The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE
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Comment Letter on Proposed Simplified Minimum Required Distribution Calculations, April 2001

Via Hand Delivery

April 17, 2001

Ms. Cathy A. Vohs
CC: M&SP:RU (REG-130477-00/REG-130481-00)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D.C. 20224

Re: Section 401(a)(9) Proposed Regulations

Dear Ms. Vohs:

I am writing on behalf of the Investment Company Institute[1] (the "Institute") in order to provide comments on the Proposed Regulations under section 401(a)(9) of the Internal Revenue Code (REG-130477-00/REG-130481-00) ("Proposed Regulations") on required minimum distributions ("RMDs"). These Proposed Regulations are of great interest to Institute members, many of whom offer IRAs, qualified retirement plans and 403(b) arrangements to their shareholders. As of year-end 1999, approximately 49% of the $2.5 trillion IRA market was invested in mutual funds and 45% of the $2.6 trillion defined contribution plan market was invested in mutual funds.[2]

Although we do have numerous comments and some specific concerns with the Proposed Regulations as discussed below, taken as a whole, the Proposed Regulations are a vast improvement over the proposed regulations originally issued by the Internal Revenue Service (the "Service") in 1987. They would provide a substantially simpler method for calculating RMDs and would eliminate many of the variables taxpayers must consider under the current proposed regulations. Moreover, most taxpayers will benefit from a slower rate of distribution from their employer-sponsored retirement plans, IRAs and 403(b) arrangements. Additionally, because taxpayers will better understand how to calculate their annual RMD, increased taxpayer compliance will likely result. For all of these reasons, we applaud the Service's efforts in developing the proposal.

Nevertheless, we believe the Proposed Regulations could be improved in certain respects. Set forth below are our suggested changes, which we ask the Service to consider seriously before finalizing the Proposed Regulations. First, and most importantly, we recommend that the Service adopt an alternative approach to the new reporting requirement that would be imposed on IRA trustees under the proposal.[3] Taking into account the types of data that trustees currently maintain about IRA owners, their spousal beneficiaries and other beneficiaries, there are significant limitations to what trustees would be able to report accurately. In particular, trustees would, in many cases, be unable to report accurate RMD amounts for all of their IRA owners. We are deeply concerned that a reporting requirement that results in the reporting of inaccurate tax information could severely undermine taxpayer confidence in the tax reporting system and the trust that mutual fund shareholders place in the financial institutions managing their retirement assets. In light of these concerns, we offer two alternative methods to assist taxpayers in complying with the rules and the Service in monitoring for compliance.

Second, the Service should, if possible, promptly issue guidance on several transition issues that must be addressed to assure that plan sponsors, IRA owners and beneficiaries can implement the Proposed Regulations in 2001. Our letter also raises some additional areas of the Proposed Regulations that need clarification.

I. IRA Reporting Requirements

According to the preamble to the Proposed Regulations, the Service intends to require IRA trustees to report annually the RMD for an IRA to the IRA owner or beneficiary and to the Service.[4] The purpose of this new reporting requirement, according to the preamble to the Proposed Regulations, is to improve compliance and further reduce the burden imposed on IRA owners and beneficiaries. While we support these objectives, we are concerned that the proposed RMD reporting by IRA trustees inevitably will result in the provision of unreliable and even misleading information to taxpayers and the Service.[5] This will lead to more, not less, taxpayer confusion regarding RMD obligations and will be of little value to the Service's enforcement efforts.

The inability of trustees to provide IRA owners and the Service with accurate RMD amounts arises from the very nature of the RMD rules. Although the Proposed Regulations would simplify significantly RMD calculations, different RMD calculation rules apply in various circumstances. For instance, the Proposed Regulations include a uniform distribution period table ("Uniform Table") that an IRA owner, using his or her date of birth, would use to calculate his or her annual RMD. In numerous cases, however, the Uniform Table alone is insufficient.

The most obvious example concerns spousal beneficiaries. If the IRA owner's sole beneficiary is a spouse more than 10 years younger, the IRA owner can choose a joint life expectancy calculation rather than using the Uniform Table. To identify these cases and accurately calculate the RMD, one would need to know facts beyond the IRA owner's age.[6] Additional complications arise if the IRA owner has died. In such cases the Proposed Regulations prescribe yet another set of rules under which the RMD calculation is made. Furthermore, the Proposed Regulations apply different rules depending on whether the beneficiary is the surviving spouse, a non-spouse individual or a "look-through" trust.

In light of these and other complexities, in order for an IRA trustee to report an accurate RMD amount upon which an IRA owner or beneficiary could safely rely, it would need certain information including, but not limited to, the following: (1) the fair market value of the IRA account as of the end of the previous year; (2) whether the IRA owner is alive; (3) the IRA owner's date of birth and current address; (4) the identification of the designated beneficiary and the date of death of the IRA owner; (5) the relationship of the primary beneficiary to the IRA owner; (6) the designated beneficiary's date of birth, Social Security number and current address; (7) if the primary beneficiary is the IRA owner's spouse, whether he or she was the sole beneficiary of the account for the entire year; (8) whether or not that spouse is more than 10 years younger than the IRA owner; (9) outstanding 60-day rollover amounts/transfers/direct rollovers; (10) recharacterization amounts; (11) marital status of the IRA owner if the default beneficiary provisions under the terms of the plan or custodial agreement name the spouse as the beneficiary; and (12) if the designated beneficiary is a trust, whether it is a qualified trust, and, if so, information about the oldest trust beneficiary. For beneficiaries, the account's designated beneficiary as of the determination date also would be required.

