

By Electronic Delivery

May 1, 2012

J. Mark Iwry
Senior Advisor to the Secretary and Deputy Assistant Secretary
for Retirement and Health Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Emily S. McMahon
Deputy Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Guidance Priority List Recommendations on Retirement Security Issues

Dear Mr. Iwry, Ms. McMahon, and Mr. Wilkins:

The Investment Company Institute¹ is pleased to submit recommendations regarding retirement security issues for projects to be included on the 2012-2013 Guidance Priority List. A separate ICI submission describes our recommendations regarding regulated investment companies.

I. Items from 2011-2012 Guidance Priority List

The 2011-2012 Guidance Priority List includes “[g]uidance on 403(b) plans.” There are two issues related to 403(b) plans that hold particular importance for Institute members—additional

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

guidance on plan termination and adoption of a pre-approval program for 403(b) prototype plans. In addition to these 403(b) plan issues, we believe another item from the 2011-2012 Guidance Priority List—guidance on the treatment of after-tax contributions in partial rollovers—deserves immediate attention. Each of these issues is described more fully below.

A. 403(b) Plan Termination

Pursuant to an item on the 2010-2011 Guidance Priority List, the IRS issued Revenue Ruling 2011-7, providing guidance on 403(b) plan terminations. While this Ruling addressed many open issues, it does not address a significant question regarding plans funded through individually-owned section 403(b)(7) custodial accounts.² Effective plan termination depends on distribution of all accumulated benefits within a reasonable period of time. Individual custodial accounts, however, typically do not provide for distribution without the consent of the participant. Therefore, any participant who fails to request a cash distribution or rollover of his or her 403(b) account could jeopardize the effectiveness of the termination for other participants or cause the employer to have to maintain a spun-off plan indefinitely. Guidance for this type of situation is essential.

Revenue Ruling 2011-7 and the regulations under section 403(b) permit the delivery of an individual annuity contract (or a certificate evidencing an interest in a group annuity) as a means of distributing accumulated benefits under a 403(b) plan termination. This ordinarily means that an annuity contract may continue as a tax-deferred vehicle after plan termination. The Ruling does not contemplate distribution of a 403(b)(7) custodial account, however. Given that section 403(b)(7)(A) provides that contributions to a custodial account shall be treated as contributions to an annuity contract, we request equal treatment for 403(b)(7) custodial accounts in a plan termination. Distribution of a custodial account that retains its 403(b) character, like the distributed 403(b) annuity contract, may be the only option for some custodians attempting to carry out terminating distributions without the consent of the participant, particularly where the custodial agreement does not permit involuntary liquidation of the account or unilateral amendment of the agreement for this purpose. Without the ability to distribute the account itself, many custodians are left wondering how to carry out an employer's wishes to terminate a plan while at the same time satisfying legal obligations to the individual account owner.

We also believe that guidance addressing a plan termination involving custodial accounts that do contemplate involuntary liquidation would be appropriate. Some have read Revenue Ruling 2011-7 to require affirmative participant consent to a distribution, which would suggest that the presence of a single unresponsive or uncooperative participant could taint a plan termination. To address this misunderstanding, guidance describing an involuntary distribution with an automatic rollover to an IRA after a specified period would be appropriate. Guidance in this regard will facilitate necessary amendments to custodial agreements to permit automatic rollovers to IRAs in connection with plan termination and would allow custodians to rely on an employer's direction that a plan is being

² See ICI letter to W. Thomas Reeder, dated March 17, 2009; and ICI letter to W. Thomas Reeder, dated Nov. 12, 2008.

terminated. The Institute has strongly urged that this guidance be published as soon as possible, given that some employers have begun the process of terminating their 403(b) plans pursuant to the 2007 final regulations issued under section 403(b).³

B. 403(b) Prototype Program

We request finalization of the draft prototype program for 403(b) plans described in Announcement 2009-34 and sample plan language released concurrent with the Announcement. It is important to establish an opinion letter program for 403(b) prototype plans so that employers and plan service providers can have greater certainty in operating under the new 403(b) regulations and guidance. As we have recommended previously,⁴ certain changes should be made to the draft Revenue Procedure and sample plan language, including allowing the terms of individual agreements to govern as appropriate and, for other purposes, allowing individual agreements to incorporate plan provisions by reference. We also urge the Service to allow prototype 403(b) plans to use vesting schedules.

C. Treatment of After-tax Contributions in Partial Rollovers

The 2011-2012 Guidance Priority List included “[g]uidance under §402(c) on distributions that are disbursed to multiple destinations.” Consistent with this item, we urge the Service to provide guidance on partial rollovers of plan distributions containing after-tax employee contributions. A sentence included in the updated model 402(f) notice published in September 2009 created widely-recognized confusion regarding the allocation of after-tax basis and pre-tax amounts in a distribution that is partially rolled over to a plan or IRA. Under the prevailing view of practitioners and service providers, Code section 402(c)(2) provides that in a distribution containing after-tax amounts that is partially rolled over (directly or indirectly), pre-tax amounts are considered rolled-over first. In the view espoused in the model 402(f) notice, however, pre-tax amounts would be considered rolled-over first only in an indirect rollover; in a direct rollover, the amount rolled over would consist of a pro-rata share of basis and pre-tax amounts.

