2013

Recent IRS Guidance Provides A Degree of Certainty for 403(b) Plans

Gregory L. Needles

Christina Payne-Tsoupros

RECENT IRS GUIDANCE PROVIDES A DEGREE OF CERTAINTY FOR 403(b) PLANS

GREGORY L. NEEDLES AND CHRISTINA PAYNE-TSOUPROS

Sponsors of Section 403(b) plans now have more certainty in regard to the establishment and administration of their plans.

The IRS has released long-awaited guidance expanding the availability of self correction for 403(b) plans and opening the pre-approved plan program. On 12/31/12, the IRS released Rev. Proc. 2013-12, 2013-4 IRB 313, which expanded its self-correction program—the Employee Plans Compliance Resolution System (EPCRS)—for 403(b) plans. On 3/28/13, the IRS issued Rev. Proc. 2013-22, 2013-18 IRB 985, opening its 403(b) pre-approved plan program.

The broader scope of correction under Rev. Proc. 2013-12 is a welcome relief to 403(b) plan sponsors, who may now take advantage of EPCRS to remedy mistakes and avoid plan disqualification in the same way available to qualified retirement plan sponsors. The pre-approved plan program will offer employers who maintain 403(b) plans an opportunity to satisfy the written plan requirement by adopting a generic plan maintained by a third party that has been reviewed and approved by the IRS, thereby providing an employer the assurance that its plan meets the 403(b) requirements. Further, the pre-approved plan program will allow the employer to rely on the third party to maintain the plan document, eliminating the cost and stress associated with maintaining an individually designed plan.

Opening EPCRS to 403(b) plans

Rev. Proc. 2013-12 contains a revised version of EPCRS, which supersedes the prior version of EPCRS set out in Rev. Proc. 2008-50, 2008-2 CB 464. EPCRS is a system of programs that retirement plan sponsors may use to correct certain failures to preserve a retirement plan's tax-qualified status.[1] The rationale underlying EPCRS is that plan sponsors and administrators should be encouraged to establish administrative practices and procedures that ensure the plans are operated properly in accordance with the Code.[2] Fees and sanctions paid under EPCRS for mistakes in plan administration should be reasonable and appropriate.[3] The IRS has made information available on its Web site to assist 403(b) plan sponsors in taking advantage of EPCRS, such as a "403(b) Plan Fix-It Guide," which is discussed below.

One of the major changes to EPCRS in Rev. Proc. 2013-12 is opening it to 403(b) plans.

GREGORY L. NEEDLES is a partner, and CHRISTINA PAYNE-TSOUPROS is an associate, in the Washington, DC office of Morgan, Lewis & Bockius LLP.

Under the prior version of EPCRS, only a small number of 403(b) plan failures related to violations of specific sections of the Code could be corrected using it. Under Rev. Proc. 2013-12, sponsors of 403(b) plans generally may correct such operational failures under EPCRS in the same manner as if the failure had occurred under a qualified plan under Section 401(a).[4] Thus, sponsors of 403(b) plans may use EPCRS to correct qualification failures, plan document failures, operational failures, demographic failures, and employer eligibility failures.

EPCRS contains three correction programs for plan sponsors: the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Audit Closing Agreement Program (Audit CAP).[5] In general, plan sponsors may use SCP to correct operational failures, if insignificant based on the surrounding facts and circumstances, by following the correction procedures set forth in section 7 of EPCRS.[6] Plan sponsors may correct using SCP without contacting the IRS or paying a fee.

Plan sponsors may use VCP to correct qualification and operational failures. A plan sponsor may take advantage of VCP at any time before the plan is notified by the IRS of an audit.[7] The plan sponsor makes a submission to the IRS that (1) includes Form 8950, "Application for Voluntary Correction Program (VCP)," and Form 8951, "Compliance Fee for Application for Voluntary Correction Program (VCP)"; (2) identifies the errors; (3) proposes corrections to the errors in accordance with the correction principles set out in section 6 of EPCRS; (4) proposes changes to the plan sponsor's administrative procedures to ensure that the error will not recur; and (5) pays a compliance fee based on the number of participants in the plan. The IRS will issue a compliance letter to the plan sponsor with respect to the failures identified and corrected on VCP.

