the authority, 403(b) plans be permitted to use the definition of compensation under IRC §415 (c)(3), without regard to IRC §415(c)(3)(E), in lieu of the definition of "includible compensation" under IRC §403(b)(3). ASPPA is not taking a position with respect to the authority of the Treasury or IRS to implement such a change, but if permitted, to support the change.

G. Timing of contributions

Prop. Reg. §1.403(b)-8(b) requires that contributions to a 403(b) plan be transferred to a funding vehicle within a period that is no longer than is reasonable for proper plan administration. That section further states that a plan could provide that 403(b) elective deferrals for a participant be transferred within a specified time after they would otherwise have been paid to the participant. A requirement that deferrals be contributed within 15 business days after the end of the month in which the amounts would otherwise have been paid to the participant is given as an example of a permissible provision.

DOL Regulation §2510.3-102(a) and (b)(1) provide rules regarding the timing of contributing "plan assets" under ERISA. Under those rules, participant contributions must generally be contributed to the plan as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets, but in no event later than the 15th business day of the month following the month in which such amounts would have otherwise been payable to the participant in cash.

ASPPA recommends that the following issues relating to the timing of contributions be addressed:

1. The Regulation should provide that the timing requirement is deemed to be satisfied if the timing requirement set forth in DOL Regulation §2510.3-10(a) and (b)(1) is satisfied.

2. The example in the Proposed Regulations should be clarified to provide that the use of a 15-day period will always be deemed to be "reasonable for the proper administration of the plan."

3. Including examples to illustrate "a period that is not longer than is reasonable for the proper administration of the plan" would be helpful for those plans that are not subject to Title I of ERISA. These could be similar to the examples included in DOL Regulation §2510.3-102 regarding the application of the rule that participant contributions become plan assets "as of the earliest

date on which such contributions can reasonably be segregated from the employer's general assets."

4. Governmental 403(b) plans may be subject to more restrictive funding timeframes, and the regulations should acknowledge that they do not supersede applicable state or local law requirements.

H. Controlled group and employer aggregation rules

ASPPA welcomes the introduction of these rules, which will give tax-exempt employers more certainty about which employees must be covered under a 403 (b) program.

ASPPA recommends that the final regulations include an example of the application of the 80% rule to a tax-exempt organization that controls another tax-exempt organization.

I. Distribution restrictions of amounts attributable to rollover contributions

In Revenue Ruling 2004-12, the IRS held that if a tax-sheltered annuity plan described in IRC §403(b)(7) or (11) receives rollover contributions, amounts attributable to rollovers that are maintained in separate accounts may be distributed at any time even though distribution of other amounts under the plan or contract is restricted. Although Prop. Reg. §1.403(b)-6 sets out special rules for the timing of distributions from a 403(b) contract, the Proposed Regulations do not include or acknowledge the early distribution features which Revenue Ruling 2004-12 allows, and therefore could be construed not to permit these distributions.

ASPPA recommends that the final regulations incorporate the holding of Revenue Ruling 2004-12 as it applies to 403(b) contracts, or otherwise affirm that the holding continues to apply to 403(b) plans.

J. Effective date of the regulations for governmental employers

Although the Proposed Regulations provide phase-in periods for collectively bargained and church plans, no similar period is provided for governmental plans.

ASPPA recommends that the final regulations extend the phase-in of the effective date of the regulations to governmental plans, particularly in view of the fact that many governmental employers may need to take legislative action to bring their plans into compliance.

K. Accounting for excess contributions

The Proposed Regulations include rules for the treatment of certain excess contributions, among them a provision that the portion of a 403(b) contract that includes an excess annual addition (within the meaning of IRC §415) will be treated as a contract to which IRC §403(c) applies.

ASPPA recommends that, in the case of any contribution greater than an applicable limit (including "maximum exclusion allowance" excesses carried over from earlier years), any requirement for separate accounts be satisfied if there is separate bookkeeping accounting for the excess, without the need for actual segregation of the excess, similar to the manner in which the separate accounting requirement may be satisfied under Treas. Reg. §1.401(a)(9)-8, Q&A 3.