In most cases, IRA trustees do not possess all of this information. Indeed, most of this information is not legally required to be obtained or retained by IRA trustees. For instance, date of birth information of the IRA owner has never been required to open an IRA. Many IRA accounts have been opened without such date of birth information. Moreover, even when trustees have some of this information, often it is not current, because IRA owners frequently neglect to notify the trustees as changes occur, for example, upon a divorce, remarriage or death of a spousal beneficiary. Additionally, many individuals simply are reluctant to provide this information to IRA trustees.

Without this information, which is necessary to calculate RMD amounts, IRA trustees will inevitably report inaccurate or misleading calculations of RMD amounts to both the taxpayer and the Service. As a result, neither the Service nor taxpayers could necessarily rely on the information. In addition, such inaccurate reporting would likely result in increased IRS audits, confusion by taxpayers regarding their RMD amounts and in many cases, excessive withdrawals from IRA accounts.

We have attached, as Appendix A, seven scenarios in which the lack of key information by IRA trustees would lead to the reporting of inaccurate RMD amounts. It should be noted that these scenarios are merely examples and other situations will inevitably occur.

Furnishing taxpayers with unreliable or inaccurate information is, of course, a serious problem in and of itself. Additional problems, however, are likely to result as well. One is the impact that such reporting would have on the relationships between IRA trustees and their customers. Customers have come to expect reliable, accurate and timely service from mutual fund firms that serve as IRA trustees. A reporting system that could result in the reporting of unreliable and inaccurate information to IRA owners would undermine consumer confidence. Similarly, public confidence in the Service's tax reporting and compliance systems also would be threatened if taxpayers were to receive data that turned out to be unreliable or inaccurate. This would be an unfortunate legacy of the Proposed Regulations and contrary to the objective of improving compliance.

Another potential problem with the proposed reporting requirement is that it is unclear on what form the calculation would have to be reported. While there have been suggestions that Form 5498 be used, this form does not appear to be well-suited for such purposes for several reasons. First, a significant portion of IRA owners in RMD status do not currently receive Form 5498s because, under current law, financial institutions are required to send Form 5498s only to those taxpayers making an IRA contribution for the year.[7] If the Service were to require RMD calculations to be included on the Form 5498, IRA trustees would need to identify and send a Form 5498 to each IRA owner aged 70 ½ and older, in addition to those IRA owners that made a contribution to their IRA. As discussed above, trustees are not likely to have date of birth information for all of their IRA owners. Even when they do, such a reporting requirement would necessitate significant changes to current Form 5498 reporting systems and practices.

Second, Form 5498s would not provide timely information to taxpayers. Form 5498s are due May 31. Some IRA owners prefer to take their RMDs throughout the year. RMD reporting to the taxpayer on Form 5498 would provide limited help to an IRA owner in need of help in calculating payments for RMDs that he or she intends to take as installment payments throughout the year.

Finally, use of Form 5498 would be especially problematic in the first year of RMD reporting. Form 5498 states the IRA account value as of December 31 of the previous year. Taxpayers aged 70 ½ who delay their initial distribution to as late as April 1 of the following year calculate their RMD amount based on the value of their account as of December 31 of their 69 ½ year. These taxpayers must take two RMDs in year 2, one that represents the "delayed" RMD for year 1 and the second that represents the RMD for year 2. In order to calculate the RMD for Year 2, the previous December 31 balance (the December 31 balance of the year in which the taxpayer turned 70 ½) must be adjusted to account for the "delayed" RMD taken that year. For reporting purposes, however, trustees would be unable to adjust the December 31 Form 5498 balance used to calculate year 2's RMD to account for the "delayed" RMD. Thus, Form 5498 would not be an appropriate vehicle for reporting RMD calculations.

For all of these reasons, the Institute believes that the proposal to require trustees to report RMD calculations to IRA owners and the IRS is ill advised. Instead, we would recommend that the Service consider two alternative approaches, each of which is described below. Under the first alternative, trustees would be required to provide IRA owners and beneficiaries with information designed to notify them of the RMD rules and how to calculate the amount. In addition, trustees would be required to provide the Service with date of birth information for their IRA owners. Under the second alternative, taxpayers would include their dates of birth on Form 1040 and refer to worksheets to calculate their RMD amounts. Both approaches would (1) make taxpayers aged 70 ½ and older and taxpayers who have inherited IRAs aware of the RMD rules; and (2) facilitate correct calculation of RMD amounts. Thus, they would achieve the Service's goals of improving compliance and reducing burdens on IRA owners and beneficiaries. At the same time, they would avoid the potential confusion and other harms of the Service's reporting proposal. Our descriptions of these two alternatives are set forth below.

