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# ERISA 403(b) Plans vs. Non-ERISA 403(b) Plans

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## Agenda

- Refresher on 403(b) Plans
- 403(b) plans that are subject to Title I of ERISA
- 403(b) plans that are not subject to Title I of ERISA
- If applicable, what are the Title I rules?
  - Document requirements
  - Fiduciary rules
  - Reporting and disclosure requirements
  - Vesting
  - Spousal rights
- Title I exemption for salary reduction only 403(b) plans
- Other important distinctions and rules



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## What Are 403(b) Plans?

- Like 401(k) plans, but not 401(k) plans!
- IRS rules set out in Code §403(b) and associated regulations
  - Different rules apply to different entities
- Some 403(b) plans are subject to Title I of ERISA and some are not
- New IRS pre-approved 403(b) plan program
- DOL and courts looking at fiduciary issues with 403(b) plans
- More TPAs and other practitioners getting involved with 403(b) plans



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## Important Rules for 403(b) Plans

- 403(b) plan - a deferred compensation plan for certain tax-exempt and educational organizations, which satisfies the requirements of Code §403(b)
  - Annuity contracts under Code §403(b)(1)
  - Custodial accounts under Code §403(b)(7)
    - Maintained by a bank or certain other financial institutions
    - Amounts are invested in mutual funds
    - Special distribution restrictions are satisfied
  - Retirement income accounts for church-related organizations under Code §403(b)(9)



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## Important Rules for 403(b) Plans

- Retirement Income Accounts – §403(b)(9)
  - Only available to church-related organizations
  - Restriction under 403(b) pre-approved plan program
    - Qualified church controlled organizations and non-qualified church controlled organizations may NOT adopt
  - Special rules
    - Plan document designation as RIA
    - Separate accounting of underlying assets
    - Investment performance is based on gain/loss of assets
    - The exclusive benefit rule is satisfied
    - No limitation on types of investments
    - Commingling allowed



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## Eligible Employers

- Educational organizations under Code §170(b)(1)(A)(ii)
  - Public schools (Higher education, K-12)
- Code §501(c)(3) organizations (“charitable organizations”)
- Churches and church-related organizations
  - “Steeple churches,” qualified church controlled organizations (QCCOs) and non-qualified church controlled organizations (NQCCOs)
- Dual Status Code §501(c)(3)/Governmental Organizations
- Ministers



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## 403(b) Plan Regulatory Requirements

- Not a 401(a) plan!
- Written plan document
  - Exception for churches as defined in Code §3121(w)(3)(A) (“steeple churches”) and a qualified church-controlled organization as defined in Code §3121(w)(3)(B)
  - 403(b) plan restatements
    - Pre-approved plan restatement deadline – March 31, 2020
    - Important to select the “right” plan document based on the adopting entity
- Universal availability rules



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## Universal Availability Rules

- All employees (subject to certain statutory exclusions) must be permitted to make 403(b) elective deferrals if any employee of the eligible employer may make elective deferrals
  - Trade-off – no ADP testing
  - Churches and Qualified Church-Controlled Organizations are **exempt** from universal availability requirements
  - Governmental employers and Non-Qualified Church-Controlled Organizations are **not exempt** to universal availability requirements



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## Universal Availability Rules

- Statutory exclusions
  - Employees who normally work less than 20 hours per week
    - An employee “normally works less than 20 hours per week” only if during the 12-month period beginning on the date employment began (initial year), the employer reasonably expects the employee to work fewer than 1,000 hours, and for each plan year ending after the close of the initial year, the employee works fewer than 1,000 hours
    - Once in always in rule
  - Students performing services described in Code §3121(b)(10)
  - Non-resident aliens described in Code §410(b)(3)(c)
  - Employees who are eligible to make elective deferrals under another 401(k), 403(b) or 457(b) plan sponsored by the same employer
  - Employees who will contribute \$200 annually or less



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## Universal Availability Rules

- Impermissible exclusion categories
  - Part-time, temporary and seasonal employees
  - Substitute teachers and adjunct professors
  - Collectively bargained employees
- Effective availability applies



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## Universal Availability Rules

- Once in always in rule
  - First-year exclusion condition - the employer must reasonably expect the employee to work fewer than 1,000 hours during the employee's first year of employment;
  - Preceding-year exclusion condition – for an exclusion year ending after the first year of employment, the employee must have actually worked fewer than 1,000 hours in the preceding 12-month period; and
  - OIAI exclusion condition - the employee may be excluded under the part-time exclusion *if and only if*, in the employee's first year of employment, the employee meets the first-year exclusion condition, *and*, in *each* "exclusion year" ending after the first year of employment, the employee has met the preceding-year exclusion condition.



