

# 403(b) Perspectives



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

SPRING 2014

## Pre-approved 403(b) Plan Update

**F**or the first time ever, prototype and volume submitter 403(b) plan documents will be pre-approved by the IRS. This was announced by the IRS last year in Revenue Procedure 2013-12. The IRS also announced that it did not intend to have an approval program for individually designed 403(b) plans. Without an individually designed program, employers will either have to adopt pre-approved plans or not have a plan approval.

In deciding whether to have a model document, a pre-approved prototype or a pre-approved volume submitter, we had to consider numerous factors. While prototype plans allow for more flexibility for the document sponsor, volume submitter plans allow more flexibility for the adopting employer to adjust plan language. Again, with no individually designed program available, we need to provide the most flexibility. Thus, since the volume-submitter approach will provide the adopting employers with the most options, that is what we will offer. Since our 403(b) clients are

used to the adoption-agreement approach, we will offer a volume submitter plan, using an adoption agreement.

The expected timeline at this point is for document drafters to submit their plans for IRS review by April 30, 2014. If the timetable for 403(b) documents is like the other pre-approved documents, the IRS review would be completed sometime in 2016 and employers would have until sometime in 2018 to restate their existing documents. When the IRS is completing its review process, there will be an IRS announcement, which will provide the specific pre-approved plan restatement window opening and closing time frames. When the IRS issues its announcement, we will keep you posted. ■

# IRS Form 8822-B

**E**ffective January 1, 2014, the Internal Revenue Service (IRS) will require any entity with an Employee Identification Number (EIN), such as a plan sponsor, to report changes to the identity of the plan's responsible party on Form 8822-B. Form 8822-B must be filed within 60 days of the change. In addition, if a change to a responsible party occurred before 2014 and the IRS has not been previously notified of this change, Form 8822-B must be filed prior to March 1, 2014, to report the previous change.

## Background

Prior to 2014, Form 8822-B had been used solely as an optional method of reporting address changes. In August 2013, the IRS published an updated version of this form, expanding its use to include reporting a change of responsible party beginning in 2014.

While reporting a change of identity of a plan's responsible party using Form 8822-B is mandatory, reporting address changes on Form 8822-B remains optional. The IRS also noted there are no penalties for failing to provide the IRS with this information. The IRS added that failing to report changes of address or changes to responsible parties could result in recipients failing to receive certain tax notices, such as a notice of deficiency or a notice of demand for tax.

Use of this form is limited, as Form 8822-B contains a box to be checked in relation to retirement plans for changes only to employee plan returns (Forms 5500, 5500-EZ, etc.).

## Responsible Party

Form 8822-B instructions contain a general definition of "responsible party" that is not specific to retirement plans. In its November 18, 2013, edition of *Employee Plans News*, the IRS attempted to clarify the definition of responsible party with respect to retirement plans by providing the following language:

***"For retirement plans, a 'responsible party' is the person who has a level of control, directly or indirectly, over the funds or assets in the retirement plan. The instructions to Form 8822-B contain a more detailed definition of 'responsible party,' and an explanation of who must sign the form."***

## Signature

Form 8822-B must be signed by an officer, owner, general partner or LLC member manager, plan administrator, fiduciary, or an authorized representative. A representative signing on behalf of the taxpayer must attach a Form 2848 (power of attorney) to Form 8822-B. ■

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## Employers Eligible for a 403(b) Plan

**U**nderstanding which employers are eligible to sponsor a 403(b) plan is a prerequisite to the proper marketing of these plans. The Internal Revenue Code defines who is eligible to sponsor a 403(b) arrangement. There are generally two major categories of eligible employers, tax-exempt Code §501(c)(3) organizations and education organizations. The Code also contains a number of other eligible employers.

### Code §501(c)(3) Tax-Exempt Organizations

Generally, a tax-exempt organization under IRC §501(c)(3) includes a corporation, foundation, community chest, or fund. Further, this type of employer must be organized and operated exclusively for one or more of the following purposes: charitable, scientific, religious, literary, education, animal or child abuse prevention, public safety testing, or the

promotion of amateur sports. However, this last purpose generally does not include the operation of a sports facility.

A major concern for the IRS in its audit of tax-exempt organizations is that some organizations maintaining Code §403(b) arrangements are not qualified as tax-exempt under Code §501(c)(3). Instead, they are tax-exempt under other sections of Code §501(c) and, therefore, are not eligible to maintain a Code §403(b) arrangement. The tax implications of opening a 403(b) and not being an eligible employer for a 403(b) are substantial. An organization may ensure that it is eligible to sponsor a Code §403(b) arrangement by applying for an IRS determination using Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of

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# Employers Eligible for a 403(b) Plan

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the Internal Revenue Code. Form 1023 is a 31-page application in which the employer provides financial information about itself and requests that the IRS rule on its tax status.