Approach 1: Notification of RMD Status by IRA Trustee

The Service could require IRA trustees to (1) help the Service identify IRAs that may be subject to the RMD rules; (2) help the Service identify when the death of an IRA owner occurs; (3) notify IRA owners aged 70 ½ and older annually about the RMD rules; and (4) provide a one-time notice to IRA beneficiaries regarding the RMD rules applicable upon death of an IRA owner when such beneficiaries identify themselves to the trustee or establish an inherited IRA with the trustee.

The Service could require trustees to help it identify IRAs that may be subject to the RMD rules based on date of birth information maintained by the trustee. The Service could require trustees to provide it with available date of birth information for all of their IRA owners. Such date of birth information could be incorporated into the current annual Form 5498 filings that IRA trustees make with the Service. Although trustees do not have date of birth information for all of their IRAs, the information that trustees currently maintain regarding IRA owners' dates of birth would certainly be useful to the Service in monitoring for RMD compliance.[8] We note, however, that the date of birth information maintained by trustees may not be completely accurate. Because trustees must rely on date of birth information provided by the taxpayer, it is sometimes incorrect.

In the alternative, the Service could add a checkbox to Form 5498 that indicates "this account may be subject to the RMD rules." Trustees could check this box when it has date of birth information that indicates the IRA owner is 70 ½ or older.

In addition, trustees could be required to provide notification to the Service when they receive information that an IRA owner has died. When a beneficiary notifies an IRA trustee that an IRA owner has died, the trustee typically changes the registration on the IRA account. For example, an account registered in the name of George Smith would change upon George's death to "George Smith, deceased, f/b/o ("for the benefit of") Sally Smith" or "George Smith Original Depositor f/b/o Sally Smith." This change in registration to the IRA, which would be included in the Form 5498 filing, would put the Service on notice that an IRA owner has died.[9] The Service may want to consider adding check-box on Form 5498 indicating that the IRA owner has died.

IRA trustees also could be required to provide IRA owners age 70 ½ and older, for whom they have date of birth information on file, an annual notice explaining the RMD rules and referencing appropriate IRS publications, worksheets and other guidance. The notice

could be based on a model developed by the Service. We would recommend that the notice to IRA owners include (1) a statement that the IRA trustee's records indicate that the IRA owner is 70 ½ or older; (2) a general statement regarding the applicability of the RMD rules to the IRA owner; (3) a statement that it is the IRA owner's responsibility to calculate the RMD amount each year; (4) information (either by reference or included in the notice) regarding the RMD calculation methods; and (5) an explanation of the aggregation rules. We further recommend that the Service require such notice to be delivered to IRA owners by January 31. Trustees could then make a business decision regarding whether the notice should be incorporated into the December 31 account statement due to the taxpayer by January 31 or processed as a separate mailing.

Information regarding the RMD calculation methods could include reference to an IRS publication or RMD "calculator" that is either web-based or a paper worksheet. [10] RMD calculators would lead a taxpayer through the simplified RMD calculation rules and help the taxpayer apply the rules to his or her own unique circumstances. By comparing the amount of the RMD to any IRA distributions made that year, the calculator would help the taxpayer determine whether additional distributions from his or her IRA were necessary. It also would clarify that the RMDs may indeed be made from one or multiple IRA accounts, thus reducing taxpayer confusion. For your convenience, we have included an example of a RMD worksheet as Appendix B.

Finally, the Service could require that, upon determination of the beneficiary(ies) after the death of an IRA owner, the IRA trustee provide each known beneficiary with a notice regarding the applicability of the RMD rules. We would recommend that this notice include (1) a general statement regarding the applicability of the RMD rules to the beneficiary; (2) a statement that it is the beneficiary's responsibility to calculate the RMD amount each year; and (3) information (either by reference or included in the notice) regarding the RMD calculation methods for beneficiaries. We further recommend that the Service require IRA trustees to provide this notice to a beneficiary only when it is notified of the death of the IRA owner (typically at the time of request for payment).

We believe this "notification" approach would best ensure taxpayer awareness of the RMD rules and correct calculation of RMD amounts. It also would avoid circumstances where IRA trustees calculate and report inaccurate RMD amounts to the IRA owner and the Service, as it takes into account the fact that the IRA owner is in the best position to calculate his or her annual RMD because he or she is the only entity with all of the information necessary to do the calculation. If the Service were to implement such a reporting requirement, we request that it be effective the January 1 following the later of the second year anniversary of publication of the final regulations and the issuance of the appropriate IRS forms.

Approach 2: The Form 1040 Alternative

Another alternative to a trustee calculating and reporting RMDs for IRA owners is having the taxpayer include his or her date of birth on the Form 1040 and calculate his or her RMD from IRAs using a worksheet that is incorporated into the Form 1040 instructions. Joint filers would provide date of birth information for each spouse. [11] If Form 1040 contained date of birth information for an IRA owner, the Service could be certain which taxpayers are subject to the RMD rules, because Form 1040s are signed under penalties of perjury. Using the Form 1040, the Service could access the information necessary to determine whether the IRA owner was subject to the RMD rules, the amount of the RMD for that IRA owner and whether he or she had taken a distribution from his or her IRA to satisfy the RMD rules for that year.[12]

For example, from the date of birth information included on Form 1040, the Service could determine whether the IRA owner was over age 70 ½. Form 1099-R information included in the return would provide information regarding the amounts distributed from IRAs for that year. Form 5498 information submitted to the Service would provide the fair market value of all of the IRA owner's accounts for the previous year. Given this information, the Service could readily review the accuracy of the information reported on an IRA owner's Form 1040 to ensure compliance with the RMD rules.[13]

We believe including dates of birth and RMD calculations on Form 1040 would be an effective and efficient means to ensure both that the Service and taxpayers have accurate RMD information and that taxpayers are aware of and can comply easily with the RMD rules. By having complete and updated information necessary to calculate the RMD in one place, the Form 1040, the Service could easily review taxpayer compliance with the RMD rules.