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## 403(b) Plan Regulatory Requirements

- Nondiscrimination rules
  - Nondiscrimination testing is applicable to nonelective employer contributions and matching contributions
    - Nondiscrimination testing under Code §401(a)(4)
    - Code §414(s)
    - ACP testing under Code §401(m)
    - Coverage testing under Code §410(b)
  - Governmental entities, certain Indian tribal governments, churches and Qualified Church-Controlled Organizations are **exempt**
  - Non-Qualified Church-Controlled Organizations are **not exempt**



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## 403(b) Plan Regulatory Requirements

- Contribution limits
  - Maximum annual limitations on contributions under Code §415 apply
    - Separate limits for 403(b) and 401(a) plans, unless the 403(b) participant is in control of another business which maintains a qualified plan
    - Nonelective employer contributions for former employees allowed
    - Special \$10,000 limit for church plans
  - Code §402(g) limit (\$19,000 in 2019) applies to elective deferrals
  - Age 50 catch-up contributions (\$6,000 in 2019)
  - Special catch-up contributions



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## 403(b) Plan Regulatory Requirements

- Restrictions on distributions
  - Elective deferrals
    - Severance from employment
    - Death
    - Hardship
    - Disability
    - Attainment of age 59 ½
  - Annuity contracts and retirement income accounts – amounts other than elective deferrals
    - Severance from employment
    - Upon occurrence of any specified event



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## 403(b) Plan Regulatory Requirements

- Restrictions on distributions
  - Custodial accounts – amounts other than elective deferrals
    - Severance from employment
    - Death
    - Disability
    - Attainment of age 59 ½



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## 403(b) Plan Regulatory Requirements

- Minimum distribution rules
- Direct rollover rules
- Taxation occurs when distributions are made
- Plan-to-plan transfers and contract exchanges permitted



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## Plans Subject to Title I of ERISA

- Title I of ERISA protects the rights of “employees” under “employee benefit plans”
- Plan must be an employee benefit plan
  - Employee benefit plans may fall into one of two categories - pension plans or welfare plans
    - 403(b) plans, like qualified plans under Code §401(a), are pension plans for Title I purposes
    - To be an employer that is subject to Title I, a person or organization must have an "employer-employee" relationship with employees covered by the plan
- Unless there is an exception, the Title I rules apply to a 403(b) plan
  - E.g., 403(b) plans maintained by 501(c)(3) organizations are subject to Title I



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## Plans Not Subject to Title I of ERISA

- Governmental Plans
  - A governmental plan is exempt from Title I of ERISA (ERISA §4(b)(1))
  - Governmental plans are defined in ERISA §3(32)
    - A plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.
    - A plan maintained by an Indian tribal government is treated as a governmental plan, if it covers only employees who perform essential governmental functions
  - DOL has ruled that the erroneous filing of annual reports (Form 5500) does **not** affect a governmental plan's exemption from ERISA
  - The Internal Revenue Code has a similar definition of governmental plan under Code §414(d)
  - Status of “charter schools”



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## Plans Not Subject to Title I of ERISA

- “Nonelecting” church plans
  - A nonelecting church plan is exempt from Title I of ERISA (ERISA §4(b)(2))
  - Church plans are defined in ERISA §3(34)
    - Generally, a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under Code §501
  - The Internal Revenue Code has a similar definition under Code §414(e)
  - Electing church plan is subject to ERISA
    - Irrevocable election by filing an election statement on Form 5500 or determination letter request



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## Title I Requirements

- Written plan document requirements
  - Every employee benefit plan “be established and maintained pursuant to a written instrument”
- Vesting requirements
  - 3-year cliff or 6-year graded
- Qualified joint and survivor annuity requirements
- Anti-cutback requirements
- Reporting and disclosure requirements
  - Form 5500, SPD, SMM, SAR, employee benefit statements, blackout period notices, automatic contribution arrangement notices
- Fiduciary requirements
  - Significant source of ERISA litigation
- Prohibited transaction requirements



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## Title I Exemption for Salary Reduction Only 403(b) Plans

- Certain salary reduction only 403(b) plans, even if employer would otherwise be subject to Title I of ERISA, are exempt from Title I coverage
- Requirements
  - The only contributions to the plan must come from salary deferrals
  - Participation of employees must be completely voluntary
  - All rights are enforceable solely by employee
  - Involvement of employer is limited to certain optional specified activities
  - Employer receives no direct or indirect compensation (other than reasonable reimbursement to cover expenses)



