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WORKING FOR AMERICA'S RETIREMENT

Recommendations on the 2006-2007 Guidance Priority List

May 24, 2006

Department of Treasury
Internal Revenue Service
Notice 2006-36

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the 2006-2007 Guidance Priority List (Guidance List) in accordance with Notice 2006-36.

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the employer-sponsored pension system. Its membership consists of nearly 6,000 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans covering tens of millions of American workers.

The Employee Benefits portion of the Guidance List comprehensively lists important guidance areas, but does not include three areas of particular concern to ASPPA members: (1) issuing an updated IRC §402(f) notice, (2) providing governmental 457(b) plan correction guidance, and (3) provide guidance regarding the distribution of settlement proceeds from a terminated plan. These three items should be included in the 2006-2007 Guidance List. Moreover, ASPPA requests that the guidance in item 19, regarding the application of IRC §414(h)(1), be given top priority, as it is currently the focus of IRS audits.

Summary of Recommendations

The following is a summary of ASPPA's recommendations. These are described in greater detail in the Discussion of Issues section.

A. The Guidance List should include updating the model IRC §402(f) notice.

B. The Guidance List should include specific guidance on the application of the 180-day rule for governmental 457(b) plans under Treasury Regulation §1.457-9 and the interplay with the Employee Plans Compliance Resolution System (EPCRS).

C. The Guidance List should include guidance regarding the tax, qualification and administrative issues due to the receipt of settlement proceeds from a terminated plan.

D. The Guidance List currently includes providing guidance on what constitutes a governmental unit under IRC §414(h)(1). This item should be made a high priority, as IRS audits are currently focusing on this issue.

Discussion of Issues

A. Updated 402(f) Notice

Many practitioners and service providers rely on the IRS's model IRC §402(f) notice, provided in Notice 2002-3, regarding the tax consequences of distributions and participant's rights. This model has been beneficial to all parties. It provides employers and plan administrators with assurance that the requirements of IRC §402(f) are being met, and it ensures that consistent information is provided to plan participants. The current model IRC §402(f) notice, however, does not address two important areas: (1) automatic rollover rules to a default IRA, and (2) the tax treatment of distributions of amounts attributable to designated Roth 401(k) and Roth 403(b) contributions.

The IRS should continue to provide a model notice. There is uncertainty whether the existing model notice can continue to be relied upon or whether the notice must be updated by practitioners to ensure that the necessary information to make informed decisions regarding their distributions is effectively communicated to participants.

ASPPA recommends that the IRS update its model IRC §402(f) notice to reflect recent law changes. This will (1) resolve a significant disclosure issue for nearly all plan sponsors of 401(a), 403(b) and governmental 457(b) plans, and (2) promote sound tax administration by providing participants uniform language explaining complex rollover rules. ASPPA intends to provide the IRS with a sample updated notice that may be helpful to the IRS in completing this project.

B. Governmental 457(b) Plan Correction Guidance

Currently, there is uncertainty regarding the application of the 180-day rule in IRC §457(b) and Treasury Regulation §1.457-9 for government 457(b) plans. The regulation provides:

[a] plan of a State ceases to be an eligible governmental plan on the first day of the first plan year beginning more than 180 days after the date on which the Commissioner notifies the State in writing that the plan is being administered in a manner that is inconsistent with one or more of the requirements of §1.457-3 through 1.457-8 or §1.457-10. However, the plan may correct the plan inconsistencies specified in the written notification before the first day of that plan year and continue to maintain plan eligibility.

A key concern is the interplay of these rules with the IRS's recent EPCRS correction procedures. Revenue Procedure 2006-27 states, "[s]ubmissions relating to §457(b) eligible governmental plans will be accepted by the IRS on a provisional basis outside of EPCRS through standards that are similar to EPCRS." It is not clear, however, what happens if a plan sponsor corrects under EPCRS (or similar standards) before or after the 180-day period or if a plan sponsor simply corrects in accordance with the IRS notification under the IRC §457(b) regulations. It is also not clear if the same protections are available under both programs.

An area of particular concern is missed minimum required distributions (MRD), and related excise taxes and other penalties, which typically are caused by a change in service providers or system upgrades. For example, would the plan sponsor need to file a Voluntary Correction Program (VCP)-type correction under EPCRS to waive the participant's MRD excise taxes, even if promptly corrected within the 180-day period?

ASPPA recommends that the Guidance List include guidance on applying the 180-day rule for governmental 457(b) plans under Treasury Regulation §1.457-9, including the types of errors and excise tax and penalties that are covered, and the interplay with EPCRS. This issue is critical for all governmental 457(b) plan sponsors to maintain their plans' tax-favored status.

C. Rollover of Settlement Proceeds

The IRS has issued numerous private letter rulings on the distribution of settlement proceeds received by a terminated plan, and the eligibility to roll over such distributions. (See, for example, PLR 200446026 and PLR 200604039.) Since these issues have been dealt with solely in the private ruling process, other plan sponsors may not rely on these rulings.

The payment of settlement proceeds from a terminated plan, and the distribution of the proceeds to the participants of that plan, present significant tax, qualification and administrative issues. Some of these issues include: (1) whether the plan needs to be "re-established" to disburse the proceeds in a manner that will be eligible for rollover, (2) whether or under what circumstances the notice and consent requirements need to be satisfied separately for these distributions, and (3) the reporting requirements applicable to the receipt and distribution of the settlement proceeds. The employer-sponsored pension system and the IRS would benefit greatly from formal guidance on these issues.

ASPPA recommends that the Guidance List include guidance regarding the tax, qualification and administrative issues presented by the receipt of settlement proceeds with respect to a terminated plan.

D. “Governmental Unit” Guidance

Employee Benefits guidance number 19 (under Section A) lists “Guidance under 414(h)(1) as to what constitutes a governmental unit.” This issue is currently being brought up on IRS audits. Providing guidance prior to IRS audits promotes sound tax administration. Therefore, issuing IRC §414(h)(1) guidance should be made a high priority.

ASPPA recommends that the IRS promptly issue guidance under IRC §414(h) as to what constitutes a governmental unit.

These comments were prepared by the IRS Subcommittee of ASPPA’s Government Affairs Committee. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration.

Sincerely,

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