We strongly urge the Service to issue guidance and a revised 402(f) notice confirming that the former view – pre-tax first – is correct. There is no statutory authority that compels the interpretation espoused in the 402(f) notice, and in the interests of sound tax policy, indirect rollovers should not be favored over direct rollovers.⁵ At a minimum, if the Service is unwilling to reverse the pro-rata interpretation implied by the 402(f) notice as we suggest, we believe it is imperative to enforce the pro-rata rule for partial rollovers prospectively only. Due to the multitude of past transactions thought to

³ 72 Fed. Reg. 41128 (July 26, 2007). See ICI letter to W. Thomas Reeder, dated March 17, 2009; and ICI letter to W. Thomas Reeder, dated Nov. 12, 2008.

⁴ See ICI letter to Internal Revenue Service re: Announcement 2009-34, dated June 1, 2009.

⁵ A participant desiring to roll over the taxable part of a distribution to another plan or IRA, while receiving the non-taxable portion in cash or rolling it over into a separate vehicle, could do so via an indirect 60-day rollover, but ostensibly could not accomplish the same result via direct rollover under the Service’s recent interpretation.

be properly executed under 402(c)(2), anything other than prospective enforcement would cause considerable disruption and challenges.

II. New 2012-2013 Guidance Priority List Items

The Institute requests that the Service add the following retirement security matters to the 2012-2013 Guidance Priority List. First, we request that the Service finalize the proposed regulations implementing section 1102 of the Pension Protection Act, which instructed the Secretary of the Treasury to modify the regulations under section 411(a)(11) to require disclosure of the consequences of failing to defer receipt of a distribution from a defined contribution plan.⁶ We strongly recommend that the Service finalize the requirements as proposed. As we stated in our comment letter,⁷ the proposal strikes the right balance by alerting the participant that the plan may have investments, or fee structures, different from those obtainable in an IRA, and alerting the participant that more information is available. This approach will not overwhelm the participant with information that obscures the key information while also assuring the participant has access to information consequential to the decision whether to take or defer a distribution from the plan.

Second, we request guidance on the proper tax treatment of escheated amounts from retirement plans and IRAs. In 2004, the Department of Labor (“DOL”) issued guidance regarding missing participants in terminating defined contribution plans.⁸ The DOL guidance requires that a plan administrator use certain search methods to locate a missing participant, and if all efforts to locate the missing participant fail, then the fiduciary should consider distributing the amounts to a federally insured bank account or escheating them to a state unclaimed property fund. The requested guidance should address certain federal tax implications of escheatment, including (1) whether Form 1099-R reporting is required, (2) whether payors should designate amounts as escheated and, if so, how payors should make such a designation, and (3) whether withholding is required. We have requested this guidance in prior years and we wish to reiterate its importance. We understand that several states have increased their efforts to collect unclaimed property in IRAs and other retirement plans.

Third, we request guidance complementing the DOL’s final regulations on the termination of abandoned plans.⁹ This guidance should implement language in the preamble to the DOL’s regulations that the Service will not challenge the qualified status of any plan termination under the DOL’s regulations or take any adverse action against a “qualified termination administrator” (the party that assumes responsibility for plan distributions and termination), the plan, or any participant or

⁶ 73 Fed. Reg. 59575 (Oct. 9, 2008).

⁷ See ICI letter to Internal Revenue Service re: proposed regulation (REG-107318-08), dated January 7, 2009.

⁸ U.S. Department of Labor, Employee Benefits Security Administration, Field Assistance Bulletin No. 2004-02, dated September 30, 2004.

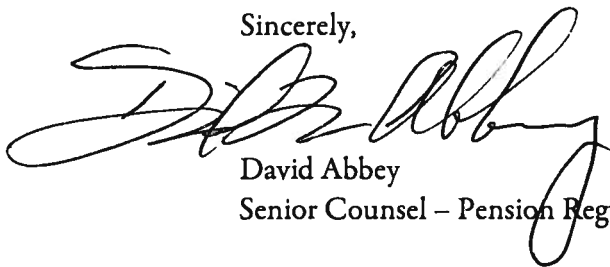
⁹ 71 Fed. Reg. 20820 (April 21, 2006).

beneficiary of the plan as a result of the termination, provided that several conditions are met.¹⁰ The guidance also should clarify how parties other than a participant can establish IRAs for abandoned plan accounts;¹¹ under the DOL's regulations, IRAs for abandoned plan participants could be established by default — without the participant's involvement — in a manner similar to IRAs established under the automatic rollover rules of EGTRRA.

* * *

If we can provide you with any additional information regarding these issues, please do not hesitate to contact Elena Chism at 202/326-5821 or the undersigned at 202/326-5920.

Sincerely,



David Abbey
Senior Counsel – Pension Regulation

cc: George H. Bostick

¹⁰ These conditions are as follows: (1) the qualified termination administrator reasonably determines whether, and to what extent, the survivor annuity requirements of sections 401(a)(11) and 417 apply to any benefit payable under the plan; (2) each participant and beneficiary must have a non-forfeitable right to the benefit as of the deemed termination date, subject to income, expenses, gains, and losses between that date and the distribution date; and (3) participants and beneficiaries must receive notification of their rights under section 402(f).

¹¹ See Notice 2005-5; Institute Letter to the U.S. Department of Labor, dated March 10, 2003.