

Practical Shepherding: Keeping Watch Over Your 403(b) Plan

by

Alison M. Sulentic¹

This December, pint-sized shepherds will once again keep watch over their flocks while night-gowned angels deliver tidings of great joy to pageant-goers. Unlike Decembers past, however, shepherds of church finances will also heed tidings this year, albeit from a less welcome source--the Internal Revenue Service. For the first time in more than forty years, the IRS has issued regulations concerning Section 403(b) retirement savings accounts. Here are a few practical Q&As to guide you as you keep watch over your employees' retirement savings.

- ***What is a 403(b) plan?***

The term "403(b) plan" is the moniker for retirement annuities purchased by a tax-exempt employer for the benefit of employees. The name derives from Section 403(b) of the Internal Revenue Code, which governs the tax treatment of these arrangements. In a 403(b) arrangement, the employer may contribute amounts toward the purchase of an annuity contract that will generally become payable during the employee's retirement years. An employee may also authorize the employer to contribute a portion of his or her salary to the 403(b) arrangement. Contributions made by the employer and, in most cases, by the employee are not included in the employee's gross income when they are made. Taxation of these amounts occurs later, when the employee receives the annuity payments.

- ***What's new in the 403(b) business?***

In the past, many 403(b) programs were simply collections of individual contracts between a participant and a vendor. Employers contributed funds or channeled employee contributions to the vendor in order to purchase the annuity contracts, but typically had little to do with the administration of the program. Compared to the active role that most employers play in the design and administration of other tax-qualified retirement plans, the employer's obligations in the day-to-day operation of a 403(b) program were straightforward and largely trouble-free.

Not any more. The new regulations are poised to align 403(b) plans more closely with other tax-qualified defined contribution plans. With some exceptions, employers offering 403(b) arrangements to their employees will shoulder more responsibility for designing, describing and facilitating their 403(b) arrangements than ever before.

- ***What do I need to do in order to comply with the new IRS regulations?***

The new regulations require most employers who offer 403(b) benefits to adopt a **written plan document** by December 31, 2008. The plan document must describe all of the material terms and conditions concerning eligibility, contributions, the timing and form of distributions, and annuity contracts, as well as any available optional features such as hardship withdrawals or loans. With certain exceptions, most 403(b) plans must be "universally available"

¹ Ms. Sulentic is an attorney with Baker Botts, L.L.P. She has written and lectured extensively on the legal and ethical issues facing religiously affiliated organizations. The views expressed in this article are those of the author and do not represent the views of Baker Botts L.L.P. as a firm or those of its clients. This article is strictly intended to provide information and does not provide legal advice. For specific information about how the Section 403(b) regulations or ERISA may apply to your employee benefit arrangements, please consult your attorney.

to all employees and must satisfy certain rules to limit economic discrimination between highly compensated employees and the less well-paid workforce.

- ***I've got copies of my employees' annuity contracts. Do they count as written plan documents?***

A plan document governs the employer's obligation to all of the participants in a 403(b) plan. In contrast, an individual annuity contract or custodial account agreement describes a specific contractual arrangement between an individual employee and the vendor. An annuity contract, no matter how well-written, is not a substitute for a written plan document.

- ***Are there special rules for churches?***

Churches, like other tax-exempt employers, must generally comply with the written plan document requirement in order to assure that the employees who participate in their 403(b) plans receive the tax advantages of Section 403(b). However, many aspects of the final regulations do not apply to churches. Chief among these is the universal availability rule. The more lenient rules can also be available to "church-controlled organizations."

But be careful! The IRS uses strict definitions of "church" and "church-controlled organization":

A ***church*** is "a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

A ***church-controlled organization*** means any church-controlled tax-exempt organization described in Section 501(c)(3) other than an organization which offers goods, services or facilities for sale to the general public (other than on an incidental basis or at a nominal charge) and normally receives more than 25 percent of its support from government sources and/or receipts from sales of merchandise or service.

Many religiously-affiliated businesses, such as faith-based hospitals or newspapers, may have difficulty in meeting these requirements and will therefore find the church plan exceptions to be out of reach.

- ***What about ERISA?***

During the process of preparing your plan document, you will also need to consider whether your 403(b) plan is subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). As the major law governing employee benefit arrangements, ERISA imposes a variety of obligations concerning reporting and disclosure, vesting and fiduciary standards, among other matters.

ERISA does not apply to all 403(b) plans. There is a limited exception for church plans, although, once again, many religiously-affiliated organizations will not meet the threshold requirements for church plan status. In the past, certain 403(b) arrangements that have been funded entirely through employee salary reductions have also qualified for an exemption from ERISA. The Department of Labor has issued some guidance that suggests that exemptions will continue to be available to certain plans.

- ***What do I do now?***

When it comes to 403(b) plans, don't try to go it alone. At a minimum, you should consult your vendor to determine whether a sample 403(b) plan document is available to

meet your needs. You should also consult your attorney concerning the issues that your church faces with respect to tax, employment laws and, in particular, ERISA.

As a steward of church finances, your job is to protect and care for your community's assets. Your employees are among the greatest assets that your church has. Be a good shepherd. Take care of your flock's retirement by taking care of your 403(b) plan.