II. Transition Issues

The Proposed Regulations raise certain "transition" issues that concern the operation of the regulations during the period of time between the effective date of the Proposed Regulations and when the rules are finalized. Guidance on these transitional issues is necessary for both IRAs and qualified plans. For each issue, we have included our recommendation regarding how it should be addressed. We respectfully request that guidance on these issues be issued as soon as practicable.

A. RMDs for Beneficiaries in Pay Status

Issue: How may beneficiaries currently in RMD pay status elect the new rules for RMD calculation in 2001?

Recommendation: Prior to the release of the final regulations, the Service should clarify that beneficiaries currently in pay status who choose to use the new RMD rules must apply the rules as if they were in effect at the time of death of the account owner. For example, a non-spousal designated beneficiary who chooses to calculate his or her RMD using the life expectancy method under the Proposed Regulations in 2001 would first need to calculate his or her age in the year following the year of the account owner's death, reducing it by one for each subsequent year until reaching the current year. Although this method would require beneficiaries currently in pay status to make an additional calculation regarding their age, it would ensure that all beneficiaries calculate RMDs consistently once the Proposed Regulations are finalized.

We recommend that the Service not allow a beneficiary currently in pay status to take RMDs based on his or her life expectancy determined in 2001, i.e., determined at the time the beneficiary elects to take advantage of the Proposed Regulations. This approach would result in two different calculation methods for beneficiaries: one for beneficiaries in pay status prior to 2001 (prior to issuance of the Proposed Regulations) and one for those beneficiaries who enter pay status in 2001 and later (after the Proposed Regulations are finalized). The resulting rules would be unnecessarily complicated for taxpayers, IRA trustees and employers.[14]

B. Model Amendment Effect on Distributions Made Prior to Date of Adoption

1. Issue: If the model amendment is adopted in a qualified plan for calendar year 2001, what is the effect of the amendment on lump sum distributions or installment payments made prior to the time that the model amendment is adopted? In general, RMD distributions made before the model amendment's adoption will be larger than would be necessary under the Proposed Rules and the amendment.

Recommendation: The Service should clarify that a distribution that occurs in the year a qualified plan is amended through the use of the model amendment, but is distributed prior to the date the model amendment was actually adopted should be treated as properly handled by the plan administrator under the 1987 proposed regulations. Such treatment would eliminate the need for plan administrators to retroactively comply with Code sections 3405 and 402(f).

With respect to plan participants who may have received such distributions, the Service should clarify that they are able to take advantage of the Proposed Regulations by rolling over within the 60-day rollover period any amounts that would not have been required distributions under the Proposed Regulations. Further, if plan participants are taking installment payments, they may request that the plan administrator adjust the installment schedule prospectively.

2. Issue: If the model amendment is not adopted in a qualified plan for calendar year 2001, what is the effect on lump sum distributions and installment payments?

Recommendation: Plan sponsors need not adopt the model amendment implementing the Proposed Regulations during the transition period.[15] The Service should clarify that these plan sponsors continue to operate under the 1987 proposed regulations and, therefore, that Code sections 3405 and 402(f) are to be applied accordingly. The Service also should clarify that participants in such plans may themselves take advantage of the Proposed Regulations by rolling over (within the 60-day rollover period) distributed amounts in excess of what the Proposed Regulations would require.

C. Model Amendment and Prototype Plans

Issue: If a prototype sponsor does not incorporate the model amendment into its prototype document, can an employer using the prototype nonetheless elect to use the model amendment?

Recommendation: The Service should clarify that if a prototype sponsor has not adopted the model amendment, each adopting employer nonetheless may elect to adopt the model amendment. The Service should clarify that an employer's adoption of the model amendment in this case will not cause the plan to be treated as individually designed. Section 5.02 of Rev. Proc. 2000-20 provides, in pertinent part, that an employer that amends any provision of an approved M&P plan, including its adoption agreement (other than to change the choice of options, if the plan permits) is considered to have adopted an individually designed plan. Section 5.02 provides further, however, for an exception to this rule in the case of model amendments published by the IRS that specifically provide that their adoption by an adopting employer will not cause such a plan to be treated as individually designed. The IRS's section 401(a)(9) model amendment should expressly provide that its adoption does not cause an adopting plan to be treated as an individually designed plan.

The Service should do so for three reasons. First, employers seeking to adopt the Proposed Regulations on a plan-wide basis would not have to rely on a prototype sponsor to do so. This likely will result in more timely adoption of the Proposed Regulations by many employers. Second, participants in plans that do adopt the Proposed Regulations would benefit, because they would not have to concern themselves with rolling over amounts, as we described in section B above. Third, this approach would relieve prototype sponsors of the need to amend their plans to take into account the transition period. Because many prototype sponsors have already submitted plans to the Service for determination letters under GUST, this approach to the issue will avoid complicating that process.

