Comments Regarding the Application of Regulations Under Code Section 401(m) to 403(b) Plans and Other Issues Relating to Matching Contributions Under 403(b) Plans

June 24, 2002

Carol Gold, Director
TE/GE Employee Plans Division
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments Regarding the Application of Regulations Under Code Section 401(m) to 403(b) Plans and Other Issues Relating to Matching Contributions Under 403(b) Plans

Dear Ms. Gold:

The American Society of Pension Actuaries ("ASPPA") offers the following comments to the Internal Revenue Service on the application of the regulations under Internal Revenue Code ("Code") Section 401(m) to 403(b) plans and other issues relating to matching contributions under 403(b) plans.

ASPPA is a national organization of approximately 5,000 members who provide actuarial, administration, consulting, legal and other professional services for qualified plans and other retirement plans, including 403(b) plans. The comments in this letter are submitted with the request that the Service clarify, expand or modify existing guidance to address the points raised in this letter affecting matching contributions under 403(b) plans.

I. Matching Contributions - Code Section 403(b)(12)(A)(i) and Notice 89-23

A. 403(b)(12)(A)(i) Safe Harbor

Part IV of Notice 89-23 provides that the Service will deem that a 403(b) plan has satisfied the nondiscrimination requirement of Code Section 403(b)(12)(A)(i) only if the 403(b) plan meets one of the three safe harbors with respect to all contributions other than matching contributions and employee contributions within the meaning of 401(m) that are not made pursuant to a salary reduction agreement. Part IV further provides that matching contributions and employee contributions must satisfy Code Section 401(m) and the regulations thereunder.

The Employee Plans Examination Guidelines Handbook, Section 13.6, Part VI, Nondiscrimination and Coverage, Examination Steps, (4) - (6), states:

Find out whether the employer aggregates plans to pass coverage under §§403(b)(12) and 410(b). Ask which test the employer uses to pass coverage, ratio percentage or average benefits.

Consider whether employer contributions satisfy the safe harbors. If not, see if there is another basis on which employer contributions satisfy good faith/reasonable interpretation.

See whether matching contributions satisfy the ACP test.

Thus, the 403(b) examination guidelines imply that if a 403(b) plan meets the safe harbors under Notice 89-23 for employer contributions other than matching contributions, and the

matching contributions satisfy the ACP test, the plan then would be deemed to satisfy 403 (b)(12)(A)(i) pursuant to Notice 89-23, regardless of whether the plan satisfies the other nondiscrimination requirements referenced in 403(b)(12)(A)(i). ASPPA requests that the Service confirm, through the issuance of regulations or other guidance, that this interpretation is correct.

B. Good Faith Interpretation

Part II of Notice 89-23 states that the Service will deem a 403(b) plan to be in compliance with Code Section 403(b)(12) if the employer operates the plan in accordance with a reasonable good faith interpretation of Section 403(b). Part II further states that in the case of employer and employee contributions other than salary reduction contributions, a 403(b) plan must satisfy the nondiscrimination requirements of Code Sections 401(a)(4), (5), (17) and (26), 401(m) and 410(b) in the same manner as if the plan were described in Code Section 401(a).

Regardless of whether a 403(b) plan relies on the 403(b)(12)(A)(i) safe harbor under Part IV of Notice 89-23 or uses a reasonable good faith interpretation to satisfy the nondiscrimination requirements under Part II, matching contributions must pass the ACP test under Code Section 401(m). ASPPA believes that, because the ACP test was structured to correspond to the ADP test applicable to 401(k) plans, and because the compliance requirements applicable to elective deferrals under a 403(b) plan differ from those applicable to elective deferrals under a 401(k) plan, a 403(b) plan should be permitted to satisfy Part II by relying on a reasonable good faith interpretation of Section 401(m) that may not require satisfaction of the ACP test. ASPPA requests that the Service issue guidance accordingly.

II. Service-Based Matching Formulas

Many 403(b) plans provide for a service-based matching contribution formula, *i.e.,* a formula under which the matching contribution rate increases as the length of a participant's service with the employer increases.

It appears that under Part IV of Notice 89-23, a 403(b) plan, which is relying on the safe harbor to satisfy Code Section 403(b)(12)(A)(i) does not need to satisfy any of the requirements under Code Section 401(a)(4) or the regulations thereunder. Consequently, it appears that a service-based matching contribution formula should come within that safe-harbor if it satisfies the ACP test, regardless of whether it also satisfies Code Section 401 (a)(4) and the regulations thereunder. ASPPA requests the Service to confirm that the foregoing is a correct interpretation of Part IV.

