

## IRS Code Section 457 Comments on Certain Plans of State and Local Government Employers (Announcement 2000-1)

March 28, 2000

Ms. Cheryl Press  
Internal Revenue Service  
Room 5201  
Post Office Box 7604  
Ben Franklin Station  
Washington, DC 20044

Re: IRS Code Section 457 Comments on Certain Plans of State and Local Government Employers  
(Announcement 2000-1)

Dear Ms. Press:

The American Society of Pension Actuaries (ASPPA) offers the following comments with respect to the Service's issuance of guidance on certain plans of state and local governments and tax-exempt employers as announced in Announcement 2000-1, 2000-2 I.R.B.1.

ASPPA is a national organization of approximately 3,700 members who provide actuarial, consulting, administrative, legal and other professional services for approximately one-third of the qualified retirement plans in the United States, the majority of which are maintained by small businesses. Many of our members also provide these services to tax-exempt and other entities which sponsor 403(b) and 457 plans. ASPPA's mission is to educate pension actuaries, consultants, administrators and other benefits professionals and to preserve and enhance the private retirement system as part of the development of a cohesive and coherent national retirement income policy. Its large and broad based membership gives it special insight into current practical problems with ERISA and qualified retirement plans, particularly on the issues faced by smaller employers.

In Announcement 2000-1, the Service announced interim reporting guidance for certain nonelective state and local government plans that have been consistently treated by the state or local government as bona fide severance pay plans under section 457(e)(11) of the Code. In addition, the Announcement stated that the Service and the Treasury Department are now considering guidance under section 457, and requests comments on "... what types of plans maintained by state and local government and tax exempt employers are properly considered bona fide severance pay plans for purposes of section 457."

ASPPA supports the issuance of guidance under section 457, and welcomes the opportunity to submit these comments on the section 457(e)(11) exception for bona fide severance pay plans.

### Summary of Comments

Our comments Summarized below:

1. We urge that there be an extended transition period for the new guidance.
2. We request that guidance be issued in proposed form with a long comment period.
3. Plans which satisfy the existing DOL regulations discussed below should be given safe harbor status.
4. Guidance should provide characteristics rather than a bright line test for plans, which qualify for the exception, but should include one or more "safe harbors".
5. The guidance should be extended to private sector plan sponsors.
6. The Service should consider adding 457 plans to EPCRS.

### Discussion of Prior Guidance

The "bona fide severance pay plan" exception was first announced in Notice 88-8, 1988-1 CB 477, which was subsequently clarified by Notice 88-68, 1988-1 CB 556 and then codified in section 457(e)(11) by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). Unfortunately, the legislative history of TAMRA gives no guidance as to the intended scope of the exception and, as the Service has acknowledged, there is currently no authoritative guidance defining the term "bona fide severance pay plan" for purposes of section 457(e)(11).

In addition, it has not been, and is still not, clear whether and to what extent other definitions of that term, which were developed for different purposes and in very different contexts, should be extended to section 457(e)(11).

For instance, the Labor Department regulations under ERISA define the circumstances under which a severance plan will be treated as a welfare plan, rather than a pension plan, under ERISA [29 CFR section 2510.3-2(b)(1)]. However, the Department of Labor acknowledges that this definition is merely a safe harbor, and that "in appropriate circumstances a severance pay plan not meeting the conditions [set forth in the regulations] might also be deemed not to be an employee pension benefit plan...." [DOL Advisory Opinion 99-01A].

The Service and the courts have also had occasion to address the distinction between, on the one hand, a severance plan and, on the other, a deferred compensation plan, for purposes of the deduction rules under sections 404, 419 and 419A of the Code and the special employment tax timing rule for deferred compensation under section 3121(v) of the Code. We suggest that the administrative and judicial determinations of these issues illustrate how difficult it can be, in practice, to distinguish between a severance plan and a deferred compensation plan.

### Detailed Suggestions

We suggest that no bright line test, or series of bright line tests, can comprehensively define what is, and what is not, a bona fide severance pay plan. However, in view of the severe income and employment tax consequences, which can result from an employer erroneously treating a plan as being a bona fide severance pay plan, a pure facts and circumstances approach is not sufficient. Accordingly, we request that the Service consider the following factors in developing guidance:

1. Employers have, for the past 11 years, been attempting to comply with the statute without any real guidance. Accordingly, we urge the Service and Treasury to provide extensive transition relief, and for the application of a reasonable good faith compliance standard, for the period prior to the issuance of guidance, as was done in the regulations under section 3121(v).

2. Public sector plan sponsors will often need significant lead time before making substantive changes to their plans, in order to comply with legislative restrictions and collective bargaining agreements. Many private sector plan sponsors are small, and have limited budgets. In addition, the universe of plan sponsors is very diverse. Accordingly, we request that any guidance initially be issued in proposed form, with ample time for public comment, and with an effective date that allows plan sponsors ample time to make necessary changes.

3. Many plan sponsors have, in the absence of other guidance, looked primarily to the DOL's regulatory safe harbor in designing their severance plans. Accordingly, we suggest that a plan that satisfies the requirements of the DOL regulations should also be accorded safe harbor status for purposes of section 457(e)(11). This is also consistent with the approach taken in the regulations under section 3121(v). We request that other reasonable safe harbors also be adopted.

4. We also suggest that, rather than trying to formulate a bright line test, the guidance should identify characteristics of plans that do and do not qualify for the exception, with as many illustrative examples as possible.

5. We also request that the Service consider extending relief under Announcement 2000-1 to private sector plan sponsors. We are not aware of any categorical differences between private sector and public sector plan sponsors which justify treating them differently. If our suggestion is accepted, then it would be necessary to omit the requirement that the plan be broad-based and maintained primarily for non-highly compensated employees. This is because tax-exempt employers do not maintain 457(f) plans, which cover non-highly, compensated employees because doing so would cause the plan to fail to be a "top hat" plan exempt from many provisions of Title I of ERISA.

6. Finally, we note that, in our experience, plan sponsors (both private sector and public sector) have attempted diligently to comply with the requirements of section 457. Furthermore, most of the employers subject to section 457 are not wealthy, regardless of how many employees they have.

Accordingly, we urge you to consider implementation of a permanent 457 correction program, similar to EPCRS.

For any period prior to the effective date of any new guidance, we urge that the transition provisions include the opportunity to correct past errors (other than willful non-compliance) without penalty.

Very Truly Yours,

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