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## FOR YOUR INFORMATION

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April 2007

News For School Clients

### **Final IRS Regulations For 403(B) Plans Delayed**

The Internal Revenue Service (“IRS”) has indicated that final regulations for 403(b) plans (also known as tax sheltered annuities) will not be issued until June 2007 at the earliest. Further, the IRS may provide a delayed effective date when the new regulations are issued. The 403(b) regulations were issued in proposed form in 2004. The proposed 403(b) regulations state that they cannot be relied upon. The yet to be issued 403(b) final regulations have become somewhat of a hot topic, and your school district may be receiving information from vendors and others regarding the 403(b) regulations.

School districts should take no action related to the 403(b) regulations until the final regulations are actually issued. The 403(b) final regulations will likely require action on the part of the school district to, among other things, put a written plan in place. The written plan will need to be in compliance with the final 403(b) regulations. Any action taken prior to the issuance of the final regulations may not meet the requirements of the new regulations. This could result in a school district that implements a plan prior to issuance of the final regulations having to go back and revise the documents and possibly renegotiate contracts in order to be in compliance with the final regulations.

Nevertheless, some features of the proposed federal regulations are important to be aware of as school districts consider retirement benefits.

The following requirements of the proposed 403(b) regulations are likely to be a part of the final regulations and as a result a school district may wish to take them into account when considering retirement benefits. The proposed regulations provide that the written plan document for a 403(b) plan must provide that the employee’s rights to his or her 403(b) account are nonforfeitable. In other words, the school district may not put a vesting schedule on a 403(b) plan or require some repayment of 403(b) contributions, even employer contributions, on separation from employment.

Also, the written document must satisfy the nondiscrimination rules, including the universal availability requirements. Specifically, under the universal availability requirement, the school district must offer all employees the ability to defer their salary to a 403(b) plan *if* any employee is offered the ability to salary defer to a 403(b) plan, except that the following may be excluded:

- (1) employees who are eligible under the Internal Revenue Code (“IRC”) § 457(b) plan of the employer that permits an amount to be contributed or deferred at the election of the employee;
- (2) employees who are eligible to make a cash or deferred election under a 401(k) plan of the employer;
- (3) employees who are nonresident aliens;

(4) employees who are students performing services; or

(5) employees who normally work fewer than 20 hours per week.

For purposes of the universal availability requirement, an employee normally works fewer than 20 hours per week if and only if: (a) for the 12-month period beginning on the date the employment commenced, the employer reasonably expects the employee to work fewer than 1,000 hours of service in such period and (b) for each plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced, the employee worked fewer than 1,000 hours of service in the preceding 12-month period.

In addition, Wisconsin Statute § 40.81(3) requires that the plan must allow any employee covered by a collective bargaining agreement to salary defer to the 403(b) plan *if* any employee may salary defer to the 403(b) plan.

The written document must also satisfy the limits on employer and employee contributions. In 2007 the limit for salary deferral contributions to a 403(b) plan is \$15,500. Additionally, an individual who turns age 50 or older during the plan year may contribute an additional \$5,000, known as the "Age 50 Catch-up Contribution." Total contributions to the 403(b) plan (Employee and Employer Contributions) cannot exceed the lesser of includable compensation for that tax year or \$45,000 in 2007. The limits are adjusted for inflation annually.

There are additional requirements that the written 403(b) plan will need to satisfy. Only a few of

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the requirements of the proposed regulations are highlighted here.

The proposed regulations also provide that employers must transmit the employees' salary deferral contribution as soon as practicable but no later than the 15<sup>th</sup> business day of the month following the date on which the amounts would have been paid to the employee.

In recent years, the proposed 403(b) regulations have been a significant part of the Lathrop & Clark LLP Annual School Law Seminar. If you would like a copy of our outline related to 403(b) regulations from one of our recent School Law Seminars, please contact us and we will be happy to provide it to you. With 403(b) final regulations a possibility by mid-year, we expect that the final regulations will be covered in detail at our 2007 annual School Law Seminar.

It has been reported that the IRS will be increasing its audit activity related to 403(b) plans in the State of Wisconsin. At this time, we have not seen evidence of an increase in 403(b) plan audits. However, we stand ready to assist your school district in the event of an audit. The possibility of increased IRS activity in this area does not change the fact that no action should be taken related to plan documents until the final 403(b) regulations are issued.

We will continue to monitor developments related to IRS final regulations, and when they are finally released, we will notify our clients. Until such time, any action related to 403(b) final regulations would be premature.