If the IRS discovers the failure on an audit of the plan or the plan sponsor, the plan will enter Audit CAP, in which the plan sponsor will enter into a closing agreement with the IRS and effect certain corrections prior to entering into the closing agreement.[8] The sanction on Audit CAP is greater than the fee submitted under VCP and will be a negotiated percentage based on an amount that is directly related to the amount of tax benefits preserved.

Errors in administration and operation of 403(b) plans. Related to the release of Rev. Proc. 2013-12, the IRS released a "403(b) Plan Fix-It Guide," which identifies ten common errors in 403(b) plans, how to find and remedy them, and how to avoid them in the future.[9] Two of the most common errors that sponsors of 403(b) plans may now correct under EPCRS include the failure to timely adopt a written plan and the failure to comply with the terms of the written plan.

Failure to timely adopt a written plan. The final 403(b) regulations require that all 403(b) arrangements be maintained pursuant to a written plan.[10] Notice 2009-03, 2009-2 IRB 250, gave 403(b) plan sponsors until the last day of the 2009 plan year to adopt a written plan document. If the plan sponsor failed to adopt a written plan by 12/31/09, the tax-favored treatment of the 403(b) plan is in jeopardy.

Plan sponsors may rectify this error by adopting a written plan and making a submission under VCP.[11] If the sponsor has not timely adopted a written plan, the sponsor should memorialize the plan's operation into a written document that complies with the final 403(b) regulations and adopt the plan. The written plan does not have to be in a single plan document, as the plan sponsor may bundle several documents that detail all the provisions of how the plan works.[12] The plan sponsor should ensure there is no conflict among the plan documents. The sponsor should apply for correction by making a submission under VCP.

The IRS has issued a "Voluntary Correction Program Submission Kit" to assist plan sponsors in requesting a compliance statement under VCP for this error.[13] The kit is designed specifically "for use by eligible organizations that sponsor a 403(b) retirement plan but that failed to adopt written plan document(s) for the plan by December 31, 2009." It includes a checklist of items to include with the VCP submission, examples of completed documents that would comprise the VCP submission, and

1 Rev. Proc. 2013-12, 2013-4 IRB 317 at 316-17.
2 *Id.*
3 *Id.*
4 *Id.* at 317, 343.
5 *Id.* at 322.
6 *Id.* at 345.
7 *Id.* at 322.
8 *Id.* at 361.
9 "403(b) Plan Fix-It Guide," available at www.irs.gov/Retirement-Plans/403(b)-Plan-Fix-It-Guide (last visited 7/27/13).
10 Reg. 1.403(b)-3(b)(3).
11 Rev. Proc. 2013-12, *supra* note 1 at 343.
12 "403(b) Plan Fix-It Guide," *supra* note 9, row 2.
13 "Voluntary Correction Program Submission Kit," available at www.irs.gov/pub/irs-tege/0430_dcnonamender_submission_kit.pdf (last visited 7/27/13).

directions for filling out those documents, as well as information about what happens after the IRS receives the VCP submission. According to the kit, plan sponsors can expect a compliance statement four to six months after mailing the submission.[14]

Until the end of 2013, a 403(b) plan sponsor may submit a plan under VCP to correct its failure to adopt a written plan document by 12/31/09, and the VCP compliance fee will be reduced by 50%. If the IRS discovers this error on audit, the IRS and plan sponsor may enter into a closing agreement under Audit CAP.

For public schools, the IRS provided model language for adopting or amending 403(b) plans to be in compliance with the final 403(b) regulations in Rev. Proc. 2007-71, 2007-51 IRB 1184. A public school employer that adopts the model provisions found in the appendix of Rev. Proc. 2007-71 will be in compliance with the regulations under Section 403(b) that were promulgated in 2007.[15]

Rev. Proc. 2013-12 opens the Employee Plans Compliance Resolution System to 403(b) plans.

With this outreach by the IRS, a 403(b) plan sponsor that did not adopt a plan document in a timely fashion should do so now and take advantage of the Service's VCP program. It is reasonable to expect that if an organization fails to take advantage of the opportunity to adopt a written plan, it will face a significantly increased chance of incurring a material sanction on audit in a subsequent year.

