403(b) PLANS – A GUIDE FOR PUBLIC SCHOOL SYSTEMS

January 2020

This guide is not intended and may not be used to avoid tax penalties, and was prepared to support the promotion or marketing of the matters addressed in this document. The taxpayer should seek advice from an independent tax advisor.

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INTRODUCTION

This *403(b) Plans - A Guide for Public School Systems* is intended to assist public schools who sponsor 403(b) plans by providing general information about the Internal Revenue Code ("Code") rules governing 403(b) plans' operation and administration.

A tax-sheltered annuity, also known as a tax deferred annuity or "403(b) plan" is a deferred compensation arrangement, which may only be sponsored by public school systems and organizations that are exempt from taxation under Code Section 501(c)(3). Please note that this Guide focuses solely on 403(b) plans sponsored by public school systems and does not address 403(b) plans sponsored by tax-exempt Section 501(c)(3) organizations, including religious organizations.

By virtue of their governmental status, 403(b) plans sponsored by public school systems are exempt from all provisions of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"). These provisions include participation, coverage, vesting, spousal consent, reporting and disclosure and funding rules. Plans sponsored by governmental entities, such as public school systems, were afforded a permanent moratorium on the compliance of their plans with various nondiscrimination and coverage rules, effective for plan years beginning on or after August 5, 1997.

The information in this Guide reflects the current status of the IRS guidance as of January 1, 2020.
State and local law (i.e., contract law and state constitution provisions) control the operation of governmental plans significantly. Although state and local laws and regulations are beyond the scope of this *Guide*, it is important for those who deal with governmental retirement plans to recognize and understand all such laws and regulations.

In an effort to better service 403(b) plans, the IRS has introduced a 403(b) plan webpage, which offers guidance, tools, educational materials, news and other resources to 403(b) plan sponsors at:

https://www.irs.gov/retirement-plans/irc-403b-tax-sheltered-annuity-plans

These resources will assist governmental plans to comply with the applicable federal tax-qualification requirements.

Please note that this Guide is intended for general informational purposes only. No part of this Guide is intended to provide tax or legal advice – this is Voya Financial® interpretation of the Code and ERISA rules. Any questions involving tax or legal matters should be referred to your 403(b) plan's legal counsel or tax advisor.

For more information on 403(b) plans, please visit Voya® dedicated website at http://foremployers.voya.com/retirement-plans/403b-regulations/

SECTION I - ELIGIBILITY

Eligible Employers

Employers that are permitted to establish 403(b) plans include:

- Public school systems: a teaching institution with a faculty, curriculum and enrolled students and includes public primary and secondary schools, state colleges and universities, and public junior colleges.

- Organizations qualified under Code Section 501(c)(3).

501(c)(3) Organizations Defined
A tax-exempt organization qualified under Code Section 501(c)(3) is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. In addition, certain public institutions, such as government-operated hospitals, libraries and museums may also have a favorable determination letter from the IRS regarding their status as Code Section 501(c)(3) organizations.

Eligible Employees

Only common law employees are permitted to participate in a 403(b) plan. In general, independent contractors and leased employees are not considered common law employees and may not be covered by a 403(b) plan.

Independent Contractor Defined
A person who provides services to the employer pursuant to one or more written or oral contracts, if such person is not a common-law employee.

Leased Employee Defined
An individual who provides services to an employer of a type historically performed by employees, pursuant to an agreement with the employer and a leasing organization, on a substantially full-time basis for a period of at least one year provided the services performed are under the primary direction or control of the employer.

An individual is considered to be eligible to participate in a 403(b) plan if he:

- performs services as an employee, either directly or indirectly, for a public school. For example, a principal, clerical employee, custodial employee and teachers at a public elementary school are employees performing services directly for an educational organization; or
- occupies an elective or appointive office if the office is one to which an individual is elected or appointed only if s/he has received training or is experienced in the field of education.

Universal Availability

In general, 403(b) plans sponsored by public school systems are not subject to the various nondiscrimination and coverage rules that are applicable to 403(b) plans sponsored by 501(c)(3) organizations. However, salary reduction and Roth 403(b) (if permitted under the 403(b) plan) contributions are subject to the “Universal Availability Rule,” which is satisfied only if the 403(b) plan permits every eligible employee (subject to the exceptions listed below) to have the opportunity to make salary reduction and Roth 403(b) contributions, if applicable, of at least $200 annually. An employer is not permitted to impose a minimum percentage of contributions on salary reduction and Roth 403(b) contributions as an administrative convenience.

A 403(b) plan may exclude the following employees from making salary reduction and Roth 403(b) contributions:

- Employees whose maximum salary reduction and Roth 403(b) contributions under the 403(b) plan would be no greater than $200,
- nonresident aliens with no U.S. source of income,
- Student-employees whose compensation is not subject to FICA wages,
- Employees eligible to make deferred compensation contributions to a 457(b) plan, a 401(k) plan or another 403(b) plan sponsored by the employer, or
- Employees who normally work less than 20 hours per week.

An employee is considered to work fewer than 20 hours per week only if:

- For the 12-month period beginning on the date the employee's employment began, the employer reasonably expects the employee to work fewer than 1,000 hours of service in such period; and
- For each plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced (or, if the plan provides, each subsequent 12-month period), the employee worked fewer than 1,000 hours of service in the preceding 12-month period.

"Once in, always in" Rule

Under the "fewer than 20 hours per week" exception rule, once an employee becomes eligible to have salary reduction contributions made on his or her behalf to the plan under this standard, the employee cannot be excluded from eligibility to have salary reduction contributions made on his or her behalf in any later year. Thus, if a 403(b) plan elects this provision and an employee completes 1,000 hours of service in any year, then the employer must allow that employee to participate in the 403(b) plan in any later year, regardless of the number of hours of service that employee subsequently completes. This is known as the "once in, always in" rule. That is, the only way that an employee could be excluded as having worked "fewer than 20 hours per week" is if that employee never completed at least 1,000 hours of service in any year.

For example, ABC School's 403(b) plan document excludes employees from making salary reduction contributions if the employee works fewer than 20 hours per week. Ms. Y, a teacher at ABC school, is hired in 2019 and is not permitted to participate in the ABC 403(b) plan in 2019 since she is reasonably expected to complete less than 1,000 hours of service per year. However, in 2019, Ms. Y completes 1,050 hours of service. Since Ms. Y completed more than 1,000 of service in 2019, she must be permitted to make elective deferrals to the ABC 403(b) plan in all subsequent years, regardless of the number of hours she subsequently performs under the "once in, always in" rule. Additionally, ABC School must remember to provide Ms. Y, as an eligible employee, with the annual Universal Availability Notice informing her of the opportunity to participate in the school's 403(b) plan.

Notice to Eligible Employees to meet "Universal Availability"

At least once each plan year, an employer must provide employees who are eligible to participate in a 403(b) plan a notice informing them that they have the opportunity to make salary reductions and, if applicable, Roth 403(b) contributions, or change deferral elections, when they can make those elections, the maximum amount permitted and whether there are conditions on those elections. **If the 403(b) plan document permits catch-up contributions, these contributions should also be included in the notice.**

Some plan sponsors have an automatic enrollment feature included in their plans as a way of increasing plan participation. The following is a chart that explains the different types of automatic enrollment options and the features of each type of option.

Plan Provision	Automatic Contribution Arrangement (ACA)	Eligible Automatic Contribution Arrangement (EACA)
General Description	A deferral percentage is automatically contributed for eligible employees who do not have a valid deferral agreement in place, or have not opted out of the ACA.	A uniform deferral percentage is automatically contributed for eligible employees who do not have a valid deferral agreement in place, or have not opted out of the EACA. Note: an EACA generally may be added to the plan only effective as of the beginning of the plan year.
Eligible Employees	Employees meeting plan criteria are automatically enrolled in the plan.	Employees meeting plan criteria are automatically enrolled in the plan.
Rate of automatic deferral	Plan determines the automatic deferral percent.	Uniform automatic deferral percent, as determined by the plan.
Annual Automatic Rate Escalator	Permitted	Permitted
Investment of Automatic Contributions	Plan-designated investment option until the participant provides investment direction.	Plan-designated investment option until the participant provides investment direction.
Ability to Opt Out of Automatic Enrollment	Participants subject to an ACA may elect either to: • Stop contributions to the plan; or • Elect a different deferral percentage	Participants subject to an EACA may elect either to: • Stop contributions to the plan; or • Elect a different deferral percentage
Participant Withdrawal of Automatic Contributions before distributable event	Not permitted	Permissible upon participant request made no earlier than 30 days and no later than 90 days of the first automatic deferral. Note: Any matching contributions attributable to withdraw automatic contributions are forfeited.
Notice Contents	Notice must include an explanation of: • Automatic contribution default percentage provided under the plan; • A participant's right to not participate in the ACA and how to elect out; • Default Investment option of automatic enrollment contributions; • Information about electing to: ○ Contribute an amount different from the plan's automatic enrollment contribution; ○ Select another investment option, if permitted by the plan.	Notice must include an explanation of: • Automatic contribution default percentage provided under the plan; • A participant's right to not participate in the EACA and how to elect out; • Default Investment option of automatic enrollment contributions; • Information about electing to: ○ Contribute an amount different from the plan's automatic enrollment contribution; ○ Select another investment option, if permitted by the plan; ○ How and when to withdraw automatic enrollment contributions.