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## Title I Exemption for Salary Reduction Only 403(b) Plans

- Permissible employer functions
  - Administrative reviews
  - Correction steps
  - Maintain plan activity records
  - Share participant information
  - Adopt written plan
  - Compliance reviews



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## Title I Exemption for Salary Reduction Only 403(b) Plans

- Allowable activities include:
  - Permitting annuity contractors to publicize their products
  - Requesting information concerning proposed providers and compiling such information to facilitate review and analysis by employees
  - Entering into salary reduction agreements and collecting and remitting amounts to providers
  - Holding one or more group annuity contracts in the employer's name covering employees
  - Limiting funding media or products available to employees to a number and selection designed to afford employees reasonable choice



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## Title I Exemption for Salary Reduction Only 403(b) Plans

- Discretionary employer determinations may cause loss of exemption
  - Authorize plan-to-plan transfers
  - Process distributions
  - Determine hardship, QDROs, loans, etc.
  - Negotiate terms with vendors
- Matching contributions to another plan based on salary deferrals in 403(b) plan voids exemption



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## Other Important Distinctions and Rules

- Nondiscrimination requirements
  - Nondiscrimination testing is applicable to nonelective employer contributions and matching contributions
    - Nondiscrimination testing under Code §401(a)(4)
    - Code §414(s)
    - ACP testing under Code §401(m)
    - Coverage testing under Code §410(b)
  - Governmental entities, certain Indian tribal governments, churches and Qualified Church-Controlled Organizations (QCCOs) are **exempt** from nondiscrimination rules
  - Non-Qualified Church-Controlled Organizations (NQCCOs) are **not exempt**



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## Other Important Distinctions and Rules

- Nondiscrimination requirements
  - Qualified Church-Controlled Organization (QCCO) - an organization described in Code §3121(w)(3)(B) and regulations, and generally refers to any church controlled, tax-exempt organization described in Code §501(c)(3) of the Internal Revenue Code, other than an organization which:
    - Offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and
    - Normally receives more than 25% of its support from either: (1) governmental sources, or (2) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.
  - Examples – seminaries, general assembly agencies



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## Other Important Distinctions and Rules

- Nondiscrimination requirements
  - Non-Qualified Church-Controlled Organization (NQCCO) - a church-controlled, tax-exempt organization described in Code §501(c)(3) that does not meet the definition of a Qualified Church-Controlled Organization (QCCO).
  - Examples – church-affiliated hospitals, universities, nursing homes, retirement housing



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## Other Important Distinctions and Rules

- Universal availability
  - All employees (subject to certain statutory exclusions) must be permitted to make 403(b) elective deferrals if any employee of the eligible employer may make elective deferrals
  - No ADP testing
  - Churches and Qualified Church-Controlled Organizations are **exempt** from universal availability requirements
  - Governmental employers and Non-Qualified Church-Controlled Organizations are **not exempt** from universal availability requirements



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## Other Important Distinctions and Rules

- Compensation limit under Code §401(a)(17)
  - \$280,000 in 2019
  - Generally applicable to 403(b) plans
  - Churches and Qualified Church-Controlled Organizations are **exempt**
  - Governmental plans and Non-Qualified Church Controlled Organizations are **not exempt** from the compensation limit



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## Other Important Distinctions and Rules

- Vesting requirements
  - Plans covered by Title I are subject to the current vesting rules applicable to defined contribution plans
    - 3-year cliff
    - 6-year graded
  - Plans not covered by Title I are not subject to the current vesting rules
    - However, any vesting schedule must satisfy the pre-ERISA Code vesting requirements
      - 15-year cliff
      - 20-year graded



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## Other Important Distinctions and Rules

- Related Employer rules
  - A Related Employer means any entity which is under common control with the Employer under Code §§414(b), (c), (m) or (o). This determination is made consistent with the principles set forth under Treas. Reg. §1.414(c)-5 and any other guidance issued by the IRS relating to control groups of tax-exempt organizations or Electing Churches.
  - If the Employer is a Public School, the Employer shall determine which entities are Related Employers based on a reasonable, good faith standard and taking into account the special rules applicable under IRS Notice 89-23.



