INVESTMENT COMPANY INSTITUTE

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By Electronic Delivery

July 22, 2020

David Kautter
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Priority Guidance Plan Recommendations on Retirement Security Issues

Dear Mr. Kautter and Mr. Desmond:

The Investment Company Institute[1] is pleased to submit recommendations regarding retirement security issues for projects to be included on the 2020-2021 Priority Guidance Plan. A separate ICI submission will describe our recommendations regarding regulated investment companies.

I. Guidance Implementing Provisions of the SECURE Act

We request guidance relating to several changes to the Internal Revenue Code ("Code") enacted under the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act" or "Act"), which was included as Division O of the Further Consolidated Appropriations Act, 2020 (H.R. 1865).[2]

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$24.8 trillion in the United States, serving more than 100 million US shareholders, and US$6.5 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] In a letter to the Department of the Treasury ("Treasury") and Internal Revenue Service (IRS) dated January 23, 2020, we requested compliance relief and guidance urgently needed to implement certain provisions of the SECURE Act that generally became effective immediately or as of January 1, 2020. The letter is available at https://www.ici.org/pdf/32170a.pdf.

A. Modification of required distribution rules for designated beneficiaries (section 401 of the SECURE Act)

Section 401 of the Act modifies the required minimum distribution (RMD) rules for post-death distributions from defined contribution (DC) plans and IRAs to designated beneficiaries. It requires the participant's or IRA owner's account to be fully distributed within 10 years following the year of the participant's or IRA owner's death, unless the distribution is made to an "eligible designated beneficiary" (e.g., a surviving spouse, a disabled or chronically ill individual, an individual who is not more than ten years younger than the participant or IRA owner, or a child of the participant or IRA owner who has not reached the age of majority). Eligible designated beneficiaries can continue to "stretch" RMD payments over life expectancy.

The provision is generally effective for RMDs with respect to participants or IRA owners with a date of death after December 31, 2019, although there are special rules for certain situations and a delayed effective date for governmental and collectively bargained plans.

We previously requested that Treasury and the IRS provide expedited guidance addressing situations where a plan administrator or IRA provider inadvertently provides beneficiaries with outdated information regarding the applicable RMD rules.[3] Like many provisions in the SECURE Act, this provision became effective almost immediately, presenting implementation challenges to plan and IRA providers. In addition, section 401 raises numerous interpretive questions, for which ICI requests the following guidance:

- Confirmation that eligible designated beneficiaries may elect the 10-year payout rule instead of life expectancy distributions;
- Confirmation that the "at least as rapidly" rule no longer applies for any designated beneficiary;
- Guidance concerning the status of "look-through" or "conduit trusts," including multi-beneficiary trusts that benefit a combination of beneficiaries who would otherwise qualify as designated beneficiaries and/or eligible designated beneficiaries;
- Guidance on the implications of the special rule provided for "applicable multi-beneficiary trusts" benefitting disabled or chronically-ill individuals, including any documentation requirements;
- Guidance regarding any documentation requirements with respect to eligible designated beneficiaries who are disabled or chronically ill (and there is no conduit trust). We urge guidance allowing providers to rely on a beneficiary's representation that he or she satisfies the definition of disabled or chronically ill. Any required documentation by the beneficiary should be provided to the IRS.

[3] Letter to Treasury and IRS, dated January 23, 2020, available at https://www.ici.org/pdf/32170a.pdf.

- Guidance relating to other multi-beneficiary scenarios (where there is no conduit trust). Where multiple beneficiaries (who would qualify as designated beneficiaries and/or eligible designated beneficiaries) are designated and such beneficiaries do not create separate accounts by the applicable deadline, questions arise similar to the multi-beneficiary trust scenarios. For example, if the oldest designated beneficiary is an eligible designated beneficiary, would the RMD be calculated based on that beneficiary's life expectancy? In this case, what are the implications if not all of the multiple designated beneficiaries are eligible designated beneficiaries? What rules apply when the oldest eligible designated beneficiary dies?
- Additional clarification of rules applicable to successor beneficiaries;
- Guidance providing a standardized definition of age of majority; and
- Clarification of whether non-governmental 457(b) plans are covered by the 10-year payout rule.

We note that, in the absence of guidance, inadvertent errors in applying the new post-death RMD rules could have far-reaching implications for plans and beneficiaries. It is imperative that Treasury and the IRS provide transition relief for reasonable, good faith interpretation of the SECURE Act changes.