Plan Provision	Automatic Contribution Arrangement (ACA)	Eligible Automatic Contribution Arrangement (EACA)
Timing to Provide Notice	Notice must be provided initially before an employee becomes subject to an ACA and annually thereafter: • Initially: at least 30 days but not more than 90 days before the date that employee is eligible to make elective contributions (or, if applicable, becomes subject to the ACA). Special rule for newly hired employees immediately eligible to participate in the plan, notice may be provided on the date of hire. • Annually: At least 30 days but no more than 90 days before the beginning of each plan year thereafter.	Notice must be provided initially before an employee becomes subject to an EACA and annually thereafter: • Initially: In general, at least 30 days but not more than 90 days before the date an employee becomes eligible to make elective contributions (or, if applicable, becomes subject to the EACA) Special rule for newly hired employees are immediately eligible to participate in the plan, notice may be provided on the date of hire. • Annually: At least 30 days but no more than 90 days before the beginning of each plan year thereafter.

*An additional form of automatic enrollment, known as a Qualified Automatic Contribution Arrangement (QACA), provides a plan with relief from certain nondiscrimination testing requirements. Since governmental plans are deemed to be nondiscriminatory under the Taxpayer Relief Act of 1997, a QACA would not appeal to governmental employers.

Note: plan sponsor should be sure to check their state's payroll withholding laws to ensure there are no restrictions which would prohibit an automatic enrollment feature.

SECTION II - CONTRIBUTIONS AND RELATED LIMITATIONS

Contributions to a 403(b) Plan

A 403(b) plan may provide for more than one type of contribution, including participant and/or the employer contributions, to the extent permitted under state law and the written 403(b) plan. The following is an overview of the rules for 403(b) contributions.

Participant Contributions

Salary Reduction: amounts deferred on a before-tax basis by a participant from compensation.

Roth 403(b): amounts deferred on an after-tax basis by a participant from compensation. Note: If a 403(b) plan permits Roth 403(b) contributions, participants must have the choice to make salary reduction contributions or Roth 403(b) contributions or a combination of the two types of contributions. A participant's election to make Roth 403(b) contributions is irrevocable once the election is made.

In-Plan Roth Rollovers & Conversions – A plan may permit a participant to take a portion of their vested plan balance and roll it over to the plan's designated Roth account. The plan may specify which sources of vested contributions are available for rollover in such a manner, as well as if distributable (Rollover) and/or non-distributable (Conversion) amounts are allowed to be rolled over and how often such rollovers can be made. Any amount rolled over or converted will be includable in gross income for the year in which it is moved to the designated Roth account, minus any basis on the amount transferred. The plan does not withhold taxes from the IRR transaction—a participant may want to increase their payroll tax withholding or make an estimated tax payment to account for the additional taxable amount. The plan must offer Roth Contributions in order to make In-Plan Roth Rollovers (IRRs) and Conversions available.

Special rules apply if amounts from an IRR are withdrawn within the 5-year taxable period.

Salary Reduction Agreement Defined

A participant elects in a salary reduction agreement to defer salary reduction or Roth 403(b) contributions from his or her salary into a 403(b) plan.

Note: a participant must make or modify a salary reduction agreement election at any time before the affected salary would otherwise become payable. Also, the salary reduction agreement must be legally binding under law. For example, in most states, an individual who is under the age of 18 or who is mentally incapable of entering into a contract may not make a salary reduction agreement.

<u>Rollovers into plan</u>: If permitted by the plan, an individual may roll over eligible amounts from an *eligible rollover plan* to a 403(b) plan.

Eligible Rollover Plan Defined

An eligible rollover plan is another 401(a)/(k), 403(b) or governmental 457(b) plan, a traditional IRA or a SIMPLE IRA after two years of participation. While Roth IRAs meet the definition of an eligible retirement plan, they are not allowed to be rolled into other plan types.

Payments after Severance from Employment

A participant who has had a severance from employment may be able to defer certain payments to a 403(b) plan for up to the later of 2 1/2 months or the end of the calendar year following severance from employment. Payments that are eligible to be deferred include regular compensation, payments for overtime, commissions, bonuses, sick pay, vacation pay or other leaves that would have been payable or available if the participant had not had a severance from employment.

Employer Contributions

Employer contributions made to a 403(b) plan may be a discretionary amount, a fixed amount or percentage or may match participants' salary reduction or Roth 403(b) contributions.

<u>Non-Elective Employer Contributions</u>: may either be a discretionary amount or based on the 403(b) plan's contribution formula.

<u>Employer Matching Contributions</u>: contributions that match all or a portion of a participant's salary reduction or Roth 403(b) contributions.

An employer may require that a participant complete a certain number of hours of service and/or be employed on the last day of the year in order to receive an allocation of the employer contributions.

<u>Employer Contributions after Severance from Service</u>

Employers are permitted to make contributions to a 403(b) plan on behalf of retired or terminated participants for a period of up to 5 years after the year of the participant's retirement or termination. Such contributions may be made to participant accounts up to the Code Section 415(c) annual additions limit for each of the 5 post-retirement years, based on the terminated employee's final year's includible compensation.

Eligible 403(b) Investments

There are three different types of investments for 403(b) plans:

- **<u>403(b)(1) annuity contract</u>**: contributions are invested in either individual or group annuity contracts issued by life insurance companies.
- **<u>403(b)(7) custodial accounts</u>**: Assets under a custodial account must be held by a bank, trust company, or other authorized entity and must be invested solely in regulated investment company stock (i.e., mutual funds). Any dividends from the investment in mutual funds must be reinvested.
- **<u>403(b)(9) retirement income account</u>**: contributions are held in retirement income accounts maintained for employees of *certain church-affiliated organizations*. Note: a public educational system without a church affiliation may invest its 403(b) plan assets in a 403(b)(1) annuity contract and/or a 403(b)(7) custodial account, but <u>not</u> in a 403(b)(9) retirement income account.

Taxation of Contributions

Federal and State Income Taxation

In general, salary reduction and employer contributions, including earnings thereon, are subject to federal and, if applicable, state income tax only when directly distributed from the plan. However, Roth 403(b) contributions are generally subject to federal and, if applicable, state income tax when these amounts are contributed, but earnings on those amounts may be distributed tax-free if certain conditions are met.

Taxation under the Federal Insurance Contributions Act ("FICA")

FICA imposes a tax on employers and employees in order to provide retirement and welfare benefits to individuals who are no longer employees. FICA taxes are based on wages paid to employees of an employer. Only salary reduction and Roth 403(b) contributions, because they are deferred from a participant's compensation, are subject to FICA taxes when contributed to a 403(b) plan. However, no contributions to a 403(b) plan, regardless of source, and earnings under a 403(b) plan are subject to FICA taxes when distributed.

Saver's Tax Credit

A nonrefundable tax credit for salary reduction and Roth 403(b) contributions may be available to certain participants. The maximum annual contribution eligible for the credit is $2,000, and the maximum credit rate is 50%. The credit is pro-rated and depends on a participant's adjusted gross income and his or her federal income tax filing status. The chart below indicates the AGI levels for various filers and the percentage of credit available (for 2020, subject to annual cost of living adjustments).

Joint-filer AGI	Head of Household AGI	All Others - AGI	Credit
$0 – $39,000	$0 – $29,250	$0 – $19,500	50%
$39,001 – $42,500	$29,251 – $31,875	$19,501 – $21,250	20%
$42,501 – $65,000	$31,876 – $48,750	$21,251 – $32,500	10%

Vesting Requirements

Participant Contributions

Salary reduction, Roth 403(b) and rollover contributions must always be 100% vested, i.e., nonforfeitable upon being contributed to the plan. For this purpose, as well as for distribution reasons, salary reduction and Roth 403(b) contributions must be accounted for separately. In addition, if permitted by the plan, rollover contributions may be distributed at any time.