D. The Proposed Regulations and Section 411(d)(6)

Issue: May a plan eliminate the old calculation method options under the 1987 Proposed Regulations without violating the anti-cutback rules under Code section 411(d)(6)?

Recommendation: The Service should clarify that plans may eliminate calculation methods prescribed under the 1987 Proposed Regulations for RMD calculations without violating section 411(d)(6). The purpose of the Proposed Regulations is to simplify RMD calculations for taxpayers. Requiring plan sponsors to maintain the 1987 Proposed Regulations rules for previously accrued benefits would substantially undermine this goal. It also would unnecessarily burden plan sponsors, who would be required to maintain segregated benefit accruals or account balances and two systems to calculate RMDs for their participants.[16]

III. Additional Issues Needing Clarification

Below we set forth additional issues needing clarification when the regulations are finalized. They include various questions regarding (a) individuals currently taking distributions under the 1987 Proposed Regulations; (b) RMD calculations; (c) rollovers and transfers; and (d) other miscellaneous issues. For each, we identify the issue and make a specific recommendation.

A. Rules Under the Final Regulations

Issue 1: Once the Proposed Regulations become final, must all taxpayers, including those already using the 1987 Proposed Regulations, calculate RMDs using the new rules?

Recommendation: Once the final regulations are in effect, the Service should require all taxpayers to utilize the calculation methods prescribed in the regulations, including those already using the 1987 Proposed Regulations, even if their RMD would be smaller under the 1987 Proposed Regulations.

In general, the Proposed Regulations give participants and beneficiaries the longest payout schedule they could have obtained under the 1987 Proposed Regulations. Although there will be some limited situations where participants and beneficiaries must take larger RMD amounts under the new rules,[17] in the spirit of simplification, we request that the Service not include grandfathering rules for any of the old calculation methods not available under the new rules.

Issue 2: What will be the effective date of final regulations?

Recommendation: The Institute recommends that the effective date of the regulations be January 1 following the date the regulations are finalized. [18] A prospective January 1 effective date will ensure that all RMDs taken for that year will be calculated using the new rules and avoid the "adjustment" issues that occurred in 2001, when the Proposed Regulations were issued after January 1 and some taxpayers had already taken part or all of their RMD payments for the year.[19]

B. RMD Calculations

Issue 1: If a designated beneficiary is not determined until December 31 of the year following the death of the plan participant or IRA owner, how can distributions be made by December 31 of that year?

Recommendation 1: Setting December 31 as the date for designated beneficiary determination causes significant administrative difficulties. [20] In order to make a timely distribution on December 31, plan administrators and IRA trustees must process the distribution before that date, at which time they will have not yet determined the identity of the designated beneficiary. In light of this concern, we recommend that the Service establish an earlier date for the determination of a designated beneficiary, such as September 30 of the year after the year of the participant's death. This date should provide beneficiaries sufficient time to make decisions with respect to their plan and IRA accounts.[21] A September 30 determination date also would ensure that plan administrators and IRA trustees would be able to process distributions prior to the December 31 deadline.

Issue 2: For RMD distributions during an IRA owner's lifetime (including the year of his or her death), how can the joint life expectancy calculation (if applicable) be used if the spouse must be the sole beneficiary until December 31?

Recommendation 2: §1.401(a)(9)-5 Q&A 4(b) provides special rules that permit use of a joint life expectancy method to calculate RMDs if the spouse is the sole designated beneficiary of the account for the entire year – until December 31. This requirement causes administrative difficulties similar to those discussed above. In addition, plan administrators or IRA trustees do not typically maintain an automated system to identify if a beneficiary change has been made during the distribution calendar year. A simplified method for IRA owners and plan administrators would determine the owner's eligibility for the spousal rules as of a certain defined date. In general, we recommend that the Service require the spouse be the sole beneficiary as of September 30. Plan administrators and IRA trustees would be able to process RMD distributions to the IRA owner (or to the spousal beneficiary in the year of the IRA owner's death) by the December 31 deadline if the rules provided that the deadline for determination was September 30. We further

recommend that for the year of the IRA owner's death, the Service not require the surviving spouse to be the sole beneficiary of the decedent's IRA for the entire year, but only as of the earlier of death or September 30 of the year of death.

Issue 3: If a beneficiary misses the first distribution date (December 31 of year after death), can he or she still elect to take life expectancy distributions, assuming that he or she is subject to the 50% excise tax penalty?

Recommendation 3: We recommend that the Service clarify that a beneficiary of a plan or IRA who fails to make a RMD by the December 31 following the year of death of the plan participant or IRA owner is still eligible to utilize the life expectancy method. The Service should require that beneficiaries calculate the current year's RMD based on life expectancy and take any prior RMDs based on prior year's life expectancy. Prior years' RMDs would be subject to the 50% excise penalty. The Service should clarify that the taxpayer should include all RMD amounts in income in the year of actual distribution.

C. Rollovers and Transfers

Issue 1: Must an IRA trustee distribute a RMD amount for a taxpayer over age 70 ½ before transferring the account to another plan or financial institution?