Failure to comply with the terms of a written plan. Plan sponsors should ensure that the operation of their 403(b) plans is in accordance with the written terms of the plan. Similar to the correction methods available for a plan qualified under 401(a), a 403(b) plan sponsor that has adopted a written plan but has failed to operate the plan in accordance with its terms generally may correct such an operational failure by retroactively adopting a plan amendment that conforms the plan document to how the plan was operated.[16] A retroactive amendment may generally be adopted only through the approval of the IRS under VCP. Alternatively, the plan sponsor may retroactively correct the administrative errors that arose to make the plan's operation consistent to the plan's terms. This correction applies only for years beginning in 2009 because, for years before then, there was no requirement to operate a 403(b) plan in accordance with its terms. Plan sponsors should conduct a review annually to ensure the plan operates in accordance with its terms.[17] For example, if the plan allows for loans, hardship distributions, or catch-up contributions, the written 403(b) plan must allow for these programs and explain their distribution. Benefits under the plan should be computed properly and provided to plan participants in accordance with terms of the plan. Correction of errors is available under SCP and VCP, and which one an employer might rely on will depend on the severity of the plan failure and when the failure is discovered.

Ineligibility of organization to sponsor a 403(b) plan. Generally, only Section 501(c)(3) organizations—plus non-exempt schools, colleges, and universities—may offer 403(b) plans. An organization that sponsors a 403(b) plan when it is not eligible to do so commits an employer eligibility failure.[18] VCP is the only IRS correction program that allows an employer to voluntarily correct this error. The employer should stop all contributions and make a submission under VCP.

Universal availability failure. Under the universal availability rule, with few exceptions, a plan sponsor must give all of its employees the opportunity to make elective deferrals.[19] A plan sponsor may exclude (1) employees who contribute $200 annually or less; (2) employees who are eligible to participate in the employer's 401(k), 457(b), or a different 403(b) plan; (3) non-resident aliens; (4) employees who normally work fewer than 20 hours a week, such that they do not accumulate at least 1,000 hours in a year; and (5) students performing certain services as set forth in Section 3121(b)(10).[20] If a plan sponsor includes one employee from one of these excludable groups, it may have to include all employees from that particular group.[21]

[14] *Id.* at 9.
[15] Rev. Proc. 2007-71, 2007-51 IRB 1184 at 1184-85.
[16] Rev. Proc. 2013-12, 2013-4 IRB 323.
[17] "403(b) Plan Fix-It Guide," *supra* note 9, row 3.
[18] "403(b) Plan Fix-It Guide," *supra* note 9, row 1.
[19] Reg. 1.403(b)-5(b)(1).
[20] *Id.*, Reg. 1.403(b)-5(b)(4).
[21] "403(b) Plan Fix-It Guide," *supra* note 9, row 4.
[22] Reg. 1.415(c)-2(f).
[23] "403(b) Plan Fix-It Guide," *supra* note 9, row 5.
[24] *Id.*
[25] Reg. 1.403(b)-4(c)(3)(iii).
[26] "403(b) Plan Fix-It Guide," *supra* note 9, row 6.
[27] *Id.*
[28] Reg. 1.414(v)-1(g)(3).
[29] "403(b) Plan Fix-It Guide," *supra* note 9, row 7.
[30] *Id.*

To determine whether a plan improperly excludes employees from the opportunity to participate in the plan, the plan sponsor should develop a strategy based on its plan's structure. The Fix-It Guide suggests making a list of the employees who received a W-2 but did not participate in the 403(b) plan to determine whether those employees received proper notification of their eligibility to participate in the plan. Similarly, the employer should review a list of employees who received a W-2 and who did participate in the plan. If an employee who could have been excluded as a member of an excludable group, but was included, the plan sponsor may have a universal availability problem to correct.

The 403(b) plan must offer employees the effective opportunity to make or change their cash or deferred election. Plan sponsors should provide any improperly excluded employees the opportunity to participate in the plan in current and future years. The plan sponsor should make a corrective contribution to the plan for those improperly excluded employees that compensates for their missed deferral opportunity. Plan sponsors can make these corrections through SCP or VCP, depending on the extent of the error.

Failure to limit total contributions. The total of all employer contributions, employee after-tax contributions, and employee elective deferrals may not exceed limits set under Section 415(c), which is $51,000, or 100% of includable compensation, whichever is less, for 2013.[22] Age 50 catch-up contributions are excluded from the Section 415(c) limitation.[23] Plan sponsors should review the employer contribution and elective deferral amounts for each participant and, for each participant, determine whether the total of employee deferrals and employer contributions exceeds the lesser of the limit of 100% of his or her compensation or the dollar limitation under Section 415(c). To correct this type of error, plan sponsors should transfer amounts in excess of the Section 415(c) limits (including earnings) to a separate annuity, or distribute those amounts to participants by the end of the year in which the excess occurred.[24] The excess will be includable in the participant's gross income. SCP and VCP are available to correct these errors.

