

## Employee Benefits and Executive Compensation

March 14, 2011

### IRS Clarifies 403(b) Plan Termination Process

The Internal Revenue Service recently issued Revenue Ruling 2011-7 (Ruling), which provides additional guidance on the process for terminating a 403(b) plan.

In short, a “403(b) plan” (also known as a “tax-sheltered annuity plan”) is a type of retirement plan that can be offered to employees of certain tax-exempt entities and educational institutions. These plans are funded by annuity contracts and/or custodial accounts. In 2007, the IRS issued final regulations that made sweeping changes to 403(b) plans, including the new ability of an employer to terminate its 403(b) plan (subject to certain requirements) and distribute all benefits to participants upon such termination. However, many plan sponsors and practitioners were left wondering what constituted “distribution” under these regulations, and the tax consequences to the recipient of such a distribution. The Ruling attempts to address these questions by presenting and discussing different 403(b) plan scenarios.

The Ruling provides the following guidance regarding 403(b) plan distributions:

- An individual annuity contract is considered distributed when a fully paid annuity contract is delivered, or a single sum payment is made, to the participant, beneficiary or alternate payee, as applicable, as soon as administratively practicable after the 403(b) plan’s termination date.
- A group annuity contract is considered distributed when an individual certificate evidencing fully paid benefits is provided to each participant, beneficiary or alternate payee, as applicable, whose benefit is funded by the group annuity contract. Such certificate must be delivered as soon as administratively practicable after the 403(b) plan’s termination date.
- Custodial accounts (whether individual or group) are considered distributed when the amount credited to a participant, beneficiary or alternate payee, as applicable, is paid directly to him or her or, if elected by the distributee, to an individual retirement account or annuity as a rollover distribution. If the 403(b) plan required payment of an individual’s benefit in the form of an annuity, distribution of the custodial account is made by delivering a fully paid individual insurance annuity. Like above, distribution of a custodial account must be made as soon as administratively practicable after the 403(b) plan’s termination date.

The Ruling also clarifies the tax treatment of distributions from a terminating 403(b) plan. When a distributee receives a fully paid individual annuity contract or an individual certificate for a group annuity contract, he or she does not incur income. Instead, income

For more information, please contact your Katten Muchin Rosenman LLP attorney, or any of the following members of Katten’s **Employee Benefits and Executive Compensation Practice**.

Gregory K. Brown  
312.902.5404 / [gregory.brown@kattenlaw.com](mailto:gregory.brown@kattenlaw.com)

Christopher K. Buch  
312.902.5509 / [christopher.buch@kattenlaw.com](mailto:christopher.buch@kattenlaw.com)

William B. Duff  
212.940.8532 / [william.duff@kattenlaw.com](mailto:william.duff@kattenlaw.com)

Michael R. Durnwald  
312.902.5697 / [michael.durnwald@kattenlaw.com](mailto:michael.durnwald@kattenlaw.com)

Russell E. Greenblatt  
312.902.5222 / [russell.greenblatt@kattenlaw.com](mailto:russell.greenblatt@kattenlaw.com)

Gary W. Howell  
312.902.5610 / [gary.howell@kattenlaw.com](mailto:gary.howell@kattenlaw.com)

Ann M. Kim  
312.902.5589 / [ann.kim@kattenlaw.com](mailto:ann.kim@kattenlaw.com)

Daniel B. Lange  
312.902.5624 / [daniel.lange@kattenlaw.com](mailto:daniel.lange@kattenlaw.com)

William E. Mattingly  
312.902.5266 / [william.mattingly@kattenlaw.com](mailto:william.mattingly@kattenlaw.com)

---

is received when amounts are actually paid pursuant to such contract, provided that the contract continues to adhere to the applicable requirements set forth in Section 403(b) of the federal tax code. Any other distribution from a terminating 403(b) plan (e.g., payment from a custodial account) will be included in the distributee's gross income, unless it is rolled over to an IRA or other eligible retirement plan within 60 days of the distribution.

# Katten

[www.kattenlaw.com](http://www.kattenlaw.com)

**Katten Muchin Rosenman LLP**

CHARLOTTE

CHICAGO

IRVING

LONDON

LOS ANGELES

NEW YORK

WASHINGTON, DC

Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2011 Katten Muchin Rosenman LLP. All rights reserved.

*Circular 230 Disclosure: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997). London affiliate: Katten Muchin Rosenman UK LLP.*