Recommendation 1: The Service should modify the requirement under the Proposed Regulations that IRA trustees distribute a RMD amount before transferring the account of an IRA owner aged 70 ½ or older to another financial institution.[22]

This requirement is inconsistent with other IRS guidance. Notice 88-38 provides that a taxpayer may elect to withdraw his RMD amount from any one of his or her IRAs. If an IRA owner wishes to transfer his account to another plan or IRA, the entire account balance should be transferred regardless of the IRA owner's age and, consistent with Notice 88-38, the IRA owner, not the IRA trustee, should determine both the account from which a RMD should be made and the timing of the distribution.[23]

Issue 2: May a plan require a participant over age 70 ½ to take a RMD before transferring or rolling over the account balance to another plan or financial institution?

Recommendation 2: The Service should clarify that, similar to the transfer rules for IRAs, plans may not require a plan participant aged 70 ½ to take a RMD prior to transferring or rolling over his account balance to another plan or financial institution. The Proposed Regulations state in §1.401(a)(9)- 7 Q&A 3 that transferring plans may "hold back" the RMD amount from the transfer or rollover. As discussed above, plan participants, like IRA owners, should determine the timing of their RMDs during the year. A transfer request to another plan or financial institution should not result in a premature RMD.

Issue 3: If an amount is distributed by one plan (distributing plan) or IRA and rolled over to another plan (receiving plan) or IRA in a different calendar year how are the benefits and the RMD under the receiving plan affected?

Recommendation 3: The Service should clarify that if a rollover is received in a different year than the year in which it was distributed, then it is treated as having been received by the receiving plan or IRA in the year it was received.

§1.401(a)(9)-7 Q&A 2 states that if a rollover is received in a different year than the year in which it was distributed, then it is treated as having been received in the prior year. It is not feasible for a receiving plan to know whether assets left the distributing plan prior to December 31 of the prior year and thus, were not captured by the distributing plan's RMD calculation mechanism. This information is not currently transferred to the receiving plan with the account. Current reporting systems capture year-end account balances as of December 31. The receiving plan should be required to report account balances based on information it has available to it regarding its own plan, not based on the other plan's records. This same rule should apply to IRAs as well.

For IRAs, we have recommended that the IRA owner utilize a RMD worksheet or calculator to determine his or her RMD for the year. These worksheets and calculators will require the IRA owner to add any rollovers that cross years into the December 31 balance used to calculate the RMD. This will ensure proper calculation of a RMD in instances where, for example, an IRA owner takes a distribution from one IRA on December 30 and rolls it over to a different IRA in January.

Issue 4: If a surviving spouse over age 70 ½ elects to roll over a deceased IRA owner's IRA to an IRA in the name of the surviving spouse in the calendar year of the IRA owner's death, are two RMDs (one for the IRA owner and one for the surviving spouse) required?

Recommendation 4: We recommend that the Service provide clarification that where an IRA owner has died after his or her required beginning date, the only RMD required for the year of death is the RMD that the IRA owner would otherwise have been required to receive. [24] A surviving spouse who is also over age 70 ½ should not be required to take an additional RMD until the year following the year of death. Proposed Regulation § 1.408-8, Q & A-5 appears to require that a surviving spouse past his or her required beginning date must take a RMD for the year of the rollover, even if the rollover occurs in the year of the IRA owner's death and the

IRA owner received his or her RMD before death.

Issue 5: Is a surviving spouse eligible to roll over to his or her own IRA assets that are payable to a trust of which the spouse is the sole beneficiary?

Recommendation 5: The provisions of Proposed Regulations §1.401(a)(9)-8, Q&A-5, appear to conflict with a series of Private Letter Rulings (for example see PLR 20025062 and 9820020) regarding the circumstances under which a spouse may retain rollover rights and rollover trust assets into her own IRA. We recommend that the Service clarify that the standards set forth in the PLRs remain valid. We further recommend that the Service permit a surviving spouse in these circumstances to roll over amounts from an IRA through a trustee-to-trustee transfer from the decedent's account directly to the spouse's account. The Service should not require the proceeds to be first distributed to the trust, then distributed from the trust to the spouse, who in turn would be able to roll over the proceeds.

D. Miscellaneous Issues

1. Section 72(t)

Issue: How do the Proposed Regulations affect substantially equal payments under section 72(t)?

Recommendation: The Service should clarify that if distributions satisfying the substantially equal payments exception are being made based on the 1987 proposed regulations, such distributions should continue to satisfy that exception after issuance of the final regulations. If substantially equal periodic payments have been based on the 1987 proposed regulations, the Service should clarify that taxpayers may use the new calculations under the Proposed Regulations without causing recapture of the section 72(t) 10% penalty tax.

2. Separate Shares

Issue: What is the effect of segregating a plan account or IRA into separate accounts under the RMD rules?

Recommendation: We recommend that the Service clarify that the RMD rules apply individually to a separate share of a plan account or IRA immediately upon segregation. For example, the Service should clarify that if the spouse is one of multiple beneficiaries at the time of the IRA owner's death and the account is subsequently divided into separate accounts for each beneficiary by December 31 of the year following the year of the IRA owner's death, the surviving spouse can elect to treat the IRA owner's IRA as his or her own IRA. Proposed Regulation Section 1.401(a)(9)-8, Q&A-2 generally provides that in the case of post-death RMD payouts, if the plan account or IRA is divided into separate accounts for each beneficiary as of the end of the year following the IRA owner's death, the RMD rules may be applied separately to each separate account. Further, the Proposed Regulations provide that if the IRA owner dies prior to the required beginning date and the spouse is the sole beneficiary of one of the separate accounts, he or she may delay taking RMDs until the end of the year in which the IRA owner would have reached age 70 ½.