Failure to comply with 'catch-up' contribution rules. If the employer's 403(b) plan allows for "15-years of service catch-up" contributions, the employee must have 15 years of service with the same eligible 403(b) employer.[25] Employers whose plans may offer this provision are public school systems, hospitals, home health service agencies, churches, and conventions or associations of churches. These employers may increase the limit on any elective deferrals to the participant's 403(b) account in any tax year, subject to a lifetime limit for each employer of $15,000, if an employee has at least 15 years of service with the same employer. The failure occurs when an employee making a 15-years of service catch-up contribution does not have the required 15 years of full-time service with the same employer.[26]

To determine whether there is a plan failure with respect to this provision, plan sponsors should review whether, for any employee whose total deferrals exceed the limit under Section 402(g), the excess is due to the 15 year catch-up.[27] If so, 403(b) plan sponsors should review the rules to determine whether the years of service are with the same employer. For example, an employee who works for the same public school district, but at different schools within that school district, is treated as employed by the same employer for purposes of this failure.

If the plan sponsor discovers an error, the plan should refund excess deferrals plus earnings and report the corrections on Form 1099-R. Plan sponsors can correct through SCP and VCP.

Failure to limit elective deferrals. An employer need not offer catch-up contributions in its 403(b) plan. If an employer chooses to allow catch-up contributions, it must offer them to all plan participants who are eligible to make elective deferrals.[28] The catch-up contribution limit for elective deferrals, including catch-up and designated Roth contributions for 2013, is $5,500, and is subject to cost of living increases. The catch-up contributions are not subject to the limits under Section 402(g). Eligible employees may contribute $5,500 per year under the catch-up contribution as well as the $3,000 extra for the 15-year catch up.[29] A failure in this area occurs when the plan does not limit elective deferrals to these annual limits.

Plan sponsors should track elective deferrals for each employee and conduct year-end reviews of deferrals for each participant.[30] Sponsors should compare these amounts to the limits under Section 402(g) and determine whether any amounts above the 402(g) limit are based on the 15-year of service or age 50 catch-up contributions. If the plan sponsor discovers an error, the plan should refund excess deferrals plus earnings and report the corrections on Form 1099-R. Plan sponsors can correct this error through SCP and VCP.

Allowing elective deferrals for post-severance contributions. Section 403(b) permits employers to make post-severance contributions on behalf of an employee for up to five years following his or her termination.[31] However, such contributions are limited to employer contributions. An employee may not make post-severance elective deferrals. When the plan sponsor discovers the error, the plan should refund the deferrals plus earnings and report the corrections. Correction is available under SCP or VCP.

Failure to comply with the requirements for plan loans. Plan sponsors are responsible for determining that each participant loan meets the requirements of its loan program. Participant loans must meet the requirements of Section 72(p) to avoid being treated as a taxable distributions.[32] To satisfy Section 72(p), (1) the plan must base the loan on a legally enforceable agreement; (2) the plan administrator must limit the loan to 50% of the participant's vested account balance at the time of the loan or $50,000, subject to certain exceptions; (3) the participant must repay the loan within five years, unless the participant used the loan to purchase his or her personal residence; and (4) the terms of the loan must require the participant to make substantially level payments over the life of the loan.[33] Common failures that occur with respect to plan loans include making participant loans when the plan does not allow for the loans, plan loans that exceed the dollar limit, plan loans exceeding the 5-year limit, and plan loans that defaulted because participants fail to make required payments.[34] Plan sponsors should review their plans and all outstanding loan agreements to ensure that the loans comply with the terms of the plan and that employees are repaying their loans timely. SCP is available to correct a 403(b) plan that allowed for plan loans in operation when the written plan document did not authorize the loans. Other plan loan failures may be corrected only through VCP.