If a service-based matching contribution formula which satisfies the ACP test must also satisfy Code Section 401(a)(4) and the regulations thereunder, the following points should be considered.

A. Treasury Regulations Section 1.401(a)(4) - 4(e)(3)(i) states that different rights or features exist if a right or feature is not available on substantially the same terms as another right or feature. Treasury Regulations Section 1.401(a)(4)-4(e)(3)(G) states that the right to each rate of matching contributions is a separate right or feature.

Treasury Regulations Section 1.401(m)-1(a)(2) states that the "right to each level of matching contributions, are benefits, right or features . . . and each level must therefore generally be available to a group of employees that satisfies Section 410(b)." ASPPA interprets this to mean that the contribution rate group will satisfy Code Section 410(b) if the group comprises a reasonable classification group and each rate group must benefit enough non-highly compensated employees to pass certain numerical tests. Reasonable classifications generally include specified job categories, nature of compensation (*i.e.,* salaried or hourly), geographic location, and similar bona fide business criteria. ASPPA believes that a "service classification" would be considered reasonable. Although Treasury

Regulations Section 1.410 (b)-4(c)(3)(ii) provides some guidance under "factual determinations," ASPPA requests that the Service clarify, through the issuance of new regulations or other guidance, that a service classification is a reasonable classification.

B. It would therefore appear that a service-based matching contribution formula that fails applicable coverage tests as a benefit or feature may satisfy Code Section 403(b)(12)(A)(i) through reliance on a reasonable good faith interpretation standard. We understand that according to a Service field directive, during the good faith compliance period, only optional forms of benefits would be tested under the 401(a)(4) regulations and rights and features are therefore subject to good faith standards.[1] We request that the Service issue an updated field directive or other guidance, which confirms that this inference is correct.

III. Reliance on 401(k) Regulations.

The regulations under Code Section 401(m) parallel the regulations under Code Section 401(k). For that reason, ASPPA requests that the Service confirm through formal guidance that 403(b) elective deferrals are to be treated the same as 401(k) elective deferrals for interpreting and applying 401(m) regulations to 403(b) plans. For example, the concept of qualified nonelective contributions ("QNECs") is a part of the 401(k) regulations. QNECs should be expressly permitted to be made to 403(b) plans to correct ACP failures or other eligible correction failures under VCT, and other correction procedures.

The Service's examination guidelines relating to hardship distributions of 403(b) elective deferrals direct that "to determine an employee's eligibility for a hardship distribution, consult rules applicable to hardship distributions under § 401(k)." Therefore, it appears that 403(b) elective deferrals are treated the same as 401(k) elective deferrals to the extent that they are subject to the same or similar statutory requirements. Guidance is needed which expressly states that this is the case.

IV. Operational Difficulties Caused by the Nature of 403(b) Plans

Because 403(b) plans often have little employer involvement or control, it is difficult, as a practical matter, for matching contributions, which exceed the amounts permitted under the ACP test to be removed from participant accounts.

Completing the refund of excess aggregate contributions within 2½ months after the plan year end is difficult because many 403(b) vendors will not permit the employer to access information concerning the accounts of participants in 403(b) plans, and frequently will not honor employer requests for transactions, such as refunds, without specific written participant permission. This practice makes it difficult for excess aggregate contributions to be refunded in a timely matter. Consequently, the imposition of a 10% excise tax on the employer, who will have little, if any, control of the distribution, for failure to distribute excess aggregate contributions within 2½ months of the end of the taxable year is inequitable.

A compressed time period within which the employer must determine the earnings on excess aggregate contributions in accounts controlled by the participant (and not by a trustee or custodian) makes compliance difficult, if it is the employer's responsibility to report the excesses in Forms 1099-R.

In light of these operational difficulties, ASPPA requests that the Service consider the following as a practical approach to correcting ACP failures under 403(b) plans: Require the employer to give notice to the affected participant, but to allow the correction process to be the responsibility of the participant and/or the vendor.

These comments have been prepared by the Tax-Exempt & Governmental Plans Committee of ASPPA's Government Affairs Committee and principally authored by Theresa Lensander. We appreciate the opportunity to provide these comments, and are available to discuss them with you further.

Sincerely,

Amiram J. Givon, Esq., APM, Co-Chair Tax-Exempt & Gov't Plans Subcommittee	Brian H. Graff, Esq., CPA Executive Director
David A. Pratt, Esq., APM, Co-Chair Tax-Exempt & Gov't Plans Committee	Bruce L. Ashton, Esq., APM, Co-Chair Government Affairs Committee
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cc:

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[1] IRS Field Directive dated June 12, 1992.

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