Employer Contributions

Employer Contributions may be subject to a vesting schedule. Code Section 403(b) plans sponsored by public school systems are exempt from the minimum vesting standards of ERISA. However, the vesting schedule applicable to employer contributions may be dictated by state law.

Separate Accounting for Amounts Subject to Vesting Schedules

The IRS final 403(b) regulations state that only vested amounts are considered 403(b) monies, with all other nonvested monies tracked separately until those amounts are vested (i.e., nonforfeitable). Thus, if the 403(b) plan provides for a graded or cliff vesting schedule, the vested portion will be treated as amounts held under a 403(b) contract; the amount that is not vested is forfeitable and would be treated as amounts held under a contract to which Section 403(c) would apply (or such provision of the Code as may apply). As a participant becomes vested in some or all of the portion of that separate tracking, the vested amounts are now considered 403(b) monies.

When a participant terminates employment without being 100% vested, the non-vested portion of his or her account may be used to reduce future employer contributions, pay 403(b) plan expenses or be reallocated among remaining participants' accounts as specified by the 403(b) plan.

Timing of Contributions

Contributions must be remitted to the 403(b) plan's funding vehicles no later than is reasonable for the proper administration of the 403(b) plan. In addition, state laws may provide for specific timeframes by which employer contributions must be remitted to the plan's funding vehicles.

Annual Contribution Limits

The two annual separate limits for contributions made to 403(b) plan are:

Code Section Limit	***Contributions to be Included***
Code Section 415(c)	*All contributions and forfeitures made to the plan except age 50+ and rollover contributions.*
Code Section 402(g)	*Salary reduction contributions and Roth 403(b) contributions.* *This limit is coordinated with all elective deferrals made by a participant under another 403(b) plan, a 401(k) plan, a salary reduction simplified employee pension (SARSEP) plan or a SIMPLE retirement plan in a tax year.*

The following is a general description of the various limitations. For more detailed information, please refer to IRS Publication 571 – Tax-Sheltered Annuity Plans for Employees of Public Schools and Certain Tax-Exempt Organizations. This Publication can be found on the IRS website at http://www.irs.gov/pub/irs-pdf/p571.pdf.

Code Section 415(c) Contribution Limits

Code Section 415(c) provides that annual additions to 403(b) plan on behalf of a participant cannot exceed the lesser of:

- $57,000 (for 2020, subject to annual cost of living adjustments) or
- 100 percent of the participant's includible compensation.

***Watchout**:* If a participant in a 403(b) plan also participates in another defined contribution retirement plan of the employer, such as a 401(a) qualified plan, in general, the amounts contributed to a participant's 403(b) account are considered "separate" for Code Section 415(c) contribution limitation purposes from the amounts under the 401(a) plan. However, a participant will have a combined Code Section 415(c) contribution limit in the case where s/he also participates in a defined contribution plan (typically, a Keogh plan) in which s/he has a controlling interest in that plan sponsor (more than a 50% interest) ("Common Control Rule"). In the Common Control Rule situation, all retirement plans are deemed to be "owned" by the participant. If a plan sponsor adopts an IRS-preapproved 403(b) plan document, one of the requirements of the plan is that participants are provided with notice regarding the need to coordinate 415 limits with any other plans that are required to be aggregated with the participant's 403(b) account.

For example:

Doctor Jones is employed by a public university that maintains a 403(b) plan and also owns a private practice where s/he is a 60 percent shareholder. Doctor Jones' private practice sponsors a 401(a) plan. Because Dr. Jones is deemed to "own" both the 403(b) plan and the 401(a) plan, the retirement plans must be combined for purposes of Code Section 415(c).

Includible Compensation

Generally, includible compensation is the amount of compensation determined on a calendar year basis received from the employer sponsoring the 403(b) plan that is includible in the employee's gross income for the most recent period that may be counted as a "one-year period of service" and also includes:

- Salary reduction and Roth 403(b) contributions.
- Deferrals under 457(b) and 401(k) plans,
- Qualified transportation benefits excluded from gross income under Code Section (132(f)(4))

- Code Section 125 cafeteria plan salary reduction amounts, and
- Deferrals under a salary reduction simplified employee pension (“SARSEP”) and a savings incentive match plans for employees (“SIMPLE”).

Includible Compensation does not include:

- Employer contributions,
- Code Section 414(h) pick up contributions; and
- Contributions made to the 403(b) plan that are considered made pursuant to a one-time irrevocable election.

One-Year Period Service Defined
For full time employees: generally, the current taxable year.
For part-time and retiring employees: the most recent one-year period of service consists of the service in the current year and the service for as many previous years as is necessary to total one full year of service.

Code Section 401(a)(17) Compensation Limit

For purposes of employer contributions, the Code requires that compensation be limited to $285,000 (for 2020, subject to annual cost of living adjustments).

Before January 1, 1996, the Code Section 401(a)(17) limit applicable to governmental plans was $200,000 (as indexed). When the compensation limit was reduced after December 31, 1995, the regulations provided transitional rules for governmental plans. In order to preserve the limit in effect on December 31, 1995, a governmental plan may provide that the compensation of an “eligible participant” be not less that such participant’s compensation determined as of July 1, 1993. For this purpose, generally an eligible participant is an individual who first became a participant in the governmental plan before the first day of the first plan year beginning after December 31, 1995. As indexed for cost of living adjustments, in 2020 the compensation limit for such eligible participants is $425,000.

Code Section 402(g) Contribution Limits

In general, Code Section 402(g) imposes a limit on salary reduction and Roth 403(b) contributions. The limit is $19,500 in 2020 and is subject to annual cost of living adjustments. This limit is coordinated with all elective deferrals made by a participant under another 403(b) plan, a 401(k) plan, a salary reduction simplified employee pension (SARSEP) plan or a SIMPLE retirement plan in a tax year.

If an employer maintains a 457(b) deferred compensation plan, the salary reduction contribution limits of 403(b) plans do not impact an individual’s ability to make deferrals to a 457(b) deferred compensation plan. Generally, this means for the 2020 calendar year that a participant can defer up to $19,500 to a 403(b) plan and separately defer up to $19,500 to a 457(b) plan, before catch-ups.

15-Year Catch-Up Provision

A 15-year catch-up election for salary reduction and Roth 403(b) contributions is available to employees of public school systems. Employees who have 15 or more years of service with their current school employer may be able to contribute an amount up to $22,500 (for 2020, as indexed annually for cost of living adjustments). For eligible employees, the general $19,500 limit is increased by the lesser of the following amounts:

- $3,000,
- $15,000 reduced by salary reduction and Roth 403(b) contributions not included in gross income for prior taxable years because of this provision (which was effective 1/1/87), or
- $5,000 times years of service minus all prior elective deferrals made to Code Section 403(b), 401(k), SARSEP and SIMPLE plans of the employer in prior taxable years.

Note: the 15-year catch-up of up to $3,000 per year cannot exceed cumulatively $15,000 over the lifetime of the employee.

For example:

Professor Jones has worked for 15 years with a university, has never used the increased limit and has made $30,000 in salary reduction contributions in prior years. Professor Jones' calculation would be the lesser of a), b) or c):

a) $3,000	*$ 3,000*
b) $15,000 (because increased limit was never used)	*$15,000*
c) $5,000 times 15 minus $30,000	*$45,000*

Therefore, in 2020, Professor Jones is eligible to use the 15-year catch-up to make catch-up contributions in the amount of $3,000.

Age 50 Plus Catch-Up Provision

If a participant is at least 50 years old by the end of a calendar year, s/he is eligible to make additional contributions to a 403(b) plan in the amount of $6,500 (for 2020, as indexed annually for cost of living adjustments), provided s/he has contributed the maximum amount up to the Code Section 402(g) limit as well as any available amounts under the 15-year catch-up. As with the Code Section 402(g) limit, the age 50 plus catch-up contributions are coordinated with age 50 plus catch-up contributions under another 403(b) plan, a 401(k) plan, a SARSEP or a SIMPLE retirement plan. Age 50 plus catch-up contributions are not subject to the Code Sections 415(c) and 402(g) limits. In addition, an employer is permitted to make matching contributions with respect to these catch-up contributions.

Overview of 403(b) Contribution Limits: 2020

Employee Deferral	**$19,500**
15-year catch-up	**3,000**
Age 50+ catch-up	**6,500**
Employer contributions*	**34,500**
	$63,500*

***The age 50+ catch-up contributions do not count toward the 415(c) contribution limit of $57,000.**

Contributions in Excess of the Code Section 415(c) Contribution Limit

Excess Annual Additions are contributions made to a 403(b) plan that are in excess of the Code Section 415(c) limit. Under the final 403(b) regulations, excess contributions (and earnings) must be separately accounted for. In addition, the IRS provides for a method of correction under EPCRS.

