



Third Quarter 2005

# Retirement PLAN WATCH

## LINKS and LINES

www.advisoryservices.com  
www.irs.gov  
www.legendgroup.com  
The Legend Group:  
800-749-4221 (other than NY)  
800-749-4321 (NY only)  
561-694-0110 (local)

## Proposed §403(b) Regulations

The Internal Revenue Service and the U.S. Treasury Department have recently published §403(b) Proposed Regulations. While this was long overdue, Legend feels that many provisions of the Proposed Regs will be onerous for employers and for Legend as a vendor. But Legend, with 40 years of experience in the §403(b) market and its own proprietary software system, is unique in its flexibility and depth of knowledge and can help you weather the changes in the §403(b) rules, whatever they eventually turn out to be.

And after a meeting the Treasury Department and IRS held with two industry representatives on July 12th, it appears that they are putting little weight on the difficulties employers and vendors will have in complying with these regulations. Among other requirements, the current Proposed Regulations mandate that all §403(b) arrangements *establish and maintain a written plan* that contains the eligibility provisions, benefits, applicable limits, products available in the plan, and the time and form of benefit distributions. A key point to all employees is that *Rev. Ruling 90-24 transfers will be eliminated*. This will greatly impact the portability of an individual's §403(b) account while employed and after retirement.

Legend has been supplying employers with ERISA plan documents, discriminatory governmental plan documents and §457 plan documents for many years and will be available to assist employers in establishing and maintaining their own plan ac-

ording to the finalized regulations. Some vendors are heralding plan documents that will exclude all other vendors – this is not the intent of the Proposed Regulations. An employer may appoint as many vendors as its Board sees fit.

Other compliance headaches that will be created if these Proposed Regs are finalized are hinged on:

- **Optional features in plan documents** – hardship withdrawals, loans, acceptance of rollovers, in-service withdrawals, in-service transfers, plan to plan transfers – employer control of these provisions, even if just through adoption of the features in the written plan, creates a fiduciary responsibility to oversee the vendors' adherence to the plan provisions. Legend has always monitored these provisions with its proprietary software system and can aid an employer in its oversight duties.
- **Failure to satisfy §403(b) or §415 contribution limits** – annuities must segregate excess contributions in separate §403(c) accounts; custodial accounts must treat excess contributions under §61, §83 or §402(b) – in other words, the vendor must segregate the excess and the excess is immediately includible in the employee's gross income or *the*



*employer's whole §403(b) plan would be disqualified* – this part of the Proposed Regs will endanger an employer's whole program. Legend already notifies employees and employers of possible excesses in October each year and after year end. This includes employees for whom we perform common remitting of contributions.

- **Clarification that Qualified Domestic Relations Orders** (i.e., the division of assets in divorce actions) are required for §403(b) plan assets – this must be included in the written plan document and therefore the ultimate responsibility of determining that an Order is qualified falls on the employer. Legend will determine whether the QDRO is qualified or not for the employer.
- **Requirement that elective deferrals be remitted to vendors as soon as administratively possible**, i.e., no later than 15 business days in the month following the reduction of salary – must be included in the written plan document.
- **Restrictions on distributions from employer contributions made to §403(b) annuities.** Legend can help review the annuity contracts for inclusion of the proper language.
- **Universal availability requirement** – employers must give written notice each year to employees of the right to participate in the plan and, if excluding employees who work less than 20 hours per week, those employees must actually work less than 20 hours per week and less than 1000 hours per year. Legend will supply the employer with a sample written notice to provide to their employees for this requirement.

When these Proposed Regs are finalized, you may need the help of a company like Legend that has

40 years of experience dedicated to the §403(b) marketplace. We will be able to provide:

- **A written plan document** that meets the requirements of the final regulations, allowing you to offer the optional features that your employees enjoy now;
- **Assistance in monitoring the optional features that are adopted**, including loan limits, restricting loans if employees have had previous defaults, monitoring in-service transfers, etc.;
- **Assistance in monitoring the contribution limits** and each vendor's adherence to the required treatment of any excesses;
- **Assistance in monitoring each vendor's adherence** to the distribution restrictions;
- **Review of any Qualified Domestic Relations Orders** for adherence to the requirements of §414(p) of the Code;
- **Guidance on complying with the universal availability requirement.**

From the tenor of the recent meeting with the IRS and Treasury Department, it appears that the Treasury Department might formally adopt the Proposed Regulations as Final Regulations effective 1/1/2006 or on some later date with minimal changes. Legend will keep you abreast of the news on this regulatory front.

