403(b) Perspectives

Insights into the Administration of §403(b) Tax-Sheltered Arrangements

SPRING 2016

Midyear Changes to Safe Harbor 403(b) Plans

Long-awaited relief regarding midyear amendments to safe harbor 403(b) and 401(k) plans arrived when the IRS released Notice 2016-16 on January 29, 2016. The new rules were immediately effective and apply to both 403(b) and 401(k) traditional safe harbor plans and qualified automatic contribution arrangement (QACA) safe harbor plans. 403(b) plans meet nondiscrimination of elective deferrals by a universal availability versus the actual deferral percentage test so the safe harbor 403(b) plan is a plan design that eliminates the actual contribution percentage (ACP) test for the matching contributions and after-tax contributions.

Scope of the New Rule

Rather than the very short list of permitted midyear changes that we had before the guidance, we now have a short list of what are prohibited midyear changes, leaving all other midyear changes now available. Notice 2016-16 generally defines a "midyear change" as — (i) a change that is first effective during a plan year but not effective as of the beginning of the plan year, or (ii) a change that is effective as of the beginning of the plan year but adopted after the beginning of the plan year.

The Notice further provides that a midyear change to either a safe harbor plan or to a plan's safe harbor notice won't violate the safe harbor rules merely because it is a midyear change, *provided that* (1) if the change to the plan affects anything in the plan's required safe harbor notice content, the applicable notice and election opportunity conditions are satisfied, and (2) the midyear change is not a prohibited midyear change.

Notice and Election Opportunity Conditions

Midyear changes affecting anything in the safe harbor notice require that participants receive an updated safe harbor notice. The updated safe harbor notice must describe the midyear change and its effective date. Timing requirements will generally be deemed satisfied if the notice is given to participants at least 30 days and not more than 90 days ahead of the change. If it is not practicable to provide the notice before the effective date of the change, such as for amendments retroactive to the beginning of the plan year, the notice is treated as timely provided if given no later than 30 days after the change is adopted.

Whenever an updated safe harbor notice is provided, participants must have a reasonable

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opportunity to update their deferral and after-tax contribution elections before the effective date of the change. Notice 2016-16 deems a 30-day election period as a reasonable allowance to make a deferral change.

Prohibited Midyear Changes

Notice 2016-16 also provides IRS prohibited midyear changes, including those that:

- Violate the anti-cutback, anti-abuse, or nondiscrimination rules.
- Increase the number of years of vesting service required for vesting in QACA safe harbor contributions.
- Reduce the number or otherwise narrow the group of employees eligible for safe harbor contributions.
- Change the type of safe harbor arrangement — e.g., from a traditional to a QACA safe harbor. In addition, the plan may not be changed from safe harbor NEC to safe harbor matching contributions midyear, and vice versa.
- Increase a safe harbor benefit by modifying (or adding) a formula used to determine matching contributions (including the definition of "compensation" that is used to determine matching contributions), or permitting a discretionary matching contribution. However, this prohibition will not apply if, at least three months prior to the end of the plan year, the change is adopted and the updated safe harbor notice and election opportunity are provided and the change is made retroactively effective for the entire year.

Existing 12-month Plan Year Exceptions Unaffected

Existing guidance regarding exceptions to the 12-month safe harbor 403(b) plan year requirement is not affected by Notice 2016-16. Specifically, the following exceptions to the 12-month plan year requirement are unaffected by the notice:

- Change of the plan year, by use of a short plan year, provided that the safe harbor short plan year is preceded and followed by a 12-month safe harbor plan year.
- Adoption of a brand-new safe harbor 403(b) plan, provided there are at least three months of the plan year remaining.
- Reduction or suspension of safe harbor contributions midyear, which would require the safe harbor contribution and the ADP and ACP tests.
- Midyear plan termination of a safe harbor 403(b) plan.

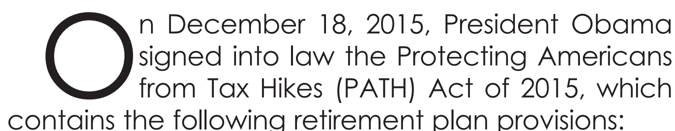
Examples of Permissible Changes

The guidance presents seven examples of permissible midyear changes, including the following two:

Example. The sponsor of a safe harbor plan makes a midyear amendment to add an age 59½ in-service withdrawal feature. The midyear change is deemed permissible if both an updated notice describing the withdrawal feature and an appropriate election opportunity are provided to the employees required to be provided with a safe harbor notice.

Example. The sponsor of a safe harbor plan makes a midyear plan amendment with two new provisions — one changing the entry date for commencement of participation of employees who meet the plan's minimum age and service eligibility requirements from monthly to quarterly and the other changing plan rules regarding arbitration of disputes. The amendment is effective with respect to employees who are not already eligible to participate in the safe harbor plan. Because the safe harbor notice is not required to include the plan entry date or information on arbitration procedures, neither an updated notice nor an additional election opportunity is required. ■

PATH Retirement Plan Provisions



On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes (PATH) Act of 2015, which contains the following retirement plan provisions:

1. The allowable exclusion from gross income for qualified charitable donations from individual retirement accounts (IRAs), which had expired December 31, 2014, will be made permanent.
2. Rollovers may be made into a SIMPLE IRA from an employer-sponsored retirement plan after the individual has participated in the SIMPLE IRA plan for two years.