If the employee also participates in a defined contribution plan in which s/he has "**common control**" and s/he has an excess of the Code Section 415(c) limit, the excess must first be corrected under the 403(b) plan.

Excise Tax

Code Section 4973 imposes a 6% cumulative excise tax on excess contributions made to a custodial account. (The excise tax is not applicable to excess contributions made to an annuity contract.) However, the excise tax does not apply to excess deferrals under a custodial account. The excise tax is imposed specifically on the employee (and not the employee or provider), and is not tax deductible. The excise tax is determined as of the close of the taxable year and is imposed for each taxable year until the excess contribution is eliminated by an allowable method of correction.

Contributions in Excess of the Code Section 402(g) Contribution Limit

Excess deferrals are salary reduction and Roth 403(b) contributions made by a participant in excess of the Code Section 402(g) limit. To correct an excess deferral, both the excess and any associated earnings must generally be distributed to a participant by the April 15 immediately following the close of the taxable year in which the contribution was made. The excess deferral is includible in income in the year deferred; however, earnings associated with the excess deferral are includible in income in the year distributed. The distribution is not rollover eligible and is not subject to the IRS 10% premature distribution penalty tax.

Generally, if correction of excess deferrals does not occur by the April 15 following the year in which the deferral was made, the excess deferral may only be distributed to the participant when s/he is entitled to receive a distribution. Such distributions are subject to double taxation. That is, the excess deferral is taxable in the year the excess was made and in the year the amount is distributed. Additional correction methods may be available under EPCRS.

Military Leave

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"), veterans returning to employment from certain military service are entitled to the restoration of pension benefits that would have accrued but for the employee's military service. Specifically, the re-employed veteran's military service is considered service with the employer for purposes of 403(b) plan contributions. Make-up contributions on behalf of re-employed veterans are neither subject to the contribution limitations for the year made, nor are they considered in applying the limits to any other contributions made during the year. However, the make-up contributions are subject to the applicable limitations (including any previous cost-of-living adjustments that were in effect) with respect to the year the contribution relates.

In calculating the amount of any make-up contributions, compensation used for such calculation is the compensation the participant would have earned had the participant not engaged in military service. There is no requirement that the 403(b) plan provide for earnings to be credited to make-up contributions for any period before the contributions were actually made or make-up forfeitures occurring during the period of military service. Also, if the 403(b) plan contains a vesting schedule, re-employed veterans must receive credit for purposes of vesting service for periods of military service.

If any contribution under the 403(b) plan is contingent upon the making of contributions by the participant (e.g., matching contributions), the participant must make up the missed contributions before receiving the employer's contribution. For additional information refer to the Department of Labor website at https://www.dol.gov/agencies/ebsa.

If an employer provides differential pay to individuals who are on military leave, that individual may defer all or a portion of that pay to a 403(b) plan. Differential pay is amounts an employer pays an individual who has been called to active military service as a way of replacing some or all of the difference between the individual's military pay and the compensation the individual would have received from the employer had s/he remained in active employment.

If a participant takes a loan from the plan and then performs military service, then the plan can provide for:

- The participant to be obligated to continue to repay the loan while on military leave or
- The suspension of loan repayments until the individual returns from military leave.

If the loan is suspended during the period of military leave, interest will still accrue on the loan; however, the Service members Civil Relief Act of 2003 generally prohibits the plan or contract from charging more than 6% interest on that loan during active military service, provided that participant provides written notice and appropriate documentation of his or her military service no later than 180 days after the termination of the military service. In addition, if loan repayments are suspended during the military leave, loan repayments must resume upon rehire and the repayment period may only extended beyond the loan's maximum repayment period by the length of military service.

A reservist or national guardsman is permitted to take a distribution from a 403(b) plan, which is not subject to the IRS 10% premature distribution penalty tax if all of the following requirements are met:

- The participant was ordered or called to active duty after September 11, 2001.
- The participant was ordered or called to active duty for a period of more than 179 days or for an indefinite period as a member of a reserve component.

- The distribution consists of salary reduction or Roth 403(b) contributions.
- The distribution was made no earlier than the date of the order or call to active duty and no later than the close of the active duty period.

All or part of a qualified reservist distribution can be recontributed to an IRA within 2 years after the end of military duty.

In addition, an employer sponsoring a 403(b) plan must treat an individual who dies or becomes disabled while performing qualified military service as if the individual has resumed employment on the day preceding death or disability and terminated employment on the actual date of death or disability. Therefore, beneficiaries obtain additional benefits such as accelerated vesting, incidental death benefits or other survivor benefits that are provided to those participants who terminate employment due to death.

Social Security Alternative Plans

The Omnibus Budget Reconciliation Act of 1990 ("OBRA") amended the Code and the Social Security Act by expanding the definition of "employment" for FICA tax purposes to include service performed by employees of state and local governments, including public school systems. The result was that only those employees of a government entity who met certain requirements would be exempt from paying. In order for an employee to be exempt from paying FICA taxes:

- The government must maintain a "retirement system" that provides a specified "minimum benefit," and
- The employee must be a "qualified participant" in the retirement system.

A "retirement system" is defined as a system that provides retirement type benefits and includes a 401(a), 403(b) and a 457(b) plan. A "minimum benefit" is defined as an annual allocation (not including earnings) of at least 7.5% of compensation. In this case, compensation means wages defined for FICA tax purposes; wages earned above the FICA taxable wage base can be disregarded if so desired. Allocations to the employee's account may be either from employer and/or employee contributions. A "qualified participant" means an employee who receives an allocation that satisfies the minimum benefit requirement. Qualified participants may include part-time, seasonal and temporary employees.

SECTION III - DISTRIBUTIONS

Permissible Distributions from 403(b) Plans

The Code permits a 403(b) plan to make distributions to a participant or beneficiary when a participant has a distributable event. A list of distributable events under a 403(b) plan are listed below. Note that a 403(b) plan document can be more restrictive than the Code requirements.

<u>403(b)(1) Annuity Contracts</u>

Salary reduction and Roth contributions (including earnings) may generally be distributed only upon:

- Attainment of age 59 ½
- Severance from employment
- Death
- Disability, or
- Hardship.

<u>Note</u>: Hardship withdrawals are limited to salary reduction contributions made after 12/31/88 (not including earnings) and amounts attributable to QNECs and QMACs (including earnings).

<u>403(b)(7) Custodial Accounts</u>

Salary reduction, Roth and employer contributions (including earnings) may only be distributed upon:

- Attainment of age 59 ½
- Severance from employment
- Death
- Disability, or
- Hardship.

<u>Note</u>: Hardship withdrawals are limited to:
- Salary reduction contributions and
- '88 cash value (earnings on salary reduction contributions and employer contributions (including earnings) as of 12/31/88)

403(b)(1) Annuity Contracts	403(b)(7) Custodial Accounts

Exceptions to the above distribution rules:

No Code withdrawal restrictions apply to:

- ’88 cash value (salary reduction contributions (including earnings) as of 12/31/88)
- Employer contributions (including earnings)

Note, however, employer contributions (and earnings) made to an annuity contract issued after December 31, 2008 may not be distributed before:

- the participant’s severance from employment, or
- the occurrence of an event, such as after a fixed number of years, the attainment of a stated age, or disability.

Distribution of Roth 403(b) Contributions

Distributions of Roth 403(b) contributions will be tax-free for federal income tax purposes if they are “qualified distributions” and the following criteria is met:

- The funds must be held for a 5-year holding period, AND
- The distribution must be due to attainment of age 59 1/2, death, or disability.

In general, the 5-year holding period begins on the first day of the calendar year for which the employee first makes Roth 403(b) contributions to the 403(b) plan and ends when 5 consecutive taxable years have been completed.

If a participant rolls over designated Roth amounts from a designated Roth account, the following rules apply:

- If a *direct* rollover is made from a designated Roth account to a 403(b) plan, the 5-year holding period begins on the first day of the calendar year for which the employee first made designated Roth contributions to the prior plan.
- If an *indirect* rollover is made from a designated Roth account to a 403(b) plan, the 5-year holding period begins on the first day of the calendar year that the employee makes a designated Roth contribution to receiving 403(b) plan.

Distribution of Rollover Contributions

If permitted by a 403(b), amounts rolled over into the plan can be distributed to a participant before a participant has a distributable event as described above.

Types of Distributions

The common distribution options under a 403(b) plan are:

- Lump sum distribution
- Immediate or deferred annuity
- Direct rollover to an eligible rollover plan
- Deferred distribution
- Periodic payments from the 403(b) plan
- Combination of these options
- In addition, if a participant dies, a spousal beneficiary may continue the account subject to the RMD rules. However, no additional contributions may be made to the account.