B. Penalty-free withdrawals from retirement plans for individuals in case of birth of child or adoption (section 113 of the SECURE Act)

Section 113 of the Act adds a new exception from the 10 percent early distribution penalty under Code section 72(t)(2) for qualified withdrawals from a DC plan or IRA for the birth or adoption of a child. Under the new exception:

- Qualified withdrawals are limited to $5,000 in the aggregate across an individual's accounts with respect to a birth or adoption.
- The withdrawal must be made within one year after the birth or adoption date.
- The distribution may be recontributed to an eligible retirement plan or IRA, subject to certain limitations, and is treated as a rollover.

The provision applies to distributions made after December 31, 2019.

We previously requested that Treasury and the IRS provide expedited guidance addressing some of the more time sensitive questions arising under this provision.[4] These questions relate to application of the dollar limitation in the case of multiple births or adoptions occurring at the same time; whether any time limit for repayment of distributions will apply; and whether the new distribution opportunity is permissive or mandatory in terms of plan design, among others. Guidance on these issues is imperative for providers implementing system changes.

[4] Letter to Treasury and IRS, dated January 23, 2020, available at https://www.ici.org/pdf/32170a.pdf.

Treasury should confirm that this provision creates a new in-service distributable event for plans (in addition to a new exception from the early distribution penalty). If the provision does create a new distributable event (i.e., a participant may take a qualified birth or adoption distribution even if not otherwise eligible for a distribution under the plan), it would be helpful for Treasury to provide:

- Confirmation that the new in-service distribution option is optional for a plan;
- Guidance on whether the distribution option is a protected benefit under Code section 411(d)(6);
- Guidance for plan administrators on applicable tax treatment in situations where a participant is eligible for both a qualified birth or adoption distribution and another distribution (such as a hardship distribution or a distribution upon severance from employment); and
- Confirmation that a plan administrator may rely on participant representations that the participant meets the requirements of a qualified birth or adoption distribution, without providing any "source" documents such as a birth certificate (e.g., it would be sufficient for the participant to state that a birth or adoption has occurred and that the participant will provide the child's name, TIN, and other required information on his or her tax return).

In addition, detailed guidance is needed with respect to repayment of qualified birth or adoption distributions, including whether a time limit for making repayments will apply; confirmation that a plan is not required to accept repayment of such distributions (even if it accepts other rollovers); clarification on whether and how repayments must be tracked by the plan; and guidance on any circumstances where repayments include after-tax basis.

While guidance on these questions is needed as soon as possible, another immediate concern facing plan administrators and IRA providers is the likelihood that distributions in the coming months intended to be qualified birth or adoption distributions will be treated incorrectly until systems are updated to apply the correct tax treatment. In particular, a service provider may report and withhold income taxes from the distribution in compliance with prior law and provide the special tax notice otherwise required under Code section 402(f). For this reason, absent detailed implementing guidance, relief is needed for incidental non-compliance in the short term and for good faith compliance efforts. As explained earlier, it would be impractical for providers to make systems changes without answers to the questions outlined above.

C. <u>Multiple employer plans; pooled employer plans (section 101 of the SECURE Act)</u>

In connection with the creation of pooled employer plans (PEPs) (a new type of multiple employer plan (MEP) for otherwise unrelated employers), section 101 of the Act amends Code section 413 to allow PEPs (and MEPs adopted by groups of related employers) to continue to be treated as satisfying the tax qualification requirements despite the violation of certain requirements with respect to one or more participating employers. In the case of a violation of the tax qualification requirements by a participating employer, the Act allows the plan to spin off the portion of the plan's assets attributable to

that participating employer, into a separate plan maintained by that employer. The provision applies to plan years beginning after December 31, 2020.

Prior to enactment of the SECURE Act, Treasury and IRS proposed changes to the regulations under the "unified plan" rule that would similarly provide a process for dealing with violations of qualification requirements by one or more participating employers in a defined contribution MEP, without jeopardizing the tax-qualified status of the entire MEP. The proposal would provide an exception to the application of the unified plan rule in certain circumstances where a participating employer in a MEP fails to satisfy a tax qualification requirement or fails to provide information necessary to determine compliance with a tax qualification requirement, if the plan administrator follows prescribed procedures for addressing the non-compliant employer. We previously expressed support for the proposal, recommending certain changes intended to streamline and simplify the requirements for addressing non-compliant employers.[5]

We urge Treasury and the IRS to simply the unified plan rule proposal as recommended and update it to reflect and incorporate the SECURE Act changes to Code section 413. It should be possible to reflect the SECURE Act requirements without significant substantive changes to the proposal.

