

403(b) PLAN EXECUTIVE SUMMARY

January 2009



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What is a 403(b) Plan?

A Section 403(b) plan is a deferred compensation program offered to employees of a tax-exempt organization or employees of certain educational organizations.

Who Can Sponsor a 403(b) Plan?

403(b) plans may be maintained by governmental organizations, tax-exempt organizations under §501(c)(3) (a.k.a. non-profit organizations), churches, or educational organizations.

What are the Differences Between ERISA and Non-ERISA 403(b) Plans?

Non-ERISA 403(b) plans are not subject to Title I requirements of the Employee Retirement Income Security Act (ERISA). Non-ERISA 403(b) plans do not require any formal discrimination testing (e.g. coverage testing), nor do they need to file an annual Form 5500. *Note: As of 1/1/09, non-ERISA 403(b) Plans will need to have a plan document.*

ERISA 403(b) plans are subject to ERISA's Title I requirements, including the requirement to have a plan document, annual participant disclosures, fiduciary responsibility and filing an annual Form 5500.

Effective for plan years starting after 1/1/09: ERISA 403(b) plans with more than 100 participants will be subject to the large plan filing requirements, which will require an independent CPA audit opinion to be attached to the annual Form 5500 filing.

When is a 403(b) Plan Subject to ERISA?

A 403(b) plan is exempt from ERISA if the employer has only limited involvement with the plan. The IRS has issued a list of tasks an employer may perform on behalf of the plan and still be exempt from ERISA, including:

- Permitting annuity contractors, agents, and brokers to publicize their products to employees;
- Collecting and remitting annuity or custodial payments;
- Holding, in the employer's name, one or more group contracts covering employees;
- Limiting the funding media to products available to employees, or the annuity contractors who may approach employees, to a number and selection that is designed to afford employees a reasonable choice in light of all relevant circumstances, including, but not limited to:
 - The number of employees affected,
 - The number of contractors that have indicated interest in approaching employees,
 - The variety of available products,
 - The terms of the arrangements, and
 - The administrative burdens and costs to the employer.

A plan is considered to have sufficient involvement by the employer if the employer makes contributions other than elective deferrals (e.g. matching contributions) and if the employer makes any of the following discretionary administrative determinations, and is therefore subject to ERISA.

- Processing distributions;
- Making hardship withdrawal determinations;
- Authorizing plan-to-plan transfers; or
- Determining eligibility for the enforcement of plan loan provisions.

Must All Employees be Eligible to Participate?

All 403(b) plans, non-ERISA and ERISA, must follow the universal availability requirements.

Current universal availability requirements allow 403(b) plan sponsors to exclude the following individuals from participation:

- All employees who normally work less than 20 hours per week;
- Employees eligible to participate in certain governmental plans;
- Non-resident aliens;
- Students performing certain services to a school, college or university;
- Union employees covered by a collective bargaining agreement;
- Visiting professors; and
- Certain employees subject to religious vows.

In addition, ERISA 403(b) plans have to meet other coverage rules, which may require inclusion of some of the above employees that are excludable under the universal availability requirements.

Effective **1/1/2010**, universal availability requirements will allow 403(b) plan sponsors to exclude only the following from participation:

- Employees who are *expected* to work less than 1,000 hours in a 12-month period, and the employee *actually* works less than 1,000 hours during this period;
- Students performing services for a school, college or university; and
- Non-resident aliens with no U.S.-source income.

What is an Information Sharing Agreement?

Under the Final Regulations, the plan sponsor and the investment vendor must enter into an Information Sharing Agreement (ISA) which provides for the exchange of information between the two entities.

Do I Need an Information Sharing Agreement?

The IRS assumes if a custodian is eligible to receive ongoing contributions, the plan sponsor and that custodian are already coordinating information. Therefore, an ISA would not be required. These custodians are sometimes referred to as “payroll slot vendors.”

However, if a participant wishes to exchange their contract for another contract that is not currently a payroll slot vendor, then an ISA between the receiving contract and the employer will be necessary in order to keep the monies from being a taxable distribution.