Severance from Employment

A 403(b) plan may allow a participant who has terminated employment with the employer to receive his or her vested account balance upon severance from employment in accordance with the 403(b) plan rules. In addition, an individual generally has a severance from employment if that individual transfers from one public school to another public school of the same state employer.

Required Minimum Distributions ("RMD") under Code Section 401(a)(9)

The Code requires that payment of benefits under a 403(b) plan must begin no later than the April 1 of the calendar year following the later of the year in which the participant reaches age 70 1/2 or retires from the employer sponsoring the 403(b) plan.

The amount of the RMD is based on the participant's account balance (as of the previous December 31) divided by the applicable life expectancy. Generally, there is a single table that is used to determine a participant's applicable life expectancy that does not take into account a participant's designated beneficiary unless the participant's sole primary beneficiary is a spouse whose age difference is more than 10 years of the age of the participant. In this case, the applicable life expectancy is the participant's and spouse's joint and last survivor life expectancy. Life expectancies are determined under tables provided by the IRS.

<u>Pre-'87 Account Balance</u>

For required minimum distribution (RMD) purposes, if the vendor maintains the records necessary to identify the 12/31/86 cash value, such cash value (as of 12/31/86) does not have to be factored into the RMD amount until the later of the April of the calendar year following the year in which the participant attains age 75 or retires.

Death

Distributions, upon the death of a participant, are made to a designated beneficiary. A participant in a 403(b) plan sponsored by a public school system is generally not required to designate a spouse as a beneficiary unless the plan rules so provide. However, in states that are subject to community property laws, a spouse may be entitled to a death benefit even if s/he is not a designated beneficiary under a participant's account(s). In a community property state, each item of property acquired by either spouse during a marriage is treated as being owned equally by each spouse. Under these laws, assets under a 403(b) plan generally are community property to the extent the contributions were made while the participant and his or her spouse were married and domiciled in a community property jurisdiction.

Generally, a 403(b) plan will offer various distribution options, although regulations require death benefits to be distributed within a certain period of time. The timeframe depends upon whether the beneficiary is a spouse or non-spouse.

If RMD payments *have not begun upon a participant's death*, payments must be distributed to a designated beneficiary no later than:

- **Designated Beneficiary Rule:** Payment of the deceased participant's account balance must begin no later than December 31 of the calendar year immediately following the calendar year of the participant's death, payable over a period not to exceed the life expectancy of the beneficiary.

- **Designated Beneficiary is Surviving Spouse**: If the designated beneficiary is the surviving spouse, the payments to the spouse must begin by the later of:

  - December 31st of the calendar year immediately following the calendar year in which the employee dies, or
  - December 31st of the calendar year in which the employee would have attained age 70 1/2.

The payments to the surviving spouse must be made over a period not to exceed the spouse's life expectancy.

In the alternative, a spouse or non-spouse beneficiary may elect to have death benefits paid under the five-year rule.

- **Five-year rule:** The deceased participant's entire account balance must be distributed to a designated beneficiary no later than the December 31 of the calendar year containing the fifth anniversary of the participant's death.

If RMD payments *have begun to be made to a participant before death*, payments of the deceased participant's account balance must continue to a beneficiary (regardless of whether the beneficiary is a spouse or non-spouse) beginning no later than December 31st of the calendar year immediately following the calendar year of the participant's death and must be paid over the longer of:

- the remaining life expectancy of the appropriate beneficiary (once the designated beneficiaries have been determined), or
- the remaining life expectancy of the participant.

The following chart indicates how payments generally must be made to designated beneficiaries over life expectancy:

Designated Beneficiary	How Life Expectancy is calculated
Spouse is sole beneficiary	Year following the year of participant's death: the life expectancy of the spouse based on the age of the spouse in the year following the year of the participant's death Subsequent years: the spouse's life expectancy is recalculated annually For the years after the year of the spouse's death: the spouse's remaining life expectancy is calculated in the year of the spouse's death, reduced by one annually thereafter
Nonspousal beneficiary	Year following the year of the participant's death: the life expectancy of the beneficiary is based on the age of the beneficiary in the year following the year of the participant's death Subsequent years: the beneficiary's life expectancy is reduced by one annually
No designated beneficiary (i.e., either a trust that is not being looked through or the participant's estate)	The year following the year of the participant's death: The participant's life expectancy is based on the attained age of the participant in the year of the participant's death Subsequent years: the participant's remaining life expectancy is reduced by one annually

Trust as Beneficiary

Only an individual may be a designated beneficiary for purposes of determining the distribution period under Code Section 401(a)(9). Consequently, a trust itself may not be the designated beneficiary even though the trust is named as a beneficiary. However, if the trust is being "looked through" distributions made to the trust will be treated as paid to the beneficiaries of the trust if certain conditions are met.

Rules of a Look-Through Trust

- The trust is a valid trust under state law,
- The trust is irrevocable or will become irrevocable upon the death of the participant,
- The beneficiaries of the trust are identifiable from the trust instrument, and
- Appropriate documentation required under the RMD rules has been provided to the plan administrator (see below).

A participant who names a trust as a beneficiary and who intends the trust be a "look through" trust during his or her lifetime, must either:

- Provide to the plan administrator (or the party who maintains the plan's beneficiary information) a copy of the trust document and agree to provide any subsequent amendments to the trust, or

- Provide to the plan administrator a list of all of the beneficiaries under the trust, indicating that the participant's spouse is the sole, primary beneficiary and that the spouse's age is more than 10 years younger than the participant, and
- Certify that the list of beneficiaries is correct and complete and that all necessary requirements are satisfied with respect to the trust, and
- Agree to provide corrected certifications to the extent that an amendment changes any information previously certified, and
- Agree to provide a copy of the trust document to the plan administrator upon request.

If a look-through trust has been named as his or her designated beneficiary, upon a participant's death, the trustee of the trust must, by the October 31st of the year following the year of the participant's death, either:

- Provide the plan administrator with:
  - a final list of all of the beneficiaries of the trust as of the September 30th of the calendar year following the calendar year of the participant's death,
  - a certification that, to the best of the trustee's knowledge, this list is correct and complete and that all applicable requirements are satisfied, and
  - agree to provide a copy of the trust instrument to the plan administrator upon request, or
- Provide the plan administrator with a copy of the actual trust document.

Disability

A 403(b) plan may permit a disabled participant to receive a distribution of 100% of his or her account balance. An individual is considered *disabled*, under Code Section 72(m)(7), if s/he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or be of a long-continued and indefinite duration.

Hardship Withdrawals

The rules for distributions from 401(k) and 403(b) plans on account of "hardship" are found under the 401(k) regulations. The Bipartisan Budget Act of 2018 (BBA 2018) and The Tax Cuts and Jobs Act of 2017 (TCJA 2017) simplified the hardship distribution rules governing 401(k) and 403(b) plans.

To be eligible for a hardship distribution, a participant must experience:

- ***An immediate and heavy financial need***, and
- ***The distribution must be necessary to satisfy the financial need.***

Hardship distributions are not rollover eligible. As a result, hardship distributions are subject to a federal voluntary 10% withholding requirement and, unless an exception applies, an IRS 10% premature distribution penalty tax.

<u>Immediate and Heavy Financial Need Standards</u>

Following the Internal Revenue Service's issuance of final hardship regulations, there are seven safe harbor events that qualify for an immediate and heavy financial need, effective for hardship withdrawals taken on or after January 1, 2020:

- Certain medical expenses incurred by the employee, the employee's spouse, a dependent of the employee or primary beneficiary of the participant, provided that such medical expenses would be deductible (without regard to the limits of Internal Revenue Code Section 213(a);
- Costs directly related to the purchase of a principal residence for the employee (does not include mortgage payments);
- Payment of tuition, related educational fees, and room and board expenses for the next 12 months of post-secondary education for the employee, the employee's spouse, child, dependent, or primary beneficiary;
- Payments necessary to prevent the eviction or foreclosure on the mortgage of the employee from the employee's principal residence;
- Payments for burial or funeral expenses for the participant's deceased parent, spouse, child, dependent, or primary beneficiary;

- Certain expenses incurred for the repair of damage to the participant's principal residence, determined without regard to the casualty loss limitations under Internal Revenue Code Section 165 as modified by TCJA 2017 (i.e., the damage to the principal residence does not need to arise as part of a federally declared disaster); and
- Losses and expenses incurred on account of a federally declared disaster designated as such by the Federal Emergency Management Agency (FEMA). Additionally, this new safe harbor:
  - Is available only to the employee who lived or worked in the disaster area. Expenses or losses of an employee's relative or dependent will not be considered eligible under this safe harbor event;
  - Is not subject to a specified deadline for a hardship distribution request related to the disaster-relief safe harbor; and
  - An employer may choose to add this disaster-relief safe harbor to the plan at a later date (for example, when such a disaster occurs), provided that the amendment to permit the disaster-relief safe harbor is adopted by the end of the plan year in which it is effective.

