SECTION OF TAXATION
State Bar of Texas

June 10, 2008

Eric Solomon, Assistant Secretary for Tax Policy
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20224

Donald L. Korb, Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
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Re: Comments on Treasury Regulations Under Section 401(a)(9)

Dear Messrs. Solomon and Korb:

On November 2, 2007, James E. Holland, Jr., A.S.A, E.A., of the Internal Revenue Service (the *"Service"*) orally requested that the Section of Taxation of the State Bar of Texas submit written comments to the Service and the Department of Treasury regarding the potential conflict between section 1.401(a)(9)-7 of the Treasury Regulations regarding merged employee benefit plans with divergent required beginning dates and section 411(d)(6) of the Internal Revenue Code. On behalf of the Section of Taxation of the State Bar of Texas, I am pleased to submit the enclosed set of comments.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE SECTION OF TAXATION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE SECTION OF TAXATION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT

SUBMISSIONS OF THE SECTION OF TAXATION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE SECTION OF TAXATION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE SECTION OF TAXATION WHO PREPARED THEM.

Respectfully submitted,

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Chair, Section of Taxation
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Comments On Treasury Regulations Under Section 401(a)(9)

These comments are presented on behalf of the Section of Taxation of the State Bar of Texas. The principal drafters of these comments were Stephanie Schroepfer and David C. D'Alessandro. Felicia A. Finston, Gary G. Short, Shane M. Tucker and Jose J. Valcarce provided helpful guidance in preparing and reviewing these comments. The Committee on Government Submissions (COGS) of the Section of Taxation of the State Bar of Texas has approved these comments. Mary McNulty is Chair of COGS, and Emily Parker reviewed these comments on behalf of COGS.

Although many of the people who participated in preparing, reviewing and approving these comments have clients who will be affected by the federal tax principles addressed by these comments and frequently advise clients on the application of such principles, none of the participants (or the firms or organizations to which such participants belong) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the subject matter of these comments.

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Date: June 10, 2008

I. EXECUTIVE SUMMARY

The following comments are submitted regarding section 401(a)(9)[1] of the Internal Revenue Code of 1986, as amended.

We respectfully recommend that Regulations section 1.401(a)(9)-7 be amended to permit merged plans with divergent required beginning dates to be permitted to comply with section 401(a)(9) in the same manner as if the plans had never been merged. The Regulations as drafted could require the elimination of optional forms of benefits that are protected under section 411(d)(6).

We also respectfully recommend that the Treasury and the IRS, whether through an amendment of Regulations section 1.401(a)(9)-7 or otherwise, expressly state that compliance with the existing provisions of Regulations section 1.401(a)(9)-7 will not result in a violation of section 411(d)(6). We respectfully request that the Treasury and the IRS consult with the Department of Labor (the *"DOL"*) concerning this matter and expressly state in revised Regulations or in the preamble thereto that the Treasury and the IRS has consulted with the DOL and understands that the DOL takes the position that compliance with the existing provisions of Regulations section 1.401(a)(9)-7 will not result in a violation of section 204(g)(1) of the Employee Retirement Income Security Act of 1974, as amended (*"ERISA"*).

Following a discussion of these issues, on November 2, 2007, James E. Holland, Jr., A.S.A, E.A., of the Service orally requested that the Section of Taxation of the State Bar of Texas submit written comments to the Service and the Treasury regarding the potential conflict between Regulations section 1.401(a)(9)-7 and section 411(d)(6).

We appreciate the opportunity to comment on Regulations section 1.401(a)(9)-7 and hope that our comments prove helpful.

1. Summary of Recommendation.

We respectfully recommend that the Service and the Treasury amend Regulations section 1.401(a)(9)-7 to provide that in the event defined benefit plans or defined contribution plans are merged, the successor plan may comply with section 401(a)(9) by making distributions at the same times and in the same amounts as if the plans had never been merged. We respectfully request that the Service and the Treasury consider amending the Regulations to permit merged defined benefit or defined contribution plans to implement an approach similar to the separate account approach contemplated in Regulations section 1.401(a)(9)-8, A-3 (involving different beneficiaries). Under the proposal, if benefits under a merged plan are separated into separate identifiable components they may be separately distributed in the same manner as if the merger had never occurred.

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[1] All references to sections herein are references to sections of the Internal Revenue Code of 1986, as amended (the *"Code"*), unless otherwise expressly stated herein, and references to "Regulations" are to the regulations promulgated under the Code by the Department of Treasury (the *"Treasury"*) and the Internal Revenue Service (the *"IRS"* or the *"Service"*).

In addition, we respectfully recommend that the Treasury and the IRS issue relief from section 411(d)(6) for those employers who operate in compliance with the existing provisions of Regulations section 1.401(a)(9)-7.