What are the Benefits of a 403(b) Plan?

For the Employee: Pre-tax employee salary deferral contributions reduce the employee's income for federal and state income tax purposes. Employer matching contributions and employer discretionary contributions are not taxable to the employee until withdrawn from the plan trust. Investment earnings on plan assets are tax-deferred. In addition to reducing taxable wages, middle-income employees receive a tax credit on the first \$2,000 in deferrals. The schedule below is our understanding of the credits and income breakdowns for 2009:

<u>Joint filers</u>	<u>Single filers</u>	<u>Tax credit</u>
earning < \$33,001	earning < \$16,501	50%
\$33,001 to \$36,000	\$16,501 to \$18,000	20%
\$36,001 to \$55,500	\$18,001 to \$27,750	10%

For the Employer: As with other employee benefit plans, 403(b) plans can serve as a way to attract and retain qualified employees. It can also reduce the employer's portion of payroll taxes, since the amount deferred by the employee is not subject to federal and state income taxes.

As with any tax matter, you are urged to discuss the tax credit with your tax advisor to verify current IRS requirements.

What are the Contribution Limits?

The maximum employee contribution amount (post-tax or pre-tax) for the year 2009 is the lesser of 100% of compensation or \$16,500. Participants who turn 50 years old or older in 2009 may make an additional "catch-up" contribution of \$5,500. *Note:* The \$16,500 is a combined limit of pre-tax and Roth contributions, and is inclusive of all other 403(b) contributions made to the plan of another employer. (IRC §402(g))

SPECIAL CATCH-UP LIMIT

For employees of certain qualified organizations (educational organizations, hospitals, church-related organizations and health and welfare agencies) who have at least 15 years of full-time service with the same employer, a "special" catch-up limit applies in addition to the "regular" catch-up limit already available. The special catch-up limit equals the lesser of:

- \$3,000;
- \$15,000 reduced by the cumulative amount of "special" catch-up contributions made in prior years; or
- The excess of (\$5,000 x years of service) over the cumulative amount of elective deferrals made in prior years.

Examples:

1. Mary has 20 years of service, and her elective deferrals under the 403(b) plan for her prior taxable years total \$60,000. She has never utilized any special catch-up contribution. For the 2009 plan year, Mary can put in an additional \$3,000, which is the least of: (1) \$3,000, (2) \$15,000, or (3) 40,000 (i.e., [$\$5,000 \times 20$] - \$60,000).
2. Bob has 20 years of service, and in prior years, Bob has made \$60,000 in deferral, of which \$13,300 were special catch-up contributions. For the 2009 plan year, Bob can put in \$1,700 in special catch-up contributions, which is the least of (1) \$3,000, (2) \$1,700 (i.e., \$15,000 - \$13,300), or (3) 40,000 (i.e., [$\$5,000 \times 20$] - \$60,000).

Do I Need to Worry About the ADP Test?

No. Neither ERISA nor non-ERISA 403(b) plans are subject to ADP testing, which compares the deferral rates of highly compensated employees to the rest of the employees.

A Highly Compensated Employee (HCE) is defined as any employee who received compensation in excess of \$110,000 in the preceding plan year, for plan years beginning in 2009.

What is the ACP Test and Why is it Relevant?

For ERISA 403(b) plans that have a matching provision, the Average Contribution Percentage (ACP) test is required each year. The test compares the matching contribution levels of the highly compensated employees to the rest of the employees. If the test fails, either highly compensated employees must take taxable distributions from the plan or the employer must make a 100% vested contribution for the rest of the employees.