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## Other Important Distinctions and Rules

- Common control
  - Facts and circumstances
  - Common control exists between an exempt organization and another organization if at least 80 percent of the directors or trustees of one organization are either representatives of, or directly or indirectly controlled by, the other organization
  - Multiple exempt organizations that maintain a single plan for their employees may treat themselves as a controlled group if they regularly coordinate their day-to-day activities, even if they lack 80% common board control



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## Other Important Distinctions and Rules

- Notice 89-23 – Applicable to governmental plans (i.e., public schools)
  - “The term "employer" includes any other educational organization described in section 170(b)(1)(A)(ii) that has the power to levy tax to provide funds to the contributing employer or to set or review the contributing employer's budget, and all other educational organizations described in section 170(b)(1)(A)(ii) that receive tax disbursements pursuant to the same tax levy of an educational organization. If the contributing employer receives a majority of its tax disbursements pursuant to a tax levy of one governmental entity, each other educational organization described in section 170(b)(1)(A)(ii) receiving at least 80% of its tax disbursements pursuant to the same levy is included in the term "employer" so long as its budget is set or reviewed by the same educational organization that sets or reviews the contributing employer's budget.”



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## Other Important Distinctions and Rules

- Application of the Controlled Group Rules to Church Plans
  - Generally, effective for Plan Years beginning after December 18, 2015, for purposes of Code §414(c) and Code §414(m), an organization that is otherwise eligible to participate in a Church Plan shall not be aggregated with another such organization and treated as a single employer with such other organization for a plan year beginning in a taxable year, unless:
    - one such organization provides (directly or indirectly) at least 80 percent of the operating funds for the other organization during the preceding taxable year of the recipient organization, and
    - there is a degree of common management or supervision between the organizations such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization.



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## Other Important Distinctions and Rules

- Application of the Controlled Group Rules to Church Plans
  - Nonqualified church-controlled organizations - an organization that is a Nonqualified Church-Controlled Organization shall be aggregated with one or more other nonqualified church-controlled organizations, or with an organization that is not exempt from tax under Code §501, and treated as a single employer with such other organization, if at least 80 percent of the directors or trustees of such other organization are either representatives of, or directly or indirectly controlled by, such nonqualified church-controlled organization.
  - Permissive aggregation among Church-Related Organizations - the church or convention or association of churches with which an organization is associated (within the meaning of Code §414(e)(3)(D)), or an organization designated by such church or convention or association of churches, may elect to treat such organizations as a single employer for a plan year.



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## Other Important Distinctions and Rules

- Application of the Controlled Group Rules to Church Plans.
  - Permissive disaggregation of Church-Related Organizations - in the case of a Church Plan, an employer may elect to treat churches (as defined in Code §403(b)(12)(B)) [i.e., Steeple church and QCCO] separately from entities that are not churches (as so defined), without regard to whether such entities maintain separate church plans.



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## 403(b) Plans for 501(c)(3) Organizations

- Plan designed for 501(c)(3) organizations (and “electing” church plans)
  - Charitable organizations - charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals
  - Other tax-exempt employers (about 30 different types of tax-exempt organizations) are not eligible, including: Trade associations - Code §501(c)(6); Social and recreational clubs - Code §501(c)(7); State-chartered credit unions - Code §501(c)(14); and Social welfare organizations - Code §501(c)(4)
- “Electing” church plans - church plans that have elected to be covered by ERISA
- Plan usually allows a wide range of plan design options, including funding through annuity contracts and/or custodial accounts, designation of eligible employees by category, numerous contribution options for salary deferrals, matching contributions and employer contributions, vesting schedules, several distribution options and other features
- Plan is similar in design to a Code §401(a) profit sharing/401(k)



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## 403(b) Plans for 501(c)(3) Organizations

- Title I of ERISA – Yes
- Qualified joint and survivor annuity requirements - Yes
- Anti-cutback requirements - Yes
- Reporting and disclosure requirements - Yes
- Fiduciary requirements - Yes
- Prohibited transaction requirements – Yes
- Written plan document – Yes
- Nondiscrimination rules – Yes
- Universal availability – Yes
- Compensation limit – Yes
- Controlled group rules – Yes
- Vesting rules under Code §411 – Yes



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## 403(b) Plans for Governmental Entities

- Plan designed for public schools and dual status organizations
  - Public school - a State-sponsored educational organization described under Code §170(b)(1)(A)(ii). Public Schools include educational organizations sponsored by Indian Tribal Governments.
    - Public colleges, universities, high schools and elementary schools
  - Dual Status Code §501(c)(3)/Governmental Organization - a governmental organization that also is recognized as a tax-exempt under Code §501(c)(3).
- Plan usually allows a wide range of plan design options
- Plan is similar in design to a governmental Code §401(a) profit sharing/401(k) plan



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## 403(b) Plans for Governmental Entities