2. Explanation.

There is legal uncertainty regarding the manner in which merged plans with divergent required beginning dates are required to be operated under section 401(a)(9) dealing with required minimum distributions.

In the context of a merger of defined benefit plans or defined contribution plans with divergent required beginning dates, there is an apparent conflict between Regulations section 1.401(a)(9)-7 and section 411(d)(6) which prohibits the elimination of certain protected benefits such as required beginning dates.

One of the plans involved in a merger may specify that the required beginning date for section 401(a)(9) purposes is April 1 of the calendar year following the calendar year in which the employee attains age 70½. Another plan involved in the merger may specify that the required beginning date for purposes of section 401(a)(9) is April 1 of the calendar year following the later of the calendar year in which the employee retirees or the calendar year in which the employee attains age 70½.

Section 411(d)(6) and a parallel provision in the Employee Retirement Income Security Act of 1974, as amended (*"ERISA"*), *i.e.*, section 204(g)(1) of ERISA, provide that a plan amendment may not eliminate an optional form of benefit. Regulations section 1.411(d)-4, Q-2(a)(3) specifies that the prohibition against the reduction or elimination of section 411(d)(6) protected benefits already accrued applies to plan mergers. Regulations section 1.411(d)-3(g)(6) provides that the term "optional form of benefit" means a distribution alternative available under the plan. Different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative. The relevant terms include all terms affecting the value of the optional form, such as differences in terms relating to timing and commencement of the benefit.

Regulations section 1.401(a)(9)-7, A-4 provides that if an employee's benefit is transferred from one plan (a transferor plan) to another plan (a transferee plan), the benefit of the employee under the transferee plan is increased by the amount transferred for purposes of determining future required minimum distributions under the transferee plan. The required beginning date of the transferee plan will evidently govern the combined benefit. There is no exception for transferor plans and transferee plans that may have divergent required beginning dates. A literal application of the foregoing Regulations could result in mandatory distributions of portions of transferor plan benefits earlier than such benefits would have been distributed prior to the merger. Such accelerated mandatory distributions would appear to violate section 411(d)(6) of the Code.

In our view the existing Regulations promulgated under section 401(a)(9) do not provide clear guidance concerning plan mergers involving plans with divergent required beginning dates. Those existing Regulations appear to contemplate that all plans will have the same required beginning dates. The ability to change required beginning dates may be limited by section 411(d)(6). The Regulations do not presently deal with the potential conflict with section 411(d)(6).

Some employers have complied with existing Regulations section 1.401(a)(9)-7 erroneously assuming that the Treasury and the IRS have granted relief from any attendant violations of section 411(d)(6). Other employers that were cognizant of the potential for violating section 411(d)(6) and section 204(g)(1) of ERISA have operated their merged plans in a manner that is consistent with the approach outlined below in the new Q&A-6 that we propose be added to Regulations section 1.401(a)(9)-7. We urge the Treasury and the IRS to expressly authorize both of these approaches taken by employers.

II. BACKGROUND AND CURRENT LAW

Divergent Required Beginning Dates Permitted

Retirement plans are permitted to have divergent required beginning dates for purposes of section 401(a)(9).

Under section 401(a)(9)(C), required minimum distributions must commence not later than the required beginning date. In general, the required beginning date is (1) in the case of a person who is a 5-percent owner[2], April 1 of the calendar year following the calendar year in which the employee attains age 70½ and (2) in the case of a person who is not a 5-percent owner, April 1 of the calendar year following the later of the calendar year in which the employee attains age 70½ or the calendar year in which the employee retires from employment with the employer maintaining the plan.[3] However, a plan is permitted to provide that the required beginning date for purposes of section 401(a)(9) for all employees is April 1 of the calendar year following the calendar year in which an employee attains age 70½ regardless of whether the employee is a 5-percent owner.[4]

Section 401(a)(9) Regulations Require Merged Plans to Use Required Beginning Date of Transferee Plan

Regulations section 1.401(a)(9)-7 requires that merged plans use the same required beginning date for purposes of section 401(a)(9). The required beginning date to be used is the required beginning date of the transferee plan.

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2 For purposes of section 401(a)(9), a 5-percent owner is an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½. Regulations section 1.401(a)(9)-2, Q-2(c).

3 Regulations section 1.401(a)(9)-2, A-1(a) and (b).

4 Regulations section 1.401(a)(9), A-2(e); and Internal Revenue Service Notice 97-75, Q-10. Prior to the enactment of the Small Business Job Protection Act of 1996, retirement plans qualified under section 401(a) were generally required to provide for a uniform section 401(a)(9) required beginning date for all participants - April 1 of the calendar year following the calendar year in which the participant attained age 70½.