L. Nonforfeitability, partial vesting requirements and separate accounts

The Proposed Regulations provide that non-vested amounts contributed to 403

(b) contracts and custodial accounts will be treated as separate contracts and accounts and subject to the requirements of IRC §403(c). Current state and federal laws do not require that non-vested 403(b) contributions be divided in such a way that would require the establishment of separate contracts or accounts for vested and non-vested contributions.

ASPPA is concerned that the requirement to hold non-vested contributions in IRC §403(c) contracts/accounts could:

- Subject non-vested contributions to IRC §409A, resulting in potential adverse tax consequences to participants or additional reporting requirements;
- Add additional administrative complexity between individual deferral plans and plans with vesting schedules making IRC §403(b) compliance efforts more difficult;
- Conflict with various insurance and security laws; and
- Increase costs that will ultimately be passed on to participants.

ASPPA recommends that the vesting rules in the proposed regulations be modified to require insurers and custodians to account for non-vested amounts in a separate notational account within the 403(b) contracts and custodial accounts without actually segregating these amounts into separate contracts or accounts or subjecting them to IRC §403(c).

M. Distribution restrictions on annuity contract amounts not attributable to IRC §403(b) elective deferrals

Under Prop. Reg. §1.403(b)-6(b), a Section 403(b) contract may distribute retirement benefits, other than amounts in a custodial account or attributable to IRC §403(b) elective deferrals, upon a participant's severance from employment or upon the occurrence of some event, such as the end of a specified time period, the attainment of a specified age or disability. That section refers to Treas. Reg. §1.401-1(b)(1)(ii), which includes corresponding early distribution restrictions for benefits under IRC §401(a) profit sharing plans, for additional guidance.

Before the Proposed Regulations were issued, there were no statutory or regulatory restrictions on early distribution of such amounts. The IRS's audit guidelines do not mention any such restrictions, even though they state restrictions on amounts held in a custodial account or attributable to IRC §403(b) elective deferrals. Consequently, these amounts usually have been contributed and held under contracts that contain no such restrictions. Application of the proposed restrictions to amounts contributed before the effective date of the final regulations would not only be inconsistent with the terms under which they were contributed, but, in the case of a 403(b) plan subject to Title I of ERISA, would also violate the anti-cutback protections of ERISA §204(g)(2)(B).

ASPPA recommends that the final regulations expressly grandfather from these distribution restrictions amounts attributable to contributions before the effective date of the regulations.

N. Year of service calculations

The Proposed Regulations provide that a year of service for purposes of the special IRC §403(b) catch-up limit and contributions for former employees be calculated based on a "work period," which may be shorter than 12 months (e.g., a nine-month school year).

ASPPA recommends that the final regulations clarify whether the "work-period" concept also applies for purposes of the exclusion of certain employees under the universal availability rules. For example, the regulation should clarify that if a schoolteacher works nine months, which is the normal work period instead of 12 months, then the 1,000-hour requirement in Prop. Reg. §1.403(b)-5(b)(4)(ii)(E)(1) is reduced to 750 hours to reflect the shorter work period.

O. Definition of health and welfare service agency

The definition of a “health and welfare service agency” in Prop. Reg. §1.403(b)-4(c)(3)(ii)(B) does not include organizations such as substance abuse counseling agencies, adoption agencies and organizations that assist the disabled. The policy reasons for extending the special IRC §403(b) catch-up provision to employees of agencies that provide medical care, anti-cruelty organizations or agencies that care for the needy would apply equally to the types of agencies listed above.

ASPPA recommends that the definition of a “health and welfare service agency” in Prop. Reg. §1.403(b)-4(c)(3)(ii)(B) be broadened to include other organizations providing health or social services, such as substance abuse counseling agencies, adoption agencies and organizations that assist the disabled.

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These comments were prepared by ASPPA's Tax Exempt and Government Plans subcommittee of the Government Affairs Committee, L. Joann Albrecht, CPC, QPA, Chair, and primarily authored by Kathleen M. Meagher, APM, Vice-chair, and Amiram J. Givon, APM, former Chair. Please contact us if you have any comments or questions regarding the matters discussed above.

Sincerely,

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