Failure to require sufficient documentation for hardship distributions. For distributions to qualify as hardship distributions, the distribution must be made because of an employee's immediate and heavy financial need and the amount must not be more than necessary to satisfy that financial need.[35]

The 403(b) written plan must allow for a hardship distribution and contain language that specifies how a hardship distribution is determined. The IRS has deemed certain distributions to qualify as made for an immediate and heavy financial need—(1) expenses for medical care previously incurred by the employee, the employee's spouse, any dependents of the employee or the employee's beneficiary or necessary for these persons to obtain medical care; (2) costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments); (3) payments of tuition, related educational fees, and room and board expenses for the next 12 months of post-secondary education for the employee or the employee's spouse, children or dependents or beneficiary; (4) payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence; (5) funeral expenses for the employee's deceased parent, spouse, child, or dependent; or (6) certain expenses relating to the repair of damage to the employee's principal residence.[36]

If the financial need can be relieved by reimbursement or compensation through insurance or otherwise, liquidation of the employee's assets, cessation of elective or employee contributions under the plan, or other distributions or nontaxable loans from plans maintained by the employer or another employer, the plan cannot make a hardship distribution to satisfy the immediate and heavy financial need. The IRS is finding that a plan's recordkeeper does not always get sufficient documentation to support the position that there is no other source from which the participant may satisfy his or her immediate and heavy financial need. Self-certification from the participant should suffice unless the plan administrator has actual knowledge that the participant has other sources of financial relief.

Plan sponsors can correct this mistake by requiring repayment of the hardship distribution. This correction may be made through SCP or VCP.

Compliance tips and trends. Each year the EP Team Audit Program (EPTA) releases its "Compliance Trends & Tips" for Section 403(b) plans and Section 457 governmental plans.[37] In the Compliance Trends & Tips issued in November 2012, the EPTA identified the following errors with respect to 403(b) plans: the failure to properly apply universal availability to participants, the failure to properly track and limit 15-year rule contributions and combine with the age 50 catch up feature, the failure to maintain a written plan document, the failure to limit contributions under

Section 415, and the failure to comply with 403(b) post severance contribution requirements. Each of these errors was identified by the IRS in its 403(b) Plan Fix-It Guide, as discussed above.

The EPTA noted the numerous factors to consider in assessing whether a plan complies with universal availability, including confirming that all employees who have the right to make elective deferrals are offered the opportunity to exercise that right in operation and that those employees receive meaningful notice of that right and the timing requirements to make and change these elections. The EPTA also noted that its exams indicate that groups improperly excluded from the universal availability rule include collectively bargained employees, visiting professors, employees who have taken vows of poverty, employees who make a one-time election to participate in non-governmental 403(b) plans, and substitute teachers, janitors, cafeteria workers, and nurses, noting that none of these groups can be permissibly excluded.

In addition to the failures that the IRS noted in its Fix-It Guide, the EPTA also noted that failure to follow controlled-group rules can significantly affect compliance with contribution limitations. It noted that the controlled group rules utilize an 80% director or trustee common-control test, which most commonly arises when a tax-exempt entity controls at least 80% of the board members of another tax-exempt entity.

In conjunction with the Compliance Trends & Tips, the EPTA referred to the Service's 403(b) Plan Checklist and the 403(b) FAQ page for further information about each of these failures.[38] The 403(b) Plan Checklist explains ten common errors and provides an overview of 403(b) plans and of EPCRS. The 403(b) FAQ page provides answers to frequently asked questions about 403(b) plan participation, contributions, investments, loans and distributions, the written plan requirement, coverage and nondiscrimination rules, and terminations.

Pre-approved plan program

With the publication of Rev. Proc. 2013-22, the IRS opened its pre-approved plan document program. Since the IRS said in Ann. 2009-34, 2009-18 IRB 916, that it was going to open a prototype plan program for 403(b) plans, 403(b) plan vendors and their 403(b) plan clients have been waiting for this revenue procedure. Plan vendors have wanted assurance that the plan documents they provided their clients were 403(b)-compliant. Plan clients have wanted assurance that the plan document on which they rely was approved by the IRS.