Regulations section 1.401(a)(9)-7, A-5 provides in relevant part as follows:

> For purposes of determining an employee's benefit and required minimum distribution under section 401(a)(9), a spinoff, a merger, or a consolidation (as defined in § 1.414(l)-1) will be treated as a transfer of the benefits of the employees involved. Consequently, the benefit and required minimum distribution of each employee involved under the transferor and transferee plans will be determined in accordance with A-3[5] and A-4 of this section.

Regulations section 1.401(a)(9)-7, A-4 provides in relevant part as follows:

> In the case of a transfer from one plan (transferor plan) to another (transferee plan), the benefit of the employee under the transferee plan is increased by the amount transferred in the same manner as if it were a plan receiving a rollover contribution under A-2 of this section.

Regulations section 1.401(a)(9)-7, A-2 provides in relevant part as follows:

> If an amount is distributed by one plan (distributing plan) and is rolled over to another plan (receiving plan), the benefit of the employee under the receiving plan is increased by the amount rolled over for purposes of determining the required minimum distribution for the calendar year immediately following the calendar year in which the amount rolled over is distributed. If the amount rolled over is received after the last valuation date in the calendar year under the receiving plan, the benefit of the employee as of such valuation date, adjusted in accordance with A-3 of § 1.401(a)(9)-5, will be increased by the rollover amount valued as of the date of receipt. In addition, if the amount rolled over is received in a different calendar year from the calendar year in which it is distributed, the amount rolled over is deemed to have been received by the receiving plan in the calendar year in which it was distributed.

Elimination of Required Beginning Date Prohibited

Section 401(a)(9) required beginning dates may not be eliminated retroactively (with respect to benefits already accrued) in the context of a plan merger without violating section 411(d)(6).

Section 411(d)(6) and a parallel provision in section 204(g)(1) of ERISA prohibit a plan amendment that has the effect of eliminating an optional form of benefit.[6] For this purpose, an

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[5] Regulations section 1.401(a)(9)-7, Q-3 addresses the situation where the employee's benefit is transferred in the first or second distribution calendar year under section 401(a)(9) and describes the obligations of the transferor plan in satisfying the section 401(a)(9) distribution requirements with respect to such employee.

[6] The Secretary of the Treasury has the ultimate authority to interpret these overlapping anti-cutback provisions. Reorganization Plan No. 4 of 1978, § 101, 43 Fed. Reg. 47713 (1978), 92 Stat. 3790; and *Central Laborers' Pension Fund v. Heinz,* 124 S. Ct. 2230 (2004).

agreement to transfer assets or to merge plans is treated as a plan amendment. Regulations section 1.411(d)-4, A-2(a)(3)(i) provides in relevant part as follows:

> The prohibition against the reduction or elimination of section 411(d)(6) protected benefits already accrued applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. Thus, for example, if Plan A, a profit-sharing plan that provides for distribution of plan benefits in annual installments over ten or twenty years, is merged with Plan B, a profit-sharing plan that provides for distribution of plan benefits in annual installments over life expectancy at time of retirement, the merged plan must retain the ten or twenty year installment option for participants with respect to benefits already accrued under Plan A as of the merger and the installments over life expectancy for participants with benefits already accrued under Plan B.

Optional forms of benefits are section 411(d)(6) protected benefits that may not be eliminated unless an express exception applies. For purposes of section 411(d)(6) the term optional form of benefit means a distribution alternative that is available under the plan with respect to an accrued benefit.[7] Different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative.[8] Different optional forms of benefit may result from differences in terms relating to payment schedule, timing or commencement.[9]

Section 401(a)(9) required minimum distributions with different section 401(a)(9) required beginning dates are different optional forms of benefits for purposes of section 411(d)(6). The Service has recognized that express exemptions from section 411(d)(6) are required in order for a plan sponsor to change section 401(a)(9) required beginning dates with respect to benefits already accrued.[10] Thus far, it appears that the Service has not yet expressly stated that a required beginning date providing for payments following retirement is a section 411(d)(6) protected benefit. However, just as the right to a required beginning date providing for payments prior to retirement is a protected section 411(d)(6) benefit, the right to a required beginning date that provides for payment following retirement should also be a protected section 411(d)(6) benefit that may not be eliminated with respect to benefits already accrued.

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7 Regulations section 1.411(d)-3(g)(6)(ii).

8 *Id.*

9 *Id.*

10 See, for example, Regulations section 1.411(d)-4, Q-10 containing a section 411(d)(6) transitional rule in which, during a limited period of time that generally expired with the end of the remedial amendment period applicable for changes under the Small Business Job Protection Act of 1996, the Service permitted plans to be amended to eliminate distribution options that provide for age 70½ distributions commencing prior to retirement from employment. For this purpose, an age 70½ distribution was a distribution commencing at any time during the period that begins on or after January 1 of the calendar year in which an employee attains age 70½ and ends April 1 of the immediately following calendar year. See also Internal Revenue Service Announcement 97-24 in which the Service recognized that an amendment that eliminates the right to receive a distribution prior to retirement after age 70½ is precluded by section 411(d)(6).