## Proposed §415 Regulations

The IRS and Treasury Department recently issued proposed regs for §415 which clarify when amounts may be deferred from checks received by former employees following severance from employment. The Treasury Department has declared that the portion of the proposed regs that affects these deferrals may be relied upon before the regs are finalized.

Generally, amounts received after severance are not considered compensation for purposes of §415 but the proposed regs provide exceptions for certain payments made within 2½ months of severance. These exceptions apply only to payments that would have been payable if employment had not terminated and to payments with respect to leave that would have been available for use if employment had not terminated (i.e., accumulated sick and vacation pay).

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***An individual can only defer from a retirement incentive or other type of bonus if it is paid out prior to his/her last day of employment.***

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This means retirement bonuses cannot be used for elective deferrals after severance of employment. An individual can only defer from a retirement incentive or other type of bonus if it is paid out prior to his/her last day of employment. Of course, the retirement bonuses can always be used for employer contributions to a §403(b) governmental discriminatory plan in the public school context.

The IRS has made it clear at a public hearing on these regs that, if an employee severed employment at the end of a calendar year and received payments from which deferrals could be made after the beginning of the next calendar year but before 2½ months had elapsed, the individual could defer such amounts using the new calendar year's §402(g) limit. A definite advantage for anyone retiring at the end of the year!! For example, John Teacher (aged 55) is retiring on December 31, 2005 and maxing his §403(b) at \$18,000. He will be paid \$20,000 in accrued sick pay in January 2006. He will be able to defer the whole \$20,000 since this will be the 2006 basic limit of \$15,000 plus the Over-Age-50 Catch-Up of \$5,000.

## **Use of §401(a) Plans for Severance Pay**

We have been receiving calls from school business officials who are confused on the feasibility and legality of discriminatory §403(b) and §401(a) plans in the current regulatory climate. Hopefully, we can answer your questions.

Regarding governmental §401(a) plans used solely for retiring employees, last fall the IRS revised its position on the types of contributions acceptable in such a plan which seriously impacts a school district's use of this plan – §401(a) plans with a plan year beginning as of January 1, 2005 cannot be used for severance pay only anymore. The IRS's position currently is that the governmental employer must make "substantial and recurring" in-service contributions in addition to the severance-type contributions made to retiring employees. This changes the nature of this plan quite drastically because the employer must institute some other retirement contribution program on an on-going nature for deposit into the §401(a) program for classes of active employees in order to use this plan for retirement incentive payouts and accrued sick/vacation payouts.

On the other hand, discriminatory §403(b) plans are alive and well! And the provision for employer contributions for five years after the retirement of an employee gives school districts an unprecedented budgeting tool. This outstanding feature was added to §403(b) by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and no other plan in the U.S. has this flexibility. Although the employee's salary deferrals must be combined with the employer's contributions for the §415 limit in the year of retirement, the five year rule allows any amounts over and above the amount that could be sheltered in the year of retirement to be carried over to subsequent years. Or the district might negotiate a 3-4 year payout with their unions. Therefore, far from being outmoded, like the severance pay §401(a) plans, the discriminatory §403(b) is still a very viable tool for use in your benefits package.



## Access bills and make changes to participant contributions online!

Employers using ADSERV's Billing Services (including Common Remitting Services) can now access their bills via the internet and make changes to participants' accounts online. It's convenient, and it improves processing time and accuracy.

When billing changes are submitted by an employer, the information is downloaded and stored in a "workfile" program on our AS/400 system. When the Employee Benefit Account Department receives the money relating to the employer's account, this bill will be pulled from the "workfile" program and processed.

Procedures on submitting checks remain the same.

A unique access code is required in order for each employer to use this system.

1. Call ADSERV at 1-800-749-4221 (other than NY) or 1-800-749-4321 (NY only) to receive your unique employer access code.
2. If you need technical help during the set-up process, or have any questions about using this process, call the appropriate phone number above and ask for Alejandra Salatino at ext. 718.



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