3. Estate and Trust Issues

Issue: To what extent may an executor and/or beneficiaries of an estate receive distributions of the estate's interest in a retirement plan prior to December 31 of the year after the owner's death and thereby enable individual beneficiaries to become designated beneficiaries? In other words, may the failure to name a designated beneficiary by naming the estate be "cured" prior to December 31 of the year after the owner's death?

Recommendation: We recommend that the Service clarify that an "estate" as beneficiary may use the methods of determining the beneficiary that are available to other possible beneficiaries (individuals, trusts, and charities). This position would be consistent with the Service's position in prior Private Letter Rulings. (For example, see PLR 9835005.) The Proposed Regulations provide that "any person" who was a beneficiary on the date of death, but is not a beneficiary on December 31 of the year after the IRA owner's death (because the person disclaims or receives a distribution) is not taken into account in determining the accountholder's beneficiary for post-death RMD payouts. Concurrent with longstanding policy the new regulations provide, however, that a person that is not an individual, such as an estate, is not a designated beneficiary. The preamble to the proposed regulations indicates that "any beneficiary" (not just a designated beneficiary) eliminated by "distribution of the benefit or through disclaimer (or otherwise)" prior to December 31 of the year after the owner's death "is disregarded."

4. QDROs

Issue: Can an alternate payee under a QDRO take RMDs based on his or her own required beginning date?

Recommendation: §1.401(a)(9)-8 Q&A 6 indicates that alternate payees must take RMDs based on the required beginning date of the employee, without regard to the alternate payee's required beginning date. This rule creates unnecessary administrative

difficulties for plan administrators, because they need to use the employee's account information to administer the alternate payee's account. Consistent with the Service's treatment of separate shares, we recommend that once an account is separated under a QDRO, the alternate payee should take RMDs based on his or her own required beginning date.

5. Certain Post-Death Distributions

Issue: What is the applicable distribution period for a post-required beginning date death in cases where a designated beneficiary is older than the employee?

Recommendation: We recommend that the Service change §1.401(a)(9)-5 Q&A-5(a)(1) to provide that the applicable distribution period is "the longer of (i) the life expectancy of the employee's designated beneficiary determined in accordance with paragraph (c)(1) or (2) of this A-5, or (ii) the remaining life expectancy of the employee determined in accordance with (c)(3) of this A-5;or". This change would ensure that a designated beneficiary who happens to be older than the employee does not have a shorter distribution period than a beneficiary (e.g., trust or estate) that does not qualify as a designated beneficiary. This change also would be consistent with the measurement of the applicable distribution period determined in accordance with §1.401(a)(9)-5 Q&A-7(c)(2).

6. Role of IRA Trustee

Issue: For purposes of the RMD rules under §1.408-8, if the IRA trustee, custodian or issuer is treated as the plan administrator, will trustees be required to administer the RMD rules similar to plan administrators?

Recommendation: The Service should clarify that although the RMD calculation rules are applicable to both plan participants and IRA owners and beneficiaries, the responsibilities to administer the RMD rules differ for a plan administrator and an IRA trustee. §1.408-8 Q&A 1(b) states that for purposes of applying the RMD rules in §§1.401(a)(9) –1 through 1.401(a)(9)-8 for qualified plans, the IRA trustee, custodian or issuer is treated as the plan administrator. A trustee should not be defined as the plan administrator for purposes of section 401(a)(9). IRA owners may wrongfully believe that their plan administrator will direct their RMD to be distributed. The plan administrator for IRAs should be the individual who owns the IRA: either the IRA owner or, in the case of an inherited IRA, the beneficiary.

* * *

We appreciate the opportunity to comment on these Proposed Regulations. We would be happy to schedule a meeting to with you and other IRS representatives to discuss the suggestions contained in this letter. Please call me at (202) 218-3563 or Russ Galer at (202) 326-5835 if you have any comments or questions regarding our recommendations.

Sincerely,

Kathryn A. Ricard
Associate Counsel

cc: Mark Iwry, Treasury Department
Marjorie Hoffman, IRS
Bill Sweetnam, Treasury Department
Deborah Walker, Treasury Department

Appendix A

Appendix B

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,414 open-end investment companies ("mutual funds"), 489 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.937 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

[2] "Mutual Funds and the Retirement Market," ICI Fundamentals, Vol. 9, No. 2, May 2000.

[3] The term "trustee" is used throughout this letter to refer to both IRA trustees and custodians.

[4] The preamble to the Proposed Regulations states that "the trustee of each IRA would be required to report the amount of the required minimum distribution from the IRA to the IRA owner or beneficiary and to the IRS at the time and in the manner provided under IRS forms and instructions. This reporting would be required regardless of whether the IRA owner is planning to take the

required minimum distribution from that IRA or from another IRA, and would indicate that the IRA owner is permitted to take the required minimum distribution from any other IRA of the owner." The preamble also states that the Service seeks comments regarding the form, timing and effective date for reporting, and notes that it hopes to minimize the reporting burden for IRA trustees and provide adequate lead time to comply with this new reporting requirement, while providing the most useful information to IRA owners and beneficiaries.