For these purposes, a primary beneficiary under the plan is an individual who is named as a beneficiary under the plan and has an unconditional right to all or a portion of the participant's account balance under the plan upon the death of the participant.

Standard for Determining the Amount Necessary to Satisfy the Financial Need

The final hardship regulations provide that there is **one method** of determining whether the participant has any other financial resources available to satisfy the requested hardship amount. As a result, an employer may no longer make this determination based on a facts and circumstances method. The following criteria must be used to assess the amount necessary to satisfy a financial need:

- The amount withdrawn cannot exceed the participant's need (including any amounts necessary to pay any federal, state, or local income tax or penalties reasonably anticipated to result from the distribution);
- The participant must first request all other available distributions under all the employer's qualified and nonqualified plans, including available ESOP dividends; and
- The participant must represent in writing or via telephone on a recorded line to the plan administrator that s/he has insufficient cash or other liquid assets that are "reasonably available" to satisfy the need. A plan sponsor may rely on such employee's representation "unless the employer has actual knowledge to the contrary."

A participant is not required to take a nontaxable loan from the plan in order to satisfy the standard for determining the amount necessary to satisfy the financial need.

If a participant takes a hardship withdrawal, this standard does not require a plan to prohibit that participant from making elective contributions and employee after-tax contributions to 401(k), 403(b) or governmental 457(b) plans of the employer for the 6-month period immediately following a hardship distribution.

An employer may decide, as a matter of plan design, to impose a suspension of employee contributions to other plan types (including a 457(b) plan sponsored by a nonprofit organization and a nonqualified plan under IRC Section 409A).

Contribution Sources Under a Plan Available for a Hardship Distribution

While BBA 2018 broadened the sources available for a hardship withdrawal effective as of 1/1/2019, there are special rules applicable to 403(b) plans:

- A 401(k) plan ***may*** permit a hardship withdrawal to include qualified matching contributions (QMAC) and their earnings, qualified nonelective contributions (QNEC) and their earnings, and earnings on elective deferrals.
- A 403(b) plan ***cannot*** allow a hardship withdrawal to include earnings on elective deferrals; Section 403(b) of the Internal Revenue Code does not permit the withdrawal of such earnings for hardships.
- Employer contributions, including earnings (however, QMAC and QNECs under a 403(b)(7) product are not permitted to be distributed on account of hardship).
  - If the product is a 403(b)(7) custodial account, withdrawal of employer contributions due to hardship is not permitted under the Internal Revenue Code.
  - If the product is a 403(b)(1) annuity contract, amounts attributable to QNECs and QMACs may be distributed to a participant requesting a hardship withdrawal, provided that both the product terms and 403(b) plan so provide.

Rollovers and Federal Mandatory 20% Tax Withholding

If a participant receives a distribution that is eligible for rollover, 20% federal income tax withholding is automatically withheld from the distribution. The following are not eligible for rollover:

- A required minimum distribution,
- A distribution that is one of a series of substantially equal periodic payments (at least annually) made (a) over the life or life expectancy of the participant or over the joint lives or joint life expectancy of the participant and the participant's beneficiary or (b) over a specified period of ten or more years,
- The portion of a distribution that is not included in gross income, or
- A hardship distribution.

A **direct rollover** is a direct transfer from a 403(b) plan to an eligible rollover plan. In a direct rollover, the check is payable to the financial institution issuing the other eligible rollover plan for the benefit of the participant or beneficiary and there is no tax withholding.

An **indirect rollover** occurs when a participant or beneficiary receives a check for the distribution and makes a rollover within 60 days of receipt of the check. The mandatory 20% income tax withholding applies to any eligible rollover distribution made directly to a participant or beneficiary. Even though taxes have been withheld, the participant or beneficiary may contribute the amount withheld from the distribution in federal income tax withholding as part of a rollover to the subsequent eligible rollover plan. If the participant or beneficiary does not replace the federal income tax withheld, s/he will be taxed on this amount. In certain circumstances, the IRS may waive the 60-day rollover requirement.

A spousal beneficiary or alternate payee who is a spouse or former spouse under a QDRO may rollover eligible amounts to a Traditional or Roth IRA or to an eligible retirement plan in which s/he participates in as a plan participant.

Non-spouse beneficiaries can directly roll their distributions to an inherited IRA instead of taking a lump-sum payment. The inherited IRA must satisfy the required minimum distribution rules.

Contract to Contract Exchanges

A contract to contract exchange is a transfer among funding vehicles within the same 403(b) plan, subject to the following rules:

- The written 403(b) plan must provide for the transfer;
- The benefit transferred must be equal to the benefit received by the subsequent vendor (excluding any applicable contractual charges); and
- The distribution rules of the receiving vendor's funding vehicle must be at least as stringent as the prior vendor's funding vehicle;
- In addition, the employer and vendor must agree to share certain participant information on an ongoing basis, including:
  - whether and when a severance of employment has occurred to determine whether the participant has a distributable event;
  - information on whether a participant is entitled to a loan; and
  - information concerning whether the hardship withdrawal rules have been satisfied.

Plan to Plan Transfers

A plan-to-plan transfer is a transfer among the same or different employers' 403(b) plans, subject to the following rules:

- The individual whose 403(b) account is being transferred must be an employee or former employee of the employer of the receiving 403(b) plan;
- Both 403(b) plans must provide for the transfer in their plan document;
- The benefit transferred must be equal to the benefit received by the subsequent employer's plan (excluding any applicable contract charges);
- The distribution rules of the receiving employer's 403(b) plan must be at least as stringent as the prior employer's 403(b) plan; and

- If the transfer involved only a portion of the 403(b) account, the receiving 403(b) plan needs to be able to account for which contributions are employee contributions and which are employer contributions.

Contract Exchange	403(b) Plan-to-403(b) Plan Transfer	Transfer to Purchase Service Credits	Rollover
➢ Among approved products under <u>same</u> 403(b) plan whether the same or different vendor ➢ Participant or beneficiary with an account can make a contract exchange if the 403(b) plan permits this optional feature ➢ No *distributable event* required ➢ Amounts only move directly from one 403(b) product approved under the plan to another product approved under that same 403(b) plan ➢ Considered a tax-free transfer from the 403(b) product making the transfer. No *tax reporting* at the time of the contract exchange. ➢ Grandfathered features under the prior 403(b) product preserved following the contract exchange (if separately tracked by prior and new product) ➢ Product receiving the contract exchange is subject to information sharing rules with the employer	➢ Among <u>different</u> 403(b) plans, even if both 403(b) plans are sponsored by same employer ➢ Participant or beneficiary maintaining an account under the 403(b) plan can make a plan-to-plan transfer if <u>both</u> the 403(b) plan making the transfer and the 403(b) plan receiving the transfer permit transfers ➢ Amounts only move directly from one 403(b) plan to another 403(b) plan ➢ Considered a tax-free transfer from the 403(b) plan making the transfer. No *tax reporting* at the time of the plan-to-plan transfer. ➢ Grandfathered features under the 403(b) plan making the transfer preserved by the 403(b) plan receiving the transfer (if separately tracked by prior and new product)	➢ From a 403(b) plan to a federal, state, or local governmental defined benefit retirement system to buy *service credit* under that governmental retirement system ➢ Participant with both a 403(b) account and benefit due under the governmental defined benefit retirement system can make a transfer to purchase service credit if the 403(b) plan permits the transfer and the governmental defined benefit retirement system determines the amount of the credit to be purchased and accepts the transfer ➢ Amounts only move directly from the 403(b) plan to the governmental defined benefit retirement system ➢ Considered a tax-free transfer from the 403(b) plan. No tax reporting at the time of the transfer.	➢ Rollover out: eligible amounts can be rolled over via either an indirect or direct rollover from the 403(b) plan to all eligible retirement plans. Spousal beneficiaries may roll eligible amounts into an eligible retirement plan in which they participate. Nonspousal beneficiaries may only roll over eligible amounts via a direct rollover to an inherited IRA. ➢ Rollover in: eligible amounts may be rolled over to a 403(b) plan from an eligible retirement plan (for purposes of rollovers in, an eligible retirement plan does not include a Roth IRA). Spousal beneficiaries may roll over eligible amounts into an eligible retirement plan in which they participate or to their own traditional or Roth IRA. ➢ A distributable event is required in order to roll over ➢ The plan receiving the rollover must permit rollovers in ➢ Tax reporting required at the time that the amounts are rolled over. Tax withholding in required for in-direct rollovers. ➢ Amounts rolled over do not retain grandfathered features under the 403(b) plan

IRS 10% premature distribution penalty tax

In general, an IRS 10% premature distribution penalty tax applies to the taxable portion of a distribution if a participant receives a distribution before reaching age 59 1/2.

