

It's Time for Tax-Exempt Entities to Restate Their 403(b) Plans

Article

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Under a new program, tax-exempt entities who sponsor retirement plans under Section 403(b) of the Internal Revenue Code (the "Code") can receive confirmation that their plan documents comply with all IRS requirements. In order to receive the protection of an IRS determination letter, a plan sponsor needs to adopt a pre-approved plan document before March 31, 2020.

Background

Under a 403(b) plan, eligible employees of 501(c)(3) entities and public school systems can elect to make contributions towards their own retirement benefits. (Cooperative hospital service organizations, as well as ministers, may also be eligible to establish 403(b) programs.) The benefit paid under a 403(b) plan often consists of an annuity purchased for the employee from a qualified insurance company. Payment of federal income tax on employee contributions is deferred until the benefits are paid to the employees following retirement.

Since 2010, the IRS has required sponsors of 403(b) plans to maintain separate written documents describing the benefits provided to eligible participants. However, unlike with 401(k) or pension plans, until now the IRS has not had a program under which a plan sponsor could receive a "determination letter" for a 403(b) plan. A determination letter is written confirmation from the IRS that a tax-qualified retirement plan document complies with the requirements of the Code.

New 403(b) Plan Remedial Amendment Period

On January 13, 2017, the IRS announced the opening of a "remedial amendment period" (or "RAP") for 403(b) plans. The RAP allows plan sponsors to retroactively amend their plans to correct errors while still maintaining the plan's tax-qualified status for the period that the non-compliant document was in effect. The RAP covers the period beginning January 1, 2010 (or, if later, the date that the 403(b) plan was first adopted) through March 31, 2020. The IRS will consider a plan sponsor who amends its 403(b) plan document before March 31, 2020 to have maintained a tax-qualified plan at all times during the RAP.

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However, the IRS will not review individually designed plan documents under the RAP. Therefore, instead of amending an existing plan document, a 403(b) plan sponsor needs to adopt an IRS-approved document in order to take advantage of the RAP.

Various entities such as insurance companies and providers of pre-approved retirement plans have received approval from the IRS for both volume submitter and prototype 403(b) plan documents. Plan sponsors can choose between the types of pre-approved plans in order to adopt a document that best reflects the terms and conditions of its existing 403(b) program.

Why Adopt a Pre-Approved 403(b) Plan?

By adopting a pre-approved document, a 403(b) plan sponsor will be entitled to rely on the IRS determination letter that confirms that the document that they adopt complies with all applicable requirements of the Code and underlying regulations. The determination letter protects the plan sponsor from an assertion (for example, in the course of an IRS audit) that their plan document is not tax-qualified and that the plan sponsor and participants are not eligible to receive the tax benefits afforded under the Code. However, an IRS determination letter does not protect a plan sponsor from liability for failing to operate a 403(b) plan in accordance with the requirements of its document.

For example, without a determination letter, a plan sponsor cannot guarantee that participants shouldn't be taxed on amounts contributed to the plan at the time the contributions are made. This type of error can result in both the sponsor and the participants owing significant back taxes and penalties on the contributions.

Therefore, it is highly recommended that sponsors of 403(b) plans adopt an IRS-approved plan document before March 31, 2020. Although the deadline for adoption is almost three years away, plan sponsors should begin discussions with their legal counsel and plan provider regarding the conversion of their current documents to either a volume submitter or prototype document soon.

For eligible entities who don't currently have a 403(b) plan, this is also a good time to investigate how such plans can assist in attracting and retaining the best available employees.

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