[5] The Service also indicated that it was considering whether similar reporting would be appropriate for 403(b) contracts. We discuss below the limited ability of IRA trustees to report accurate RMD amounts for IRAs. For these same reasons, financial institutions would be unable to report accurate RMD amounts for their 403(b) contract holders. We therefore recommend that the Service not impose reporting requirements relating to RMD amounts for 403(b) contracts.

[6] Specifically, one would need to know (1) whether the IRA owner is married and has identified his or her spouse as the sole beneficiary of the IRA, (2) the age of the spouse (or the spouse's date of birth), and (3) whether the spouse satisfies the "entire year" rule. The Service, of course, could consider eliminating the special treatment accorded this class of spouses. Doing so, however, would not eliminate numerous other issues, identified below, that prevent IRA trustees from providing reliable RMD calculations.

[7] The Service, however, receives Form 5498s each year for all IRA owners, regardless of whether a contribution has been made in that year.

[8] Because IRA trustees do not currently have date of birth information for all of their IRA owners, we request that the Service provide a safe harbor from the reporting requirements for trustees to use after making "reasonable efforts" to obtain such information. The safe harbor could be utilized by IRA trustees, for instance, after completing 2 mailings to the IRA owner requesting date of birth information without success. As noted in example 2 in Appendix A, the Institute believes that its members have dates of birth of IRA owners on record for all but 2% to 15% of the IRA accounts that they trustee.

[9] Trustees, however, should not be required to report the dates of birth of IRA beneficiaries after the death of the IRA owner. As we discussed above, IRA trustees currently do not retain this data.

[10] We anticipate that the Service will develop a RMD calculator for its website. Trustees also will be developing RMD calculators to assist IRA owners in their calculation of RMD amounts. Alternatively, for those IRA owners who do not have access to the Internet, the IRA trustee could provide them with a paper-based worksheet or direct them to a RMD worksheet prepared by the IRS.

[11] Each IRA would need to be identified as belonging to either the husband or wife to conclude whether RMDs were required for that tax year.

[12] Alternatively, the Service could explore whether, given a social security number or TIN, it could access dates of birth from the Social Security Administration. The Treasury Department already interacts with the Social Security Administration to coordinate the deposit of FICA contributions.

[13] One problem with the Form 1040 approach, however, is timing. By the time taxpayers use the worksheet in Form 1040 to calculate the RMD amount, the general deadline for making RMDs – December 31 – will have passed. Taxpayers deferring their first RMD payment until April 1 of the following year may benefit from the Form 1040 approach. The Service might want to consider extending the December 31 deadline for RMDs to April 15 for all years.

[14] A third alternative would be to permit individuals in RMD status to use their current life expectancy during the transition year, but require them to use the method prescribed in the final regulations upon their effective date. This approach also would be unnecessarily complicated and confusing.

[15] "Amendment of Qualified Plans" Section of preamble to Proposed Regulations.

[16] Moreover, the Service should recognize that plan sponsors adopted the calculation methodology set forth in the 1987 Proposed Regulations merely to comply with those regulations. As the Service has recognized in its recently published guidance on forms of benefit distribution, plan features adopted to comply with regulations, in appropriate circumstances, may be eliminated without violating the anti-cutback rule.

[17] There is at least one situation where this is true: in the case of a participant's death after the required beginning date where the participant was receiving distributions over a joint life expectancy without recalculation of the participant's life expectancy. The old rules would allow the beneficiary to continue taking distributions over the joint life expectancy while the new rules would require the beneficiary to take distributions over the beneficiary's single life expectancy. This could result in a larger RMD under the Proposed Regulations than under the 1987 guidance.

[18] As noted in our discussion of potential reporting requirements, we believe the effective date of any new reporting requirement should be addressed separately, and should be a minimum of the later of the second year anniversary of publication of the final regulations and issuance of the appropriate IRS forms.

[19] See Issue A, Section II of this Comment Letter for an example.

[20] 1.401(a)(9)-4 Q&A 4 of the Proposed Regulations states that a designated beneficiary will be determined based on the beneficiaries designated on the last day of the calendar year following the calendar year of the employee's death. 1.408-8 Q&A 1 applies Q&A for purposes of determining an IRA owner's designated beneficiary.

[21] Such decisions might include whether to take immediately a distribution that represents their entire interests in the plan account or IRA or whether to disclaim their interests in the plan account or IRA.

[22] In Proposed Regulations Q&A 8, the Service requires IRA trustees to distribute a RMD prior to transferring the IRA account to another financial institution in circumstances where the IRA owner is aged 70 or older.

[23] The Service should also note that, as previously discussed, an IRA trustee transferring the IRA would not be able to calculate accurate RMD amounts to "hold back" from a transfer because the IRA owner already may have taken that year's RMD from a different IRA.

[24] We recommend that similarly, a non-spouse beneficiary be required to take only the RMD that the IRA owner would have been required to receive.