- Title I of ERISA – No
- Qualified joint and survivor annuity requirements - No
- Anti-cutback requirements - No
- Reporting and disclosure requirements - No
- Title I Fiduciary requirements - No
- Prohibited transaction requirements – No
- Written plan document – Yes
- Nondiscrimination rules – No
- Universal availability – Yes
- Compensation limit – Yes
- Controlled group rules – Yes, but look to Notice 89-23
- Vesting rules under Code §411 – No, but subject to pre-ERISA vesting rules



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## 403(b) Plans Church-Related Organizations

- Plan designed for “nonelecting” Churches, Qualified Church-Controlled Organizations (QCCOs) and Non-Qualified Church-Controlled Organizations (NQCCOs)
  - Qualified Church-Controlled Organization (QCCO) - An organization described in Code §3121(w)(3)(B) and the Treasury Regulations thereunder, and generally refers to any church controlled, tax-exempt organization described in Code §501(c)(3) of the Internal Revenue Code, other than an organization which:
    - Offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and
    - Normally receives more than 25% of its support from either: (1) governmental sources, or (2) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.
  - Non-Qualified Church-Controlled Organization (NQCCO) - A church-controlled, tax-exempt organization described in Code §501(c)(3) that does not meet the definition of a Qualified Church-Controlled Organization (QCCO)
- NOT a Retirement Income Account Plan under Code §401(a)(9)
- Plan usually allows a wide range of plan design options



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## 403(b) Plans for Church-Related Entities

- Title I of ERISA – No
- Qualified joint and survivor annuity requirements - No
- Anti-cutback requirements - No
- Reporting and disclosure requirements - No
- Title I Fiduciary requirements - No
- Prohibited transaction requirements – No
- Written plan document – Church and QCCO – No ; NQCCO - Yes
- Nondiscrimination rules – Church and QCCO – No ; NQCCO - Yes
- Universal availability – Church and QCCO – No ; NQCCO - Yes
- Compensation limit – Church and QCCO – No ; NQCCO - Yes
- Controlled group rules – Yes, PATH Act rules apply
- Vesting rules under Code §411 – No, but subject to pre-ERISA vesting rules



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## Retirement Income Account 403(b) Plans

- Plan designed to allow for the use of the special provisions available to churches under Code §403(b)(9)
  - Plan document designation as RIA
  - Separate accounting of underlying assets
  - Investment performance is based on gain/loss of assets
  - The exclusive benefit rule is satisfied
  - No limitation on types of investments
  - Commingling allowed
- QCCOs and NQCCOs may NOT adopt a pre-approved 403(b) plan
- Self-employed ministers must adopt this pre-approved plan
  - Coverage and nondiscrimination rules apply
- Plan usually allows a wide range of plan design options



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## 403(b) Plans for Retirement Income Accounts

- Title I of ERISA – No
- Qualified joint and survivor annuity requirements - No
- Anti-cutback requirements - No
- Reporting and disclosure requirements - No
- Title I Fiduciary requirements - No
- Prohibited transaction requirements – No
- Written plan document – Yes
- Nondiscrimination rules – Generally no, but apply to self-employed ministers
- Universal availability – Generally no, but applies to self-employed ministers
- Compensation limit – Generally no, but applies to self-employed ministers
- Controlled group rules – Yes, PATH Act rules apply
- Vesting rules under Code §411 – No, but subject to pre-ERISA vesting rules



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## Salary Reduction Only 403(b) Plans

- Plan designed to allow salary reduction contributions only
- The plan is designed only for employers who intend for the plan NOT to be subject to Title I of ERISA, as provided under Department of Labor regulations
  - Plan is funded solely by salary reduction contributions
  - Participation is completely voluntary
  - The plan rights are enforceable solely by the employee or beneficiary
  - The employer's involvement is limited to certain enumerated activities
  - The employer receives no direct or indirect compensation other than reimbursement for the direct expenses of performing its duties
- Exempt from ERISA, even if 501(c)(3) organization adopts



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## Salary Reduction Only 403(b) Plans

- Title I of ERISA – No
- Qualified joint and survivor annuity requirements - No
- Anti-cutback requirements - No
- Reporting and disclosure requirements - No
- Fiduciary requirements - No
- Prohibited transaction requirements – No
- Written plan document – Yes
- Nondiscrimination rules – No, since no employer contributions
- Universal availability – Yes, unless exempted
- Compensation limit – No
- Controlled group rules – Yes
- Vesting rules under Code §411 – No, always 100% vested



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Thank you for attending!

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