III. COMMENTS

We respectfully recommend that the Service and the Treasury amend Regulations section 1.401(a)(9)-7 to permit transferor plans and transferee plans to implement an approach similar to the separate account approach contemplated in Regulations section 1.401(a)(9)-8, A-2 (involving different beneficiaries).[11] Under the proposal, if benefits under a transferee plan are separated into separate identifiable components they may be separately distributed in the same manner as if the transfer had never occurred.[12]

Specifically, we recommend that the Service and the Treasury consider amending the Regulations section 1.401(a)(9)-7 by adding thereto the following new Q-6:

> Q-6. May an employer elect to apply special distribution rules in the case of a transfer of benefits where the transferor plan and the transferee plan provide for different section 401(a)(9) required beginning dates?
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> A-6. In the case of a spinoff, merger or consolidation (as defined in § 1.414(1)-1) or other trust to trust transfer of assets (within the meaning of section 414(1)) involving a transferor plan and a transferee plan with different definitions of

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11 Regulations section 1.401(a)(9)-8, A-2(a)(2) provides in relevant part as follows:

> If the employee's benefit in a defined contribution plan is divided into separate accounts and the beneficiaries with respect to one separate account differ from the beneficiaries with respect to the other separate accounts of the employee under the plan, for years subsequent to the calendar year containing the date as of which the separate accounts were established, or the date of death if later, such separate account under the plan is not aggregated with the other separate accounts under the plan in order to determine whether the distributions from such separate account under the plan satisfy section 401(a)(9). Instead, the rules in section 401(a)(9) separately apply to such separate account under the plan.

Regulations section 1.401(a)(9)-8, A-3 provides in relevant part as follows:

> For purposes of section 401(a)(9), separate accounts in an employee's account are separate portions of an employee's benefit reflecting the separate interests of an employee's beneficiaries under the plan as of the date of the employee's death for which separate accounting is maintained.

Regulations section 1.401(a)(9)-8, A-2(b) provides in relevant part as follows:

> The rules of paragraph (a)(2) . . . of this A-2 [of Regulations section 1.401(a)(9)-8, Q-2] also apply to benefits under a defined benefit plan where the benefits under the plan are separated into separate identifiable components which are separately distributed.

12 This approach is consistent with the provisions of Regulations section 1.401(a)(9)-8, Q-14 which allow a transferee plan to distribute a benefit transferred from a transferor plan (including earnings thereon in the case of a defined contribution plan) pursuant to a Tax Equity and Fiscal Responsibility Act of 1982 (*"TEFRA"*) section 242(b)(2) election made under the transferor plan so long as the transferred amount is separately accounted for. Similarly, in the case of a TEFRA section 242(b)(2) election made under the transferee plan, Regulations section 1.401(a)(9)-8, Q-14 precludes the distribution of the transferred benefit (plus earnings thereon in the case of a defined contribution plan) from being distributed pursuant to such TEFRA section 242(b)(2) election and requires separate accounting of amounts from the transferee and transferor plans.

required beginning dates, if the benefits under the transferor plan and the transferee plan are separately accounted for in the case of defined contribution plans (including separate accounting for earnings and losses) or are separated into separate identifiable components in the case of defined benefit plans, the rules in section 401(a)(9) may be applied separately to such separate accounts (or separate identifiable components) just as if the transfer had never occurred. This treatment is available if the transferor plan and the transferee plan have different definitions of section 401(a)(9) required beginning dates even if the plan participant elects to commence distribution at a time that is not later than the section 401(a)(9) required beginning dates under both the transferor plan and the transferee plan. In the case of a transfer of assets involving a transferor plan and a transferee plan with potentially divergent section 401(a)(9) required beginning dates, if the special distribution rules of this A-6 are to apply the transferee plan must specify that the benefits under the transferor plan and the transferee plan will be separately accounted for (or separated into separate identifiable components in the case of defined benefit plans) and separately distributed for purposes of section 401(a)(9) in the same manner as if the transfer had never occurred.

For purposes of simplifying the administration of plans we respectfully recommend that merged plans with different definitions of required beginning dates be permitted to comply with section 401(a)(9) in the same manner as if the merger had never occurred, even if the date benefits actually commence under the transferee plan for a given participant is not later than the required beginning dates of both the transferor plan and the transferee plan.

We also respectfully recommend that the Treasury and the IRS, whether through an amendment of Regulations section 1.401(a)(9)-7 or otherwise, expressly state that compliance with the existing provisions of Regulations section 1.401(a)(9)-7 will not result in a violation of section 411(d)(6).