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August 23, 2013

Ms. Joyce Kahn
Acting Director, EP Rulings & Agreements
Internal Revenue Service
1111 Constitution Ave NW
Washington, DC 20224-0002

Re: 403(b) Plan LRMs

Dear Ms. Kahn:

The American Society of Pension Professionals & Actuaries (“ASPPA”) and the National Tax Sheltered Accounts Association (“NTSAA”) appreciate the opportunity to comment on the sample language recently issued by the Internal Revenue Service (“IRS”) for pre-approved Internal Revenue Code (“IRC”) Section 403(b) plans contained in the Listing of Required Modifications (“LRMs”).¹ This letter supplements comments previously provided with regard to previously issued draft LRM language² and the procedures for pre-approved IRC Section 403(b) plans announced in Revenue Procedure 2013-22.³

ASPPA is a national organization of more than 16,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA’s membership includes the members of NTSAA, a nonprofit organization that became part of ASPPA in order to expand both organizations’ strengths in serving the §403(b) marketplace. ASPPA and NTSAA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. The members of ASPPA and NTSAA are diverse but united by a common dedication to the employer-based retirement plan system.

Summary

The following is a summary of ASPPA’s and NTSAA’s recommendations which are described in greater detail in the **Discussion** section that follows.

- I. **LRM 24 “Severance From Employment” Should Be Clarified and Made Consistent With LRM 22 and Existing Guidance Under IRS Notice 89-23** – The IRS should amend LRM 24 to clarify that for purposes of determining whether a

¹ Released March 28, 2013 and available at [http://www.irs.gov/Retirement-Plans/Listing-of-Required-Modifications-\(LRMs\)](http://www.irs.gov/Retirement-Plans/Listing-of-Required-Modifications-(LRMs)).

² Available at <http://asppa.org/Main-Menu/govtaffairs/Comments/2009.aspx>.

³ Available at <http://asppa.org/Main-Menu/govtaffairs/Comments/2013.aspx>.

“Severance from Employment” has occurred, “Related Employer” status is determined under the definition contained in LRM 22. The example included in LRM 24 should be excluded entirely, or at least clarified to specifically note that all public schools within the same State are not necessarily Related Employers under the special rules of IRS Notice 89-23.⁴

- II. LRM 65 “Vesting” Should Be Clarified With Respect To the Separate Accounting Required for Plans With Vesting Provisions** – LRM 65 should be amended to clarify that any nonvested amounts that must be credited to a separate account and treated as a separate contract to which IRC Section 403(c) (or in the case of a custodial account, IRC Section 401(a)) applies requires appropriate separate recordkeeping entries (i.e., separate accounting) and not physical segregation or investment in a separate insurance contract or custodial account.

Discussion

- I. LRM 24 “Severance From Employment” Should Be Clarified to Be Consistent With LRM 22 and Existing Guidance Under IRS Notice 89-23.**

The definition of “Severance from Employment” is a critical element in IRC Section 403(b) plan administration. Generally, elective deferrals or amounts held in an IRC Section 403(b)(7) custodial account may only be distributed on or after the date the participant has had a “Severance from Employment,” dies, becomes disabled or attains age 59½.⁵ Severance from Employment is defined under applicable Treasury Regulations to mean: “[T]he employee ceases to be employed by the employer maintaining the plan.”⁶ The IRC Section 403(b) regulation then references the IRC Section 401(k) regulations, which for purposes of defining “employer,” cross reference to the definition found in Regulation §1.410(b)- 9.⁷ That regulation then broadly defines “employer” to mean the employer maintaining the plan and those employers required to be aggregated with the employer under the “Related Employer” requirements of IRC Sections 414(b), (c), (m) or (o).⁸

Application of the statutory mandate of IRC Section 414 in the context of a governmental employer, such as a public school, is not entirely clear. Status as a Related Employer in the context of an IRC Section 403(b) plan has relevancy beyond the question of whether an employee has had a “Severance from Employment.” For example, the universal availability requirement is applied to all Related Employers.⁹ In the absence of clear regulatory guidance, IRS Notice 89-93 provides a safe harbor definition for determining employer and “Related Employer” in the context of governmental educational organizations.¹⁰ The preamble to the final IRC Section 403(b) regulations specifically notes that “Until further guidance is issued, . . . State or local government public schools that sponsor 403(b) plans can continue to

⁴ Notice 89-23, 1989-1 C.B. 654.

⁵ IRC §403(b) (7)(A)(ii) and §403(b)(11).

⁶ Reg. §1.403(b)- 2(b)(19).

⁷ Reg. §1.401(k)- 6.

⁸ See, Reg. §1.410(b) - 9.

⁹ See, Reg .§1.403(b) – 5(a)(4) and (5).

¹⁰ See, Notice 89-23, Section V.B.2.b, which prescribes special rules for certain educational organizations of a state, a political subdivision of a state or an agency or instrumentality of such entities.

rely on the rules in Notice 89-23 for determining the controlled group.”¹¹ To date, no further guidance has been issued.

The safe harbor itself is complicated, but essentially determines whether two or more governmental education organizations are “related” based on whether:

1. Either has the power to levy tax to provide funds to the other;
2. Either has the power to set or review the other’s budget;
3. Tax disbursements for both are received pursuant to the same tax levy of an educational organization; or
4. If the majority of the tax disbursements for one educational organization are received pursuant to a tax levy of one governmental entity then it is related to all other educational organizations that receive at least 80% of their tax disbursements pursuant to the same levy and have their budgets set or reviewed by the same educational organization.

