



Pension Analyst

# Compliance Bulletin

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## IRS provides guidance for terminating 403(b) plans

The final 403(b) regulations, published in 2007, made it possible for employers to terminate 403(b) plans and distribute accumulated benefits, which may then be rolled over to eligible retirement plans. The regulations provided the following basic rules for 403(b) plan termination:

- The written plan must include a provision for plan termination and the resulting distribution of accumulated assets.
- Neither the employer nor any member of its controlled group may make contributions to any other 403(b) plan during the period beginning on the date of plan termination and ending 12 months after all plan assets are distributed.
- All plan benefits must be 100% vested at plan termination.
- All accumulated benefits must be distributed to all participants and beneficiaries as soon as administratively practicable after plan termination.
- For plan termination purposes, a distribution includes delivery of a fully paid individual insurance annuity contract.

Since these rules were very basic, they quickly gave rise to questions regarding their practical application. Four years later, the IRS has now provided preliminary guidance regarding these plan terminations, in the form of Revenue Ruling 2011-7.

### Clarification of 403(b) plan termination process

In the new guidance, the IRS describes four scenarios, involving non-ERISA plans and ERISA plans, as well as assets invested in individual annuity contracts, group annuity contracts and custodial accounts. These scenarios illustrate that some additional steps are required to terminate a 403(b) plan and distribute plan benefits.

The more evolved 403(b) plan termination process now requires the following employer actions:

- Adoption of a binding resolution to: cease all future 403(b) contributions, 100% vest all existing benefits, terminate the plan, and distribute all benefits as soon as practicable.
- Notification of plan participants and beneficiaries of the plan termination.
- Observance of the moratorium on 403(b) contributions to other plans for the required 12-month period.
- Providing plan participants and beneficiaries with the 402(f) rollover notice.
- Distribution of fully-paid individual annuity contracts, or if permitted by the contract, making a lump sum distribution as soon as practicable.
- Distribution of certificates from group annuity contracts, or if permitted by the contract, making a lump sum distribution as soon as practicable.
- Making complete distributions in cash or kind of custodial account balances.
- Filing a final Form 5500 (in the case of an ERISA 403(b) plan) for the plan year that includes final distributions.

### Important points

In describing the procedures required for terminating a 403(b) plan, this guidance makes the following important points about the plan termination process:

- Annuity contracts are considered to be distributed to employees once the employer adopts the appropriate resolution, notifies employees, and distributes fully paid individual annuity contracts or, in the case of a group annuity contract, delivers the appropriate certificates to employees.

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- The distribution of annuity contracts or certificates is not a taxable event; taxation only occurs when payments are made from those contracts or certificates.
- Account balances may continue to be held under the annuity contract without compromising the actual plan termination date.
- Amounts distributed from annuity contracts after the contracts or certificates have been delivered to participants remain eligible for rollover.
- Individual and group annuity contracts and certificates do not have to be amended after they are distributed to reflect changes in the law or regulations affecting 403(b) plans.
- Plans that are subject to ERISA may be required to obtain spousal consent to plan termination distributions.
- The requirement to make plan distributions as soon as administratively practicable is the same rule that applies to qualified plans. While this is a facts and circumstances determination, the general rule is that all distributions must be made within one year following the plan termination date.

## Open issues

Unfortunately, there are still a number of issues for which there are no clear answers:

- How does a plan termination affect Roth and regular after-tax employee contributions?
- What are a plan sponsor's options if a participant does not make an election to receive custodial account amounts in cash or in kind and does not elect to make a direct rollover?
- How does a distributed contract/certificate maintain its 403(b) status, even if it does not have to be updated for new laws or regulations? For example:
  - Can eligible rollover distributions still be rolled into these contracts?
  - Can contractholders still take loans from these contracts?
  - Who administers these ongoing provisions?
  - If the contract-issuer is the administrator, can it rely on participant representations?
- Can a plan be terminated if the underlying group annuity contract or individual annuity contracts do not permit termination and cannot be unilaterally amended to add a plan termination provision?

Many providers may be unable to implement 403(b) plan terminations until the IRS issues additional guidance.

## Prudential's role in 403(b) plan terminations

If you are considering the termination of a 403(b) plan that includes assets held at Prudential, you should contact your Prudential Retirement representative to discuss the options available under your contract. We will work with employers on a one-to-one basis to apply this new guidance to their specific situations.



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