In Ann. 2009-34, the IRS stated that it intended to establish a pre-approved program for 403(b) plans and had released a draft revenue procedure. Rev. Proc. 2013-22 departs from the draft revenue procedure in certain ways. For instance, Rev. Proc. 2013-22 applies to not only prototype plans, as Ann. 2009-34 indicated, but also to volume submitter plans, making the pre-approved plans more accessible for plan sponsors.[39] Rev. Proc. 2013-22 also allows for pre-approved 403(b) plans to provide a vesting schedule for nonelective employer contributions.[40] Generally, nonelective employer contributions under a pre-approved 403(b) plan must vest at least as quickly as under a 401(a) qualified plan that is subject to Section 411(a)(2)(B).[41] In addition, Rev. Proc. 2013-22 eliminated the provision of the draft revenue procedure that required full and immediate vesting of all contributions under the plan.[42]

Rev. Proc. 2013-22 expanded the definition of which organizations are eligible to sponsor a pre-approved plan to include pre-approved Section 403(b)(9) plans sponsored by churches and similar church-related organizations. The IRS previously had indicated that the pre-approved plan program would prohibit the issuance of opinion letters for plans that include

31 Reg. 1.403(b)-4(d).

32 Section 72(p)(2).

33 Section 72(p); Reg. 1.72(p)-1, Q&A 3(b).

34 "403(b) Plan Fix-It Guide, *supra* note 9, row 9.

35 Reg. 1.401(k)-1(d)(3)(i). A hardship distribution under Section 403(b) is generally subject to the same requirements that apply to Section 401(k). Reg. 1.402(b)-6(d)(2).

36 Reg. 1.401(k)-1(d)(3)(iii)(B)(1).

37 "EP Team Audit (EPTA) Program - EPTA Compliance Trends & Tips - 403(b) Tax-Sheltered Annuity Plan, 457 Plan and Governmental Plan Trends," available at www.irs.gov/Retirement-Plans/EP-Team-Audit-(EPTA)-Program---EPTA-Compliance-Trends-&-Tips---403(b)-Tax-Sheltered-Annuity-Plan-457-Plan-and-Governmental-Plan-Trends (last visited 7/27/13).

38 "403(b) Plan Checklist," available at www.irs.gov/pub/irs-tege/pub4546.pdf; "Retirement Plans FAQs regarding 403(b) Tax-Sheltered Annuity Plans," available at www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-403(b)-Tax-Sheltered-Annuity-Plans.

39 Rev. Proc. 2013-22, 2013-18 IRB 985.

40 *Id.*

41 *Id.* at 991.

42 *Id.*

provisions that are applicable only to churches and church-related organizations.[43] In addition, the IRS departed from its position that opinion letters may not be issued for plans that include terms that could only be applicable to a church or a qualified church-controlled organization (QCCO), as described in Section 3121(w)(3)(B). The example given in Rev. Proc. 2013-22 on this point is that the IRS will not decline to issue an opinion or an advisory letter for a plan because the plan fails to satisfy the universal availability requirement if the plan is available only for adoption by a church or QCCO.[44]

Rev. Proc. 2013-22 also included unfavorable news for plan sponsors regarding the Service's prior position about establishing a determination letter program for individually designed 403(b) plans. Contrary to what the IRS had stated in Ann. 2009-34, it stated in Rev. Proc. 2013-22 that it was not going to establish a determination letter program for 403(b) plans at that time.[45] The IRS cited its lack of resources as the primary reason for the Service's divergence from its previous announcement.[46] Because a determination letter program for individually designed plans is more labor intensive, it requires additional resources that the IRS does not have now. As a result, the IRS will only provide assurance to an employer regarding its 403(b) plan document compliance if the employer adopts an IRS pre-approved plan or the employer is a public school and has adopted the model plan language included in Rev. Proc. 2007-71.

While an employer that sponsors a retirement plan, even a qualified plan under Section 401(a), is not required to get IRS approval that its plan meets the applicable requirements under the Code, such a determination by the IRS gives the plan sponsor an additional level of comfort. For a plan sponsor that has a complicated and intricate 403(b) plan that will not lend itself well to a generic pre-approved plan document, this is a disappointing development.

Rev. Proc. 2013-22 also elaborates on the extended remedial amendment period for 403(b) plans set forth in Ann. 2009-89, 2009-52 IRB 1009. Under Ann. 2009-89, an employer that adopted a written plan before 2010 and then subsequently adopts a pre-approved 403(b) plan will not experience a plan document failure, provided that the plan sponsor adopts the pre-approved plan before the last day of the remedial amendment period. Rev. Proc. 2013-22 further provides that an adopter of an individually designed plan may also avail itself of the remedial amendment period, though it will not be able to rely on its plan's terms complying with the requirements of Section 403(b) unless it restates its plan by adopting a pre-approved plan.[47] Nonetheless, if the individually designed plan carefully tracks the Service's sample plan provisions for pre-approved plans, other than those that are unique to the employer's plan, it should be able to avoid a compliance problem.