The sample language contained in LRM 22 defining “Related Employer” clearly and properly reflects that the safe harbor definitions contained in Notice 89-23 continue to apply in the context of public schools. LRM 22 specifically states, “If the Employer is a Public School,...the Employer shall determine which entities are Related Employers based on a reasonable, good faith standard taking into account the special rules applicable under IRS Notice 89-23, 1989-1 C.B. 654.”

The sample language in LRM 24 defining “Severance from Employment” is inconsistent with LRM 22, the model language for public school IRC Section 403(b) plans promulgated in Revenue Procedure 2007-71, and IRS Notice 89-23. Specifically, the example added in the final draft of the LRMs (that was not present in the proposed LRMs or the model language for public school IRC Section 403(b) plans) implies that all public schools within the same state are “Related Employers.” The new example states, without qualification:

For example, if the Employer is a Public School, “Severance from Employment” means that the Employee ceases to be employed by the Employer **and is not an Employee of any other Public School of the same State**, even though the Employee may continue to be employed by a Related Employer that is another unit of the State that is not a Public School or in a capacity that is not employment with a Public School. (Emphasis added.)

The example does not address or even acknowledge the application of the special rules of IRS Notice 89-23. Its addition in the final draft of the LRMs has caused a great deal consternation within the public school community, particularly given its inconsistency with the model language for public schools in Revenue Procedure 2007-71. The example should be removed,

¹¹ Preamble to Reg. §1.403(b) -1, 72 Fed. Reg. 41128, 41138 (July 26, 2007).

or at the very least clarified to acknowledge application of the special rules of IRS Notice 89-23.

ASPPA and NTSAA recommend that the IRS amend LRM 24 to clarify that for purposes of determining whether a “Severance from Employment” has occurred, “Related Employer” status is determined under the definition contained in LRM 22. The example included in LRM 24 should be excluded entirely, or at least clarified to specifically note that all public schools within the same State are not necessarily Related Employers under the special rules of IRS Notice 89-23.

II. LRM 65 “Vesting” Should Be Clarified With Respect To the Separate Accounting Required for Plans with Vesting Provisions

Application of the vesting rules in the context of an IRC Section 403(b) plan can be challenging. Although elective deferral contributions must be nonforfeitable at all times, other contributions to an IRC Section 403(b) may be subjected to a vesting schedule. Until such amounts (and related earnings) become fully vested, they are treated as a separate contract to which IRC Section 403(c) applies¹² or, in the case of a custodial account, a qualified plan for limited purposes.¹³

LRM 65 addresses the requirements when employer contributions are subject to a vesting schedule. The LRM language states:

If only a portion of the Participant’s interest in the separate account becomes nonforfeitable in a year, then that portion of the contract will be considered a section 403(b) Annuity Contract and the remaining forfeitable portion will be considered a separate contract to which section 403(c) (or another applicable provision of the Internal Revenue Code) applies. Each contribution (and earnings thereon) that is subject to a different vesting schedule must be maintained in a separate account for the participant.

There has been some confusion over the meaning of “a separate contract” and “maintained in a separate account.” Some mistakenly believe that this wording might require a physical segregation of the nonvested amounts in a separate account or a separate and distinct annuity contract. The Preamble to the final IRC Section 403(b) regulations, however, sheds light on what these terms really mean:

The final regulations, like the 2004 proposed regulations, include technical provisions addressing certain situations in which a separate account is necessary under section 403(b). For example, **a separate bookkeeping account is required for any contract in which only a portion of the employee’s interest is vested**, in such a case, separate accounting for each type of contribution (and earnings thereon) that is subject to a different vesting schedule is necessary to determine which vested contributions,

¹² Reg. §1.403(b)-3(d)(2)(ii)(B).

¹³ Reg. §1.403(b)-3(a)(2).

including earnings thereon, are treated as held under a section 403(b) contract.¹⁴ (Emphasis added.)

In order to clear up the confusion and make abundantly clear what is required of IRC Section 403(b) plans with vesting provisions for non-deferral contributions, LRM 65 should be modified to clarify: the term “separate contract” does not necessarily mean physical segregation or a separate insurance contract; and “maintained in a separate account” merely requires that separate bookkeeping entries (i.e. “separate accounting”) to track the nonvested amounts (and earnings) be maintained as part of the plan’s recordkeeping.

ASPPA and NTSAA recommend that IRS amend LRM 65 to clarify that the mandate that nonvested amounts must be credited to a separate account and treated as a separate contract to which IRC Section 403(c) (or in the case of a custodial account, IRC Section 401(a)) applies, requires appropriate separate recordkeeping entries (i.e. “separate accounting”) and not physical segregation assets or investment in a separate insurance contract or custodial account.



These comments were prepared by ASPPA’s and NTSAA’s Government Affairs Committees. We welcome the opportunity to discuss these issues further. If you have any questions regarding the matters discussed herein, please contact Craig Hoffman, General Counsel and Director of Regulatory Affairs, at (703) 516-9300.

Thank you for your time and consideration.

Sincerely,

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¹⁴ Preamble to Reg. §1.403(b)-1, 72 Fed. Reg. 41128, 41136 (July 26, 2007).

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