The IRS 10% premature distribution penalty tax does **not apply** if the distribution is made on account of one of the following reasons:

- Death of the participant,
- The participant becomes disabled,
- Payments are made in at least annual installments over the life (or life expectancy) of the participant or the joint lives of the participant and the designated beneficiary,
- Separation from service on or after attainment of age 55,
- Payments made for medical care, but not in excess of amounts allowable as a deduction under regulations,
- Corrective distributions of excess contributions and excess deferrals,
- Payments are made to an alternate payee under a QDRO,
- Payments of a federal levy for collection of taxes; or
- As a “qualified reservist distribution,” which is a distribution of salary reduction or Roth 403(b) contributions that are (a) made to a reservist or national guardsman who was called to active duty after September 11, 2001 for a period in excess of 179 days or for an indefinite period of time, and (b) made during the period beginning on the date of the order or call to duty and ending at the close of the active duty period. In addition, a qualified reservist distribution can be repaid to an IRA at any time during the two-year period after the end of the active duty period.
- Distribution from a governmental retirement plan, including defined benefit and defined contribution plans, to a qualified public safety employee due to separation from service in the same year or later than the year in which the employee reaches age 50.

Loans

If a 403(b) plan permits loans, eligible individuals may borrow from and directly repay to their own accounts, provided all of the following requirements are met:

- The maximum loan amount cannot exceed the lesser of $50,000 reduced by the participant’s highest outstanding loan balance during the last 12 months or 50% of the participant’s vested account balance (all plans of the employer are aggregated for purposes of the maximum loan).
- The loan is repaid in level payments at least as frequently as quarterly.
- The loan must be repaid within five years unless the loan is used to acquire a participant’s primary residence.
- The loan must be set forth in a legally enforceable agreement that must specify the amount of the loan, the term of the loan and the repayment schedule.

The amount of the interest on a loan will be provided by the 403(b) plan or under the terms of the funding vehicle.

Purchase of Service Credits

If permitted by a federal, state or local defined benefit retirement system, a participant in a 403(b) plan may direct the employer to transfer amounts under a 403(b) plan tax-free to the trustee of that governmental retirement system in order to purchase years of service credits under the system or repay amounts previously cashed out under the system even if the participant is not eligible for a distribution.

Automatic Rollovers

If a 403(b) plan provides for an automatic cash out upon a participant’s severance from employment when the participant fails to elect a distribution method, vested amounts in excess of $1,000 but less than or equal to $5,000 (not counting amounts held in rollover accounts) are subject to automatic rollovers to an IRA.

SECTION IV - FIDUCIARY RESPONSIBILITIES

Code Section 403(b) Plan Fiduciaries - in General

By virtue of their governmental status, 403(b) plans sponsored by public school systems are exempt from all provisions of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"). These provisions include fiduciary, participation, coverage, vesting, spousal consent, reporting and disclosure and funding rules.

Although governmental retirement plans are not subject to the fiduciary requirements of ERISA, similar Code and state law rules may provide guidelines that a governmental employer must follow in operating its retirement plan. Generally, a person who exercises discretionary control over the management of the plan or its assets or who is paid to give investment advice regarding plan assets is a plan fiduciary.

There are four basics duties for fiduciaries under ERISA:

- Operate the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses.
- Follow the terms of plan documents to the extent that the plan terms are consistent with ERISA.
- Act prudently and diversify the plan's investments in order to minimize the risk of large losses.
- Not engage in transactions on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, services providers or the plan sponsor.

In addition, ERISA requires plan sponsors to furnish certain information to participants and beneficiaries. Civil and criminal penalties apply to fiduciaries who breach their duties.

<u>IRS Obligations for Plan Sponsors</u>

As previously mentioned, even though certain types of retirement plans are not subject to ERISA, the Code may have parallel provisions and common themes. For example, the Code provides in several sections that plans operate under a version of the "exclusive benefit rule." In a 403(b) plan, amounts held in an annuity contract are required to be nonforfeitable and amounts held in custodial accounts "cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries."

The Code also has specific rules on the timing of remitting contributions to a vendor after the amounts are withheld from a participant's pay. For 403(b) plans these rules provide that participant contributions to the plan must be transferred to the investment provider within a period that is not longer than is reasonable for the proper administration of the plan.

Similar to the ERISA requirement, all retirement plan sponsors, whether ERISA or not, must maintain a written plan, amending the plan, as needed for design and or legislative/regulatory changes and must operate the plan in accordance with its terms.

IRS rules for disclosure to participants for non-ERISA plans are not as prevalent as the ERISA disclosure rules. However, the IRS has begun to issue guidance requiring that non-ERISA plan sponsors inform eligible employees of their right to participate in the retirement plan. For example, under the final 403(b) regulations as part of the "universal availability rule," the IRS requires a 403(b) plan sponsor to inform eligible employees on an annual basis that they can participate in the 403(b) plan.

<u>State Rules</u>

Retirement plan investments may often vary, depending on each state's laws. In general, state laws look to ERISA as best practices in formulating retirement plan investment rules. State laws may also specify who is considered a "fiduciary" under state law and any civil and criminal penalties imposed on those fiduciaries that violate those rules.

Plan sponsors should be sure to check with legal counsel to determine which state law applies to which types of plans. For example, the rules for retirement plan investments may only apply to the state retirement system and not to voluntary-type plans, such as 403(b) plans. However, a 403(b) plan may be covered under the state-wide rules.

The following is an explanation of certain laws that states may elect to adopt for their retirement plans:

Two types of rules on which states may base their investment rules for retirement plans are the “prudent person rule” and the “prudent investor rule.”

- The prudent person rule requires fiduciaries of a retirement plan to evaluate an investment in isolation rather than view it as part of the total portfolio and instructs a fiduciary to avoid speculative investments.
- The prudent investor rule (sometimes called the prudent expert rule or ERISA standard) requires fiduciaries of a retirement plan to evaluate an investment as part of the total portfolio. Similar to ERISA, it acknowledges that various levels of risk may be appropriate. Some state’s investment rules blend the prudent person rule and the prudent investor standard.

Legal Lists

A state or local statute may set limits on the types of investments (e.g., stocks, bonds) and the extent of investment in each type of investment in which retirement plan fiduciaries can invest. A legal list can also prohibit certain types of investments.

Governmental sponsors of 403(b) plans must keep in mind any state law rules when it comes to choosing approved providers. Some states may require that any vendors that meet specific requirements may offer their products to plan participants. In other states, any vendor that registers their product(s) with the state may offer their products to plan participants.

Applicable Uniform Laws

The National Conference of Commissioners on Uniform State Laws (NCCUSL) drafted both the Uniform Prudent Investor Act (“UPIA”) and the Uniform Management of Public Employee Retirement Systems Act (“UMPERSA”) for adoption by state and local governmental retirement plans. A state is not obligated to adopt a uniform law; even if a state does adopt a uniform law, it may not do so on a word-for-word basis.

UPIA concentrates on investment standards of a retirement plan while UMPERSA:

- Sets out the fiduciary obligations of trustees and other individuals involved with a public retirement plan,
- Provides disclosure rules to participants, beneficiaries and the public, and
- Provides that a trustee or other fiduciary who breaches a duty is personally liable for any losses resulting from the breach.

As explained above, fiduciary responsibility rules under state and local laws are very complicated. Thus it is very important that a governmental retirement plan sponsor seek advice from their legal counsel when determining what types of investments they are permitted to offer to their retirement plan participants as well as any fiduciary obligations that might apply to those investments.

Written 403(b) Plan

A 403(b) plan sponsor is required to maintain a “written plan” and operate the 403(b) plan in accordance with its terms. The written plan must contain certain required provisions and may contain certain optional features as included below:

Required Provisions	Optional Provisions
Eligibility	Roth 403(b) and employer contributions
Benefits	Loans
Applicable limits	Hardship distributions
Timing and form of distribution options	Rollover contributions
Contracts available under plan	Contract exchanges
Delegation of roles and responsibilities	Plan to plan transfers, including buybacks of service in governmental retirement system

According to the IRS, the "written plan" may be either a plan document or a collection of documents (including the contracts, salary reduction agreements, employee handbooks, etc.). However, the IRS strongly suggests that a 403(b) plan be operated under a single plan document, especially in a multiple vendor environment.