The IRS has released a package of samples of plan provisions that it has found to satisfy certain requirements of Section 403(b) and the regulations thereunder, as well as Rev. Proc. 2007-71, Rev. Proc. 2013-22, and Rev. Proc. 2013-18.[48] The package provides sample definitions as well as provisions regarding plan administration, eligibility and participation, contributions, limitations on annual additions, distribution, hardship, plan loans, rollover contributions and transfers, investment, and plan termination and amendment.

Types of pre-approved plans. A vendor will be able to offer a plan sponsor two types of pre-approved plans: a prototype plan and a volume submitter plan. A prototype plan consists of a base plan document that has all of the nonelective provisions of the plan that will apply to the plans of adopting employers and an adoption agreement that requires the employer to select among various options available for certain plan provisions.[49] A volume submitter plan typically is a model plan document that the employer may adopt as its own and to which it may make minor modifications.[50] Between the two, the volume submitter gives the plan sponsor a greater degree of flexibility than a

43 *Id.* at 990.
44 *Id.*
45 *Id.* at 988.
46 *Id.*
47 *Id.* at 989-990.
48 "Section 403(b) Pre-Approved Plans, Sample Plan Provisions and Information Package," available at www.irs.gov/pub/irs-tege/403b_lrm0313.pdf (last visited 7/27/13).
49 Rev. Proc. 2013-22, *supra* note 39 at 992.
50 *Id.* at 993.
51 *Id.* at 992-993.
52 *Id.* at 993.
53 *Id.*
54 *Id.* at 994.
55 *Id.*

prototype, but not so much that an employer may customize the document to meet its unique needs. After all, if the plan document that the employer adopts strays too far from the document that has been pre-approved by the IRS, the employer will not be able to rely on the pre-approval.

There are two types of prototype plans: standardized and nonstandardized. Under a standardized plan, the plan must meet the following requirements in order to provide employer contributions:

1. The plan must benefit all employees of the employer's controlled group, except those who may be permissibly excluded under Reg. 1.410(b)-6, which is generally limited to nonresident aliens with no U.S. source income and collectively bargained employees.
2. If the plan calls for employer nonelective contributions, it must satisfy a design-based safe harbor, such as the same contribution percentage applying to all participants.
3. All compensation earned by the participant, including taxable fringe benefits, must be included in compensation that is used to determine employer contributions on the participant's behalf.[51]

A nonstandardized prototype plan does not need to meet the requirements described above. It can permit an adopting employer, through its adoption agreement, to exclude certain groups of employees or limit participation to the adopting employer's employees and not include all members of the controlled group.[52] The trade off for that flexibility in plan design, though, is that the plan will need to be monitored and perhaps tested to ensure that it is meeting the applicable nondiscrimination requirements in practice that the requirements described in 1 through 3, above, are intended to comply with through design. This will not be of concern to a governmental or church plan sponsor, since those plans do not have to comply with the Code's nondiscrimination requirements.

As noted above, a vendor of a volume submitter plan provides a plan sponsor with a model plan document that it may adopt as its own. The adopting employer may make minor modifications to the plan to customize it to a degree, provided it does not change the substance of the document on which IRS pre-approval is based.[53] Sometimes a volume submitter plan will include an adoption agreement that will offer different options from which an adopting employer may choose in crafting a particular plan provision.

An employer that adopts a volume submitter plan may rely upon the Service's advisory letter approving the model plan, except to the extent that the employer's plan is not identical to the approved plan. For those provisions where the employer's plan deviates from the approved plan, the employer may not rely upon the Service's advisory letter. As a practical matter, this should not be of particular concern if the employer's changes are minor and immaterial. In addition, the employer may not rely upon the Service's letter with respect to the application of the Code's nondiscrimination rules as they apply to the administration of the plan. As noted above, this will be of no concern to a sponsor of a governmental or church plan since those plans are exempt from the Code's nondiscrimination rules.

Required plan provisions. There are number of required plan provisions, mainly focused on ensuring that the plan document reflects the various requirements found under Section 403(b) and its regulations. However, there are four that will be of particular interest to the plan vendors as well as plan adopters.