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PATH Retirement Plan Provisions

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3. The law contains a set of church plan provisions which began as a separate bill called the Church Plan Clarification Act. We will be covering this law change as a series of articles in the next *403(b) Perspective* newsletter issues.

Charitable Donation IRAs

How does a charitable donation from an IRA work? An IRA owner who is 70½ or older may make a direct, tax-free donation to a qualified charitable organization of up to $100,000 per year from his or her IRA. The donated amount is also counted toward satisfaction of the required minimum distribution (RMD) for the year.

Note: This provision has been enacted, and has expired, a number of times since 2006. However, this provision is now permanent.

Keep in mind that this law does not apply to distributions from 403(b) plans or qualified plans (such as profit sharing and 401(k) plans). Further, if an individual in a 403(b) wishes to roll over funds to an IRA and then make a charitable donation from the IRA, the RMD rules require that the RMD for the year be taken from the 403(b) first and that only amounts distributed above the RMD amount may be rolled into an IRA.

For example, assume an RMD must be distributed in 2016 from a 403(b). The RMD must be distributed before funds can be rolled from the 403(b) to a new IRA. However, since the funds were not in the IRA on the preceding December 31, no RMD is required from the IRA for 2016. However, in 2017, a charitable donation from the IRA may be used to satisfy the RMD for the IRA because funds were in the account on December 31, 2016.

Rollovers into a SIMPLE IRA

This requires the SIMPLE IRA participant to have participated in the SIMPLE IRA for two years from the beginning of participation. Once this two-year period has been satisfied, a SIMPLE IRA participant may roll funds into the SIMPLE IRA from a qualified plan, such as a 401(k), a 403(b), or governmental 457(b) plan, as well as from a traditional IRA.

Church Plan Changes, Part One

As previously mentioned, we will be covering the changes to church plans in a series of articles. This first one is about a major change to the rules for church plan transfers/mergers. Generally, there cannot be a transfer or merger between a qualified plan and a 403(b) plan. The new law allows a church (using the broad definition we will define in the next issue, including Non-Qualified Church Controlled Organizations) to:

- Transfer funds from a 403(b) plan to a qualified plan of the same church.
- Transfer funds from a qualified plan to a 403(b) plan of the same church.
- Merge a qualified plan with a 403(b) plan of the same church.

As in a qualified plan merger or transfer, the transaction must ensure that each participant's total accrued benefit or account balance immediately after the transaction is not less than the total accrued benefit or account balance before the transaction. Note that the participant must be fully vested after the transaction, regardless of the participant's vested status before the transaction. The new rules became effective when the President signed the law on December 18, 2015.

Example: Church A is a large church that has established a qualified plan covering employees of the church and church-controlled organizations, including a university and a charity hospital. Church A wishes to terminate the qualified plan and transfer all the funds to a brand-new 403(b) plan it establishes. Under the provisions of PATH, Church A can make the transfer without any problem and the transfer will not adversely impact either plan. Church A could only make the transfer after December 17, 2015. If Church A were not a church but were a different type of 501(c)(3) entity, it would not be able to make the transfer. ■

VCP Fee Changes

The IRS began classifying Voluntary Correction Program (VCP) fees as user fees subject to Internal Revenue Code Section 7528 in 2015. As of February 1, 2016, plan sponsors will no longer use the VCP general fee schedule in Revenue Procedure 2013-12, the current version of the

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VCP Fee Changes

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Employee Plans Compliance Resolution System (EPCRS).

Instead, the VCP general fee schedule will be updated each year as part of the annual revenue procedure. For 2016, this is Revenue Procedure 2016-8.

To encourage employers who sponsor 403(b) plans and 401(a) qualified retirement plans to correct plan failures through the VCP, the IRS reduced the general VCP fees for most new submissions made on or after February 1, 2016. The general fee amount for plans with 101 to 500 participants remains unchanged.

Beginning February 1, 2016, plan sponsors should:

- Use Rev. Proc. 2016-8, Sec. 6.08 (and subsequent annual updates) to determine the appropriate fee for most VCP submissions.
- Continue to use Rev. Proc. 2013-12, as modified by Rev. Proc. 2015-27, for additional guidance on eligibility for reduced fees for certain submissions.

New General VCP Fees Based on Number of Participants

20 or fewer	$500
21-50	$750
51-100	$1,500
101-1,000	$5,000
1,001-10,000	$10,000
More than 10,000	$15,000

The IRS will not apply the reduced fees for VCP submissions made prior to February 1, 2016, or issue refunds for pre-February 1, 2016, VCP submissions that are withdrawn and then resubmitted under the reduced fee schedule. ■

Form 5500 Compliance Questions

The IRS recently announced that since the proposed 2015 IRS compliance questions on Forms 5500 and 5500-SF and Schedules H, I, and R were not approved by the Office of Management and Budget prior to publication of the forms in December, these questions should not be answered for the 2015 plan year.

The questions have been added to existing schedules to Form 5500 and address the following:

Schedules H and I:

- The plan's unrelated business taxable income (UBTI)
- In-service distributions
- Identity of plan's trustee or custodian

Schedule R:

- Nondiscrimination testing and methodology
- Plan amendments to address recent tax law changes
- Plan's domicile

Nevertheless, sponsors may want to review the questions now so they can take steps to prepare for next year, when the new questions may be required. Some could involve time-consuming documentation or internal analyses that would need to be started in advance.

To access the 2015 Form 5500, which includes the questions, visit *https://www.dol.gov/ebsa/forms.html*. ■

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