

New Guidance on 403(b) Plan Terminations

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Plan sponsors wanting to terminate their 403(b) plans have struggled with a lack of clear guidance on certain key issues since 2007 when IRS regulations specifically authorized 403(b) plan terminations. Some of the termination requirements set out in those regulations – especially those related to distribution of plan assets – have raised difficult questions for some 403(b) plans. A recent revenue ruling from the IRS answers some of these questions.

To terminate a 403(b) plan, the sponsoring employer must satisfy certain basic requirements. The employer must adopt a terminating resolution, amend the plan to provide for its termination, and notify participants. Participants in the plan must be fully vested, and the plan must distribute all assets within a reasonable time following the termination date. An employer that terminates a 403(b) plan generally must refrain from making contributions to any 403(b) arrangements for a specified time period after the termination.

403(b) plans are often funded with individual annuity contracts or custodial



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arrangements over which the employer has little, if any, authority or control. Even 403(b) plans funded with group annuity contracts that recognize the employer's authority over certain matters in many cases do not contemplate a plan termination or restrict the ability of the employer to terminate the arrangement. For 403(b) plans with these funding vehicles it was not clear how to complete a distribution of assets required for a plan termination.

Through a series of examples, Revenue Ruling 2011 7 provides an outline of how to complete the distribution of plan assets in a 403(b) plan termination depending on the type of funding vehicle held under the plan. The revenue ruling provides that the distribution requirements can be satisfied by:

1. Distributing to participants fully paid individual annuity contracts issued by an insurer;
2. Issuing to participants individual certificates that evidence the participants' fully paid interest in a group annuity contract; and
3. Liquidating participants' interest in their individual or group custodial account or individual annuity contract, and paying the amounts to participants or rolling over the amounts to a participant's IRA or eligible retirement plan in accordance with the terms of the plan and the account or contract.

The revenue ruling also indicates that delivery in a 403(b) plan termination of a fully paid individual annuity contract or certificate evidencing fully paid benefits under a group annuity contract is not taxable to the participant until amounts are paid out of the

contract, so long as the contract continues to comply with the requirements of Internal Revenue Code Section 403(b) in effect at the time of the plan termination. Therefore, it appears that such contracts will not have to be updated for changes to applicable statutes or regulations following the termination.

While this guidance clarifies some of the issues involved in terminating 403(b) plans, there are other legal and administrative challenges involved in terminating these plans.



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