First, the plan must incorporate by reference the underlying investment arrangements. Many investment agreements, such as annuity contracts or custodial agreements, will provide for the administration of plan distributions to which the plan document may defer. A pre-approved plan is required to incorporate the terms of such arrangements by reference.[54] The IRS, though, will review only the plan document and not the underlying investment arrangements that are incorporated by reference. Thus, the Service's opinion or advisory letter will cover only the plan documents. It will be up to the employer adopting the plan to ensure that the underlying investment arrangements comply with the applicable requirements under the Code and the Employee Retirement Income Security Act (ERISA). While a vendor typically drafts its investment contracts to be Code- and ERISA-compliant, the employer should not rely on a vendor's representation that they are. Rather, the employer should perform its own review to ensure that they are.

Second, the plan's terms control if there is a conflict with the terms of the investment arrangement. A pre-approved plan must provide that, in the event of any conflict between the terms of the pre-approved plan and terms of the investment arrangement, the terms of the plan will govern.[55] More problematically, an adopting employer will not be able to rely upon the Service's pre-approval if the investment arrangement provides that its terms will govern in the event of any conflict between the terms of the arrangement and the terms of the plan.[56] Many vendors include in their form agreements a provision that the terms of the arrangement will control if they conflict with the plan. Clearly, if an adopting employer intends to adopt a pre-approved plan and rely on the IRS letter, it will need to review its investment contracts with its vendors to ensure they comply with this requirement and, to the extent they do not, renegotiate the contract to remove the offending language.

Third, the pre-approved plan program recognizes that some 403(b) plans provide for vesting. However, because an amount that has yet to vest has the potential to be forfeited, the IRS has concluded that it cannot be contributed to a participant's 403(b) annuity or custodial account until the participant fulfills the plan's vesting requirement.[57] As a result, the portion of the participant's interest that is not vested must be maintained either in a separate account for the participant that is treated as either a separate annuity to which Section 403(c) applies or in a separate custodial account to which Section 401(a) applies.[58] Further, as the amounts in the separate account vest, they must be removed from the separate account and included in the participant's annuity/account under the 403(b) plan.[59] This should be how a plan that provides for vesting currently administers its vesting provision. Nonetheless, it may come as a surprise for some plan sponsors who have yet to adopt this administrative scheme.

Finally, a pre-approved plan must provide an appendix that will identify the parties responsible for the plan's various administrative functions.[60] Among other things, the appendix must list the all of the vendors of the plan's investment arrangements and their underlying arrangements.[61] Because this information is included in an appendix, changes in the information will not affect the employer's ability to rely on the Service's pre-approval.[62]

Retroactive remedial amendment. Rev. Proc. 2013-22 permits an eligible employer to retroactively correct defects in the form of its written 403(b) plan (including any defects in documents incorporated by reference) in order to satisfy the written plan document by timely adopting a pre-approved plan or by otherwise timely amending its plan.[63] The plan will need to be amended or the pre-approved plan will need to be adopted, effective as of the first day of the remedial amendment period, which is 1/1/10.[64] The employer must have had a written plan document on 12/31/09 to be able to take advantage of the remedial amendment period. In addition, the employer will need to adopt the pre-approved plan or amend its plan on or before the end of the remedial amendment period for the changes to take effect as of the beginning of the remedial amendment period. The IRS will announce in subsequent guidance what the last day of the remedial amendment period will be.

Conclusion

With the release of Rev. Proc. 2013-12 and Rev. Proc. 2013-22, sponsors of 403(b) plans now have more certainty in regard to the establishment and administration of their plans. Rev. Proc. 2013-12 establishes a regime under which the employer may correct errors that might arise. Sponsors of qualified plans have generally had positive experiences correcting under EPCRS, and it will be advantageous to 403(b) plan sponsors to avail themselves of the correction opportunities EPCRS offers.

Rev. Proc. 2013-22 provides a way for an employer to adopt a plan and know that the plan's terms comply with the Code's requirements. While an employer with a sophisticated and intricate 403(b) plan might not be able to take advantage of a generic pre-approved plan, the vast majority of 403(b) plan sponsors should. ■

56 *Id.*

57 *Id.* at 995

58 *Id.*

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 *Id.* at 1000-01.

64 *Id.* at 1000.