403(b) Plan Documents

Plan sponsors may adopt an IRS pre-approved 403(b) plan document in the form of either a prototype or volume submitter plan which complies with the Code Section 403(b) requirements. An employer that adopts a 403(b) pre-approved plan generally has assurance that its plan document, in form, complies with Code Section 403(b). A 403(b) plan sponsor may also adopt an individually designed plan document. A 403(b) plan sponsor needs to ensure that it operates its plan in accordance with its written terms.

On September 30, 2019, the IRS released Revenue Procedure 2019-39. The Procedure establishes a recurring remedial amendment system for individually designed and IRS pre-approved 403(b) plans. In addition, the guidance creates an annual Required Amendments List to be published by the IRS.

Disclosure Requirements

A 403(b) plan sponsored by a public school system is not subject to the reporting requirements of Title I of ERISA, including providing each participant with a summary plan description and filing a Form 5500 (Annual Report/Annual Return) series with the IRS.

Locating Missing Plan Participants

For 403(b) plans subject to ERISA, the DOL issued Field Advisory Bulletin 2014-01 to provide guidance to plan fiduciaries regarding action steps required when plan participants or beneficiaries cannot be located upon plan termination. While this guidance only applies to retirement plans subject to the ERISA, the suggested steps may be helpful to nonERISA plans seeking to locate missing individuals. In addition, the IRS provided input on locating missing participants. That information can be found at: http://www.irs.gov/Retirement-Plans/Missing-Participants-or-Beneficiaries.

Step One: DOL Search Methods

- A plan fiduciary must first attempt to deliver notice to participants and beneficiaries by routine methods, such as delivering notice by first class mail or electronic notification.
- Next, if a participant or beneficiary still cannot be located, a plan fiduciary must attempt to find the missing individual through **EACH** of the below search methods, *regardless* of the size of the account balance. These methods are:
  - **Use Certified Mail**.
  - **Check Related Plan Records**. Plan fiduciaries of the terminated retirement plan must ask both the employer and administrator(s) of related plans (e.g., health plans) to search their records for a more current address for the missing individual. If there are privacy concerns, the retirement plan fiduciary can request the employer or other plan fiduciary to contact or forward a letter on behalf of the terminated plan to the participant or beneficiary, requesting the individual to contact the retirement plan fiduciary.
  - **Check with Designated Plan Beneficiary**. Plan fiduciaries must attempt to identify and contact any individual that the missing individual has designated as a beneficiary (e.g., spouse, children, etc.) in a related plan for updated information concerning the location of the missing individual. If there are privacy concerns, the plan fiduciary can request the designated beneficiary to contact or forward a letter on behalf of the terminated plan to the missing participant or beneficiary, requesting the missing individual to contact the plan fiduciary.

- **Use Free Electronic Search Tools.** Plan fiduciaries must make reasonable use of Internet search tools that do not charge a fee to search for a missing participant or beneficiary. Such online services include Internet search engines, public record databases (such as those for licenses, mortgages and real estate taxes), obituaries and social media**.**
- **Additional Search Steps:** If a plan administrator follows the required search steps, but does not find the missing participant or beneficiary, s/he should consider the size of a participant's account balance and the cost of further search efforts in deciding if any additional search steps are appropriate. For example, a plan administrator could use Internet search tools, commercial locator services, credit reporting agencies, information brokers, investigation databases and other similar services that may involve charges.

Step Two: DOL Distribution Options

After utilizing all of the search methods described above, if a plan fiduciary still cannot locate a missing individual, the plan may distribute the account balance in accordance with one of the following distribution options:

- **Preferred Distribution Option - Individual Retirement Plan Rollovers** – The DOL suggest that in order to preserve funds for retirement, a plan fiduciary can establish an IRA (inherited IRA in the situation of a nonspouse beneficiary) for the missing individual. In order to fulfill its responsibilities under ERISA, a plan fiduciary must follow the DOL's regulatory guidance safe harbor for making distributions for a missing participant or beneficiary into an IRA under DOL Reg. Section 2550.404a-3.
- **Alternative Arrangements** – If providers are not willing to issue an IRA to a missing individual or the plan fiduciary determines based on facts and circumstances not to make a direct rollover to an IRA on behalf of a missing participant or beneficiary, the plan fiduciary may either establish (1) an interest-bearing federally insured bank account in the name of a missing individual or (2) transfer the missing individual's account balance to the state unclaimed property funds in the state in which the individual was last known to reside or work. Unfortunately, since these are distributions, neither of these methods would preserve the tax-deferred status of the amounts. In addition, the amounts distributed would become subject to mandatory income tax withholding and a possible additional tax for premature distributions and any interest accrued would also be subject to income taxation.

Other Considerations

IRS Withholding Rules. The DOL's guidance specifically states that plan fiduciaries should *not* use 100% income tax withholding as a means to distribute plan benefits to missing participants or beneficiaries.

USA PATRIOT Act. The IRS will not require the customer identification and verification provision (CIP) when a plan fiduciary establishes an account for a missing individual. The CIP requirements will apply when the missing individual first contacts the IRA issuer or federally insured bank to claim the account balance.

State law issues. A plan fiduciary should be aware of any state laws, including those governing signature requirements and escheat, which are beyond the scope of the DOL guidance.

SECTION V - MISCELLANEOUS

Qualified Domestic Relations Orders ("QDRO")

Code Section 403(b) plans sponsored by public school systems are exempt from the general rule of ERISA that a retirement benefit cannot be assigned. However, for purposes of a 403(b) plan sponsored by a public school system, a domestic relations order will be treated as a Qualified Domestic Relations Order ("QDRO") if it creates or recognizes the existence of an alternate payee's right to, or assigns all or a portion of a participant's benefit to an alternate payee. An alternate payee is either the participant's spouse, former spouse, child or other dependent. In order to be a domestic relations order for this purpose, the order must relate to the provision of child support, alimony or marital property rights to a spouse, former spouse, child or other dependent and must be made pursuant to a state domestic relations law.

If benefits are paid to a spouse or former spouse, the amount of the payment generally must be included in the spouse's or former spouse's taxable income. If benefits are paid to a child or dependent, the amount of the payment is taxable to the participant.

IRS Tax Liens and Levies

The IRS has the right to impose a tax lien or levy on a 403(b) plan account. However, the 403(b) plan should not distribute any 403(b) plan assets to the IRS until the participant has attained a distributable event as specified in the 403(b) written plan.

Bankruptcy

A participant's account under a 403(b) plan is exempt from the claims of that participant's creditors in a bankruptcy proceeding. A participant in a 403(b) plan who is involved in a bankruptcy proceeding should not list a plan loan as a debt because it is collateralized by the outstanding balance of the loan.

IRS Correction Programs for Sponsors of 403(b) Plans

The ECPRS is a comprehensive system of correction programs for sponsors of 403(b) plans that have not met applicable Code requirements for a period of time. This system permits employers to correct qualification failures thereby continue to provide their employees with retirement benefits on a tax-favored basis. The three components of the EPCRS are:

- the Self-Correction Plan (**SCP**), which permits plan sponsors to correct certain plan failures without contacting the IRS or incurring a fee,
- the Voluntary Correction Plan (**VCP**), which permits a plan sponsor to, any time before audit, pay a limited fee and receive the Service's approval for correction of plan failures, and
- the Audit Closing Agreement Plan (**Audit CAP**), which permits a plan sponsor to pay a sanction and correct a plan failure while the plan is under audit.

For further information regarding EPCRS please visit the IRS website at http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors

The IRS has also provided a 403(b) Plan Fix-It Guide to assist 403(b) plan sponsor in finding, fixing, and avoiding common mistakes in 403(b) plans. The Guide can be found at: https://www.irs.gov/retirement-plans/403b-plan-fix-it-guide.

Termination of a 403(b) Plan

If permitted by the terms of the 403(b) plan, an employer may terminate the plan and distribute accumulated benefits to the participants and beneficiaries. To terminate a 403(b) plan, the employer must take the following steps:

- Adopt a binding resolution:
  - establishing a plan termination date,
  - ceasing plan contributions,
  - fully vesting all benefits on the termination date, and
  - authorizing the distribution of all benefits as soon as administratively practicable after the termination date.
- Generally, stop contributions by the employer or any related entity to any other 403(b) plan during the period that begins on the termination date and ends 12 months after all benefits have been distributed from the terminated plan;
- Notify all plan participants and beneficiaries about the plan's termination;
- Provide a Special Tax Notice to participants and beneficiaries; and
- Distribute all plan assets within 12 months of the plan's termination date to participants and beneficiaries. Distribution of a fully paid individual insurance annuity contract is sufficient to satisfy the distribution requirements.

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