Section 101 also requires providers of PEPs (known as "pooled plan providers") to register with the Treasury and Labor Departments and provide any information that the agencies may require. We urge Treasury to work with the Department of Labor (DOL) to implement simple and reasonable registration requirements and provide other necessary guidance to allow for PEP formation beginning in 2021.

D. Treatment of custodial accounts on termination of section 403(b) plans (section 110 of the SECURE Act)

Section 110 of the Act directs Treasury to issue guidance providing that, if an employer terminates the plan under which amounts are contributed to a custodial account under Code section 403(b)(7), the plan administrator or custodian may distribute an individual custodial account in kind to a participant or beneficiary of the plan and the distributed custodial account shall be maintained by the custodian on a tax-deferred basis as a section 403(b)(7) custodial account, similar to the treatment of fully-paid individual annuity contracts under Revenue Ruling 2011–7, until amounts are actually paid to the participant or beneficiary. The guidance shall be retroactively effective for taxable years beginning after December 31, 2008.

We appreciated the opportunity to share input on implementing this provision during a telephone meeting held on March 24, 2020, with representatives from Treasury and the IRS. In follow-up to that

[5] Letter to IRS, dated October 1, 2019, available at https://www.ici.org/pdf/31990a.pdf.

meeting, we submitted a letter[6] to Treasury reiterating several points relating to the in-kind distribution of custodial accounts, an option long-supported by ICI which will be extremely helpful to participants and beneficiaries in terminating 403(b) plans. Our key points from that letter include the following:

1. Guidance should be simple. We recommend following the approach used in Revenue Ruling 2011-7 (particularly Situations 1 and 2) which describes circumstances in which plan termination distributions are effectuated by distributing fully-paid individual insurance annuities (or issuing individual certificates under a group annuity contract) to all participants and beneficiaries.

2. Guidance should be permissive. We recommend that the in-kind distribution of custodial accounts should be one tool among many to choose from when terminating a 403(b) plan. In other words, it should be up to the employer (or vendor if the employer no longer exists) to determine whether to employ in-kind distribution of custodial accounts as part of a plan termination.

3. Guidance should be flexible in terms of the mechanics of distribution and application to different situations (including application to plans funded through group custodial accounts). The mechanics of effectuating an in-kind distribution of a custodial account could vary from firm to firm and the guidance should not specify one particular method.

4. Guidance should not create adverse inferences with respect to years prior to 2009. We recommend that the guidance should be presented in a way that does not create adverse inferences for plan terminations occurring prior to the effective date of the guidance.

The letter also outlines several additional issues that guidance could address, including providing additional clarity around the tax treatment of such an in-kind distribution (*e.g.*, that the in-kind distribution of an individual custodial account is not reportable on Form 1099-R, is not a distribution requiring a 402(f) notice, and does not require withholding) and other questions relating to the termination of a 403(b) plan.

E. Combined annual report for group of plans (section 202 of the SECURE Act)

Section 202 of the Act directs the IRS and DOL to work together to modify Form 5500, Annual Return/Report of Employee Benefit Plan, so that all members of a group of DC plans meeting certain requirements (including having the same trustee, named fiduciary, and plan administrator) may file a single consolidated Form 5500. The consolidated Form 5500 must be implemented not later than January 1, 2022, and shall be effective for returns and reports for plan years beginning after December 31, 2021.

[6] Letter to William Evans, US Department of the Treasury, from Elena Barone Chism (ICI) and Martin L. Pippins (American Retirement Association), dated May 18, 2020, available at https://www.ici.org/pdf/32467a.pdf.

Consolidated reporting will be an effective way to increase efficiency and reduce costs for plans, and we urge the IRS to work expeditiously with DOL to implement the necessary changes to the Form 5500 in time for the 2022 plan year.

F. Qualified cash or deferred arrangements must allow long-term employees working more than 500 but less than 1,000 hours per year to participate (section 112 of the SECURE Act)

Section 112 of the Act requires 401(k) plans (except for collectively-bargained plans) to permit participation by workers who complete at least three consecutive years of service with at least 500 hours of service each year. Such workers would not need to be included in testing for nondiscrimination and coverage requirements or application of the top-heavy rules. The provision applies to plan years beginning after December 31, 2020, except that for determining whether the three consecutive year period has been met, 12-month periods beginning before January 1, 2021 will not be taken into account.

We request guidance confirming whether plans that voluntarily apply this provision earlier than required (i.e., by counting years before 2021 in the three-consecutive-year period), may take advantage of the testing and top-heavy relief.