The first step is to calculate the average contribution percentage for the non-highly compensated employee group. The allowable average contribution percentage for the HCEs can then be determined using the following table:

NON-HIGHLY COMPENSATED AVERAGE CONTRIBUTION RATE	MAXIMUM HIGHLY COMPENSATED AVERAGE CONTRIBUTION RATE
1.00%	2.00%
2.00%	4.00%
3.00%	5.00%
4.00%	6.00%
5.00%	7.00%
6.00%	8.00%
7.00%	9.00%
8.00%	10.00%
Greater than 8%	1.25 times NHCE%

Example of a failed ACP test with the distribution to the highly compensated employee:

Participant	Wage	Match	%	Group Average	Allowable %	Allowable \$	Taxable Distribution
HCE	\$100,000	\$10,000	10%	10%	4.5%	\$4,500	<u>\$5,500</u>
A	\$40,000	\$4,000	10%	2.5%			
B	\$40,000		0%				
C	\$40,000		0%				
D	\$40,000		0%				

Can the ACP Test be Avoided?

Yes, if your plan qualifies as a Safe Harbor 403(b) plan. Each year, the employer may elect, before the beginning of the plan year, if the 403(b) plan is to be designated as a Safe Harbor plan for that year.

What is a Safe Harbor 403(b) Plan?

A Safe Harbor plan is a 403(b) plan where the ACP test is waived and the highly-compensated employees' matching contributions are not restricted by the lack of matching contributions for the rest of the employees. In a safe harbor plan the employer must followed one of the specified Safe Harbor Matching formulas:

Example of Safe Harbor match of 100% of the first 4% of compensation that is deferred:

Participant	Compensation	Employee Deferral	4% Safe-Harbor Match
100% Owner	\$100,000	\$16,500	\$4,000
Employee A	\$40,000	\$4,000	\$1,600
Employee B	\$40,000	\$1,600	\$1,600
Employee C	\$40,000	\$0	\$0
Employee D	\$30,000	\$0	\$0
Total			<u>\$7,200</u>

Can the Plan Allow Participant Loans?

Yes. 403(b) Plans may allow participant loans. The same rules that apply to other qualified plans, apply to 403(b) plans. However, non-ERISA 403(b) plans should be careful about the administration of the loan, as any discretionary action by the employer (e.g., determining the available loan amount) may unintentionally subject the plan to ERISA.

What Types of Investments are Available to 403(b) Plans?

403(b) plans must be invested in one or more of the following types of investments:

- A custodial account that holds shares of SEC-registered “mutual” funds
- An annuity contract
- Retirement Income Account (for Church 403(b) Plans only)

What Events Allow a Participant to take a Distribution from the Plan?

Attainment of the retirement age specified in the plan and, if the plan allows, attainment of a certain period of years of participation in the plan, termination of employment, hardship condition, death, or disability.

Can the Employer Decide to Contribute Different Matching or Discretionary Employer Contributions for each Employee?

Yes. For an ERISA 403(b) plan that provides for employer discretionary contributions, if the plan discrimination testing passes then contributions may vary per employee at the employer’s discretion.

What is a Roth 403(b) Plan?

A Roth 403(b) plan is a 403(b) plan that gives participating employees the option of contributing part of their wages on a post-tax basis. The deferral will be subject to federal and state income taxes when made, but the entire Roth account (including earnings) can be withdrawn tax-free after meeting certain distribution requirements. The post-tax Roth deferrals and the current pre-tax elective deferrals will be combined for all plan purposes, including the maximum contribution limits, catch-up contributions, and discrimination testing.

What are the Possible Advantages of a Roth 403(b) Plan?

The Roth 403(b) option appeals to:

- Participants who anticipate higher personal income tax rates in the future.
- High-income earning participants who are not permitted to make Roth IRA contributions because of income restrictions.
- Participants who would like to avoid the minimum distribution requirement at age 70 ½ by rolling Roth deferrals to a Roth IRA where minimum distributions are not required.
- Participants who want to diversify retirement accounts between pre and post-tax.

What are the Tax Benefits of a Roth 403(b) Plan?

For the Employee: Post-tax employee contributions do not reduce the employee’s gross income for federal and state income tax purposes. However, the employee’s future earnings on these post-tax dollars will accrue on a tax-free basis so long as the account is in existence for at least 5 years.