## Educational Organization

An educational institution is a 403(b)-qualified employer if it is either a private 501(c)(3) organization or an organization that is operated by a state, municipal or Native American tribal government, or an agency or instrumentality thereof. A 403(b) plan may then be maintained for employees who perform (or have performed) services, directly or indirectly, for such an *educational organization*. As defined under Code section 170(b)(1)(A)(ii), an educational organization includes entities providing instruction on a primary, secondary, preparatory, high school, college, or university level. Additional substantiation requirements must also be satisfied, as follows:

1. The organization must have as its primary function the presentation of formal instruction;
2. The organization must have a regular faculty and curriculum; and
3. The organization must have an enrolled student body at the site where it regularly provides educational activities.

An eligible educational organization is not permitted to engage in both educational and non-educational functions, although functions that are purely incidental to the educational function may be permitted.

## Churches

A church is a 403(b)-eligible employer as it is a 501(c)(3) organization. A church is defined in Code section 3121(w)(3)(A), and it includes a “qualified church-controlled organization.” IRC section 3121(w)(3)(B) defines a qualified church-controlled organization as any church-controlled tax-exempt organization described in 501(c)(3), except an organization that: first, offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities, which are sold at a nominal charge which is substantially less than the cost of providing them (thus, furthering the charitable purpose) and second, normally receives more than 25% of its support from the government or from its related trade or business. Examples of qualified church-controlled organizations include schools, hospitals, and nursing homes operated or supported by a church.

## Organizations That Are Deemed To Be Code §501(c)(3) Entities

The following organizations have received IRS approval, implicitly or explicitly, to sponsor a 403(b) plan as a Code §501(c)(3) organization without the need to apply for a Form 1023 determination.

### Foundations

Non-private foundations organized under Code §509(a) or private foundations organized under Code §4942(j)(3). However, these foundations must meet the applicable Code section's criteria to be eligible.

### Cooperative Hospital Service Organizations

Cooperative hospital service organizations that under Code §501(e) perform functions on behalf of certain Code §501(c)(3) organizations.

### Uniformed Services University of Health Science

P.L. 96-613 authorizes the Uniformed Services University to sponsor a 403(b) plan for civilian staff and faculty.

### Other Organizations

Organizations operating under Code §170(c)(2), such as corporations, trusts, community chests, funds, or foundations, which meet the same goals and objectives as those required for Code §501(c)(3) organizations, may be eligible.

## Ineligible Employers

An employer will not be eligible if it:

- Has net income or profit which accrues for the benefit of any individual; or
- Influences legislation as a substantial part of its activities (except for certain lobbying activities).

Typically, the category of ineligible employers includes for-profit hospitals, for-profit healthcare agencies and research facilities, for-profit schools — including colleges and universities.

## Government Instrumentalities

Generally, state and municipal governments or Native American tribal instrumentalities are not eligible employers. *Thus, public hospitals are always ineligible to maintain a 403(b) plan.* However, if a quasi-public organization is a separate entity that is not engaged in regulative or enforcement functions and is operated pursuant to the guidelines above, it may qualify as an eligible employer. ■

# Exceptions to the 10% Penalty for Early Distribution

**U**nder Internal Revenue Code section 72(t), there is a 10% excise tax penalty to withdraw funds from a 403(b) arrangement prior to age 59½. Under section 72(t), there are also a number of exceptions to this 10% penalty. These exceptions include:

- Separation from service in or after the year that the individual has reached age 55 (age 50 for qualified public safety employees)
- Disability as defined in IRC Section 72(m)(7)
- Payments made on or after the participant's death
- Payment of unreimbursed medical expenses exceeding 10% of AGI (7.5% of AGI, if you or your spouse was born prior to January 2, 1949)
- Roth Conversion; provided the conversion remains in the Roth IRA for five years; likewise an in-plan Roth conversion must remain in the 403(b) Roth for five years
- IRS Tax Levy
- Corrective distributions: excess deferrals, excess annual additions, ineligible employees, etc.  
**Note:** Earnings distributed are subject to 10% penalty.
- Permissive withdrawals from an Eligible Automatic Contribution Arrangement
- Qualified Reservist Distribution — Individual called into active duty for more than 179 days ■