Retirement Services Legal Department
Retirement & Employee Benefits Group
Legislative and Regulatory Update

403(b) Transfer Rules: IRS Clarification

The IRS has provided additional informal clarification regarding the transfer provisions in the final 403(b) regulations which will require prompt action by plan sponsors and providers.

Plan sponsors continue to have until January 1, 2009, to satisfy the requirements under the final regulations. However, beginning September 24, 2007, plan sponsors and product providers will need to restrict transfers to providers that will satisfy one of the two conditions described below by January 1, 2009, or take the risk that transfers will cause the entire contract to fail under Section 403(b) on January 1, 2009.

The regulations provide that Revenue Ruling 90-24 will not be revoked until the general effective date of the regulations, which is January 1, 2009. However, any transfer to another provider after September 24, 2007, will cause the receiving contract to become taxable on January 1, 2009, unless one of the following two conditions is satisfied:

- The provider and contract are approved by the employer and a part of the employer's plan on January 1, 2009, or
- The provider enters into an information-sharing agreement with the employer effective not later than January 1, 2009.

In other words, the IRS views the grandfather date of September 24, 2007, as only ensuring that a transfer on or before that date will continue to be treated as a qualifying transfer. The grandfathered contract is not protected from application of the new transfer rules.

To satisfy the second condition, although it is not exactly clear what information will be required, the type of information that providers and employers will likely need to agree to share includes:

- Any information necessary for the receiving contract and other contracts in the plan to satisfy section 403(b), including
    - information concerning the participant's employment, such as whether a termination of employment has occurred
    - information taking into account other section 403(b) contracts or qualified employer plans, such as information necessary to determine compliance with applicable hardship distribution requirements
- Information necessary to satisfy other tax requirements, including whether a plan loan satisfies the applicable Internal Revenue Code provisions

Although the information-sharing agreements are not required to be in place until January 1, 2009, it is important that providers now contemplate their ability to enter into

agreements to share the information required for purposes of compliance with 403(b) and other tax requirements (e.g., employment, loan and withdrawal information) before accepting post-September 24, 2007, transfers. Failure to enter into the agreement after receiving a post-September 24, 2007 transfer will pose the risk of adverse tax consequences come January 1, 2009.

Given the potential adverse tax consequences, plan sponsors and providers accepting transfers may want to document now their intent to enter into an information-sharing agreement no later than January 1, 2009. This action would demonstrate a good faith intent to comply so that any corrective action that may be available to the plan participant to avoid current taxation may be taken.

Likewise, providers making transfers after September 24, 2007, may want to consider some safeguards to avoid possible adverse consequences. For example, a provider could add language to its transfer form warning of the consequences if the transferee provider has not satisfied one of the two conditions described above by January 1, 2009, and/or require a statement from the transferee provider of its intent to enter into the information-sharing agreement.

Finally, one open question is the status of contracts in states with “any willing provider” statutes, and whether this new set of restrictions cleanly connects up to those state rules.