On the contrary, employer matching contributions and employer discretionary contributions, and any applicable earnings, are tax-deferred, or are not taxable to the employee until withdrawn from the plan trust.

As with any tax matter, you are urged to discuss the above with your Tax advisor to verify current IRS requirements.

Are All of the Roth 403(b) Investment Earnings Tax-Free When Distributed?

Yes, *the only condition* for a tax-free qualified distribution is that the account must be in existence for at least 5 years, beginning with the first contribution.

And once one of the following occurs, there will be NO TAXES on the distribution:

- Attainment of Age 59 ½
- Death
- Disability

Note: If the account is less than 5 years old, all earnings on the Roth account are taxable to the participant in the year distributed. In addition, participants who are less than age 59 ½ may incur a 10% federal early withdrawal penalty.

However, taxation can be deferred, by rolling the plan distribution directly to a Roth Individual Retirement Account (Roth IRA) or to another qualified retirement plan with the Roth 403(b) option.

What are the Additional Costs of a Roth 403(b) Plan?

The addition of the Roth 403(b) option will add administrative complexity and costs to your 403(b) plan.

- Roth 403(b) accounts will require separate recordkeeping.
- Distribution processes will need to cover the use of different rollover options for Roth and non-Roth dollars, keep track of the timing of the contributions and distributions, and incorporate the changes to the 1099-R reporting requirements.
- In addition, the plan document and Summary Plan Description need to reflect the Roth 403(b) option.

What are Some Questions to Ask Before Adopting a 403(b) Plan?

- Should I sponsor an ERISA or non-ERISA 403(b) program?
- If I am a non-governmental tax-exempt organization (i.e. a §501(c)(3) organization), should I sponsor a 403(b) or a 401(k) plan?
- Do I want to allow my employees to choose whichever investment vendor they want, or do I want to have all deferrals go to one investment provider?

Comparison of 401(k) and 403(b) Plans

	401(k)	403(b)
<i>Who can sponsor?</i>	Any business entity, including sole proprietors, partnerships and non-profit organizations. A governmental employer <u>may not</u> sponsor a 401(k) plan unless grandfathered.	Tax-exempt organizations under §501(c)(3), non-electing church employers, and educational institutions.
<i>Is a plan document required?</i>	Yes.	Yes (effective 1/1/09).
<i>What are the elective deferral limits?</i>	For 2009: lesser of \$16,500 or 100% compensation.	For 2009: lesser of \$16,500 or 100% compensation.
<i>Are catch-up contributions available?</i>	Yes. For 2009, participants age 50 or older may contribute an additional \$5,500.	Yes. For 2009, participants age 50 or older may contribute an additional \$5,500. For employees of certain non-profit organizations, a special catch-up is available in addition to the \$5,500 listed above.
<i>Are Roth contributions allowed?</i>	Yes.	Yes.
<i>What are the limits on total annual contributions?</i>	For 2009: lesser of \$49,000 (\$54,500 if age 50 or older) or 100% of compensation. Contributions in 403(b) and 457(b) plans not counted towards this limit.	For 2009: lesser of \$49,000 (\$54,500 if age 50 or older) or 100% of compensation. Contributions in 401(k) and 457(b) plans not counted towards this limit.
<i>What are the non-discrimination requirements?</i>	<ul style="list-style-type: none"> - ADP/ACP test - 410(b) coverage testing - 401(a)(4) non-discrimination - Top Heavy test 	Universal Availability test for deferrals. Employer contributions subject to same nondiscrimination requirements as 401(k) plan (i.e. ACP, 410(b), & 401(a)(4)). No Top-Heavy testing necessary.
<i>Are there any restrictions on investments?</i>	Assets must be held in a trust, unless fully insured (i.e. welfare benefit plans).	Must invest in annuity contracts or custodial accounts.
<i>Can employer allocations be tiered?</i>	Yes.	Yes.
<i>What are the annual reporting requirements?</i>	Form 5500	None, unless employer is providing a matching contribution or a profit sharing contribution.