G. Increase in 10 percent cap for automatic enrollment safe harbor after first plan year (section 102 of the SECURE Act)

Section 102 of the Act increases the cap on automatic contribution rates for plans using the automatic enrollment safe harbor under Code section 401(k)(13)(C)(iii), from 10 percent to 15 percent (after the first year of enrollment). The provision applies to plan years beginning after December 31, 2019.

While this change is generally straightforward, there are immediate concerns for a safe harbor plan that incorporates the cap by reference to Code section 401(k)(13) in its plan document. We request that Treasury and the IRS provide relief stating that a plan will not be disqualified or treated as noncompliant with the safe harbor if it changes its deferral rates operationally by the end of 2020 to reflect the increased cap.

Finally, it would be helpful to confirm that a plan using the safe harbor under Code section 401(k)(13) may cap automatic contribution rates at a rate less than 15 percent (but no lower than the applicable rate schedule set forth in section 401(k)(13)(C)(iii)).

H. Guidance for IRA providers

We request that the IRS update the various model documents for IRAs and IRA-based plans, including the Form 5305 series for traditional IRAs, Roth IRAs, SEP IRAs, SIMPLE IRAs, and the Form 5304-SIMPLE, to reflect SECURE Act changes, such as the increased age for beginning RMDs. Similarly, updated Listing of Required Modifications (LRMs) for prototype IRA documents are needed. Many of the LRMs have not been updated for several years.

Finally, we request confirmation that no amendments are required for IRA documents in the absence of updated Forms and LRMs (or other specific guidance).

II. Other Guidance for 2020-2021 Priority Guidance Plan

ICI requests that Treasury and IRS include the following additional retirement security matters on the 2020-2021 Priority Guidance Plan. We have recommended these items in previous letters regarding the Priority Guidance Plan.

A. Regulations under Code section 411(a)(11)

We request that Treasury and IRS finalize the proposed regulations implementing section 1102 of the Pension Protection Act, which instructed Treasury to modify the regulations under Code section 411(a)(11) to require disclosure of the consequences of failing to defer receipt of a distribution from a DC plan.[7] We strongly recommend that you finalize the requirements as proposed. As we stated in our comment letter,[8] the proposal strikes the right balance by alerting the participant that the plan may have investments, or fee structures, different from those obtainable in an IRA, and alerting the participant that more information is available. This approach will not overwhelm the participant with information that obscures the key information while also assuring the participant has access to information consequential to the decision whether to take or defer a distribution from the plan.

B. Modifications to EPCRS

The 2019-2020 Priority Guidance Plan includes guidance relating to certain IRS, Tax Exempt and Government Entities, Employee Plans programs, including the Pre-approved Plan Program, the Determination Letter Program, and the Employee Plans Compliance Resolution System (EPCRS). The most recent update to EPCRS, published in Revenue Procedure 2019-19, included helpful changes to expand the self-correction program, particularly with respect to plan loan errors. We urge the IRS to continue making helpful changes to EPCRS, including expanding the availability of EPCRS in general and self-correction methods in particular. For example, we suggest that the IRS:

- Allow self-correction, without an excise tax, of an inadvertently-missed required minimum distribution payment that is made within 180 days after the distribution was required to be made from the plan;
- Provide the same comprehensive program of correction for governmental 457(b) plans; and
- Expand EPCRS to allow custodians of IRAs to address inadvertent errors for which the individual owner was not at fault. Situations would include waiver of the excise tax for failure to make required minimum distributions where the distribution is corrected as described above

[7] 73 Fed. Reg. 59575 (Oct. 9, 2008).

[8] *See* ICI letter to Internal Revenue Service re: proposed regulation (REG-107318-08), dated January 7, 2009.

for plans; and inadvertent rollovers, such as a rollover by a nonspouse beneficiary from an inherited IRA where the beneficiary had reason to believe that the distribution could be rolled over, or a rollover from a non-governmental 457 plan.

C. Additional guidance clarifying the application of the one-per-year limit on IRA rollovers

Pursuant to an item on the second quarter update to the 2014-2015 Priority Guidance Plan, the IRS issued Announcement 2014-32 which clarifies the impact a 2014 IRA rollover has on the one-rollover-per-year limitation contained in Code section 408(d)(3)(B). Announcement 2014-32 and previously issued Announcement 2014-15 were issued in response to *Bobrow v. Commissioner*,[9] a January 2014 Tax Court opinion which held that the one-rollover-per-year limitation applies on an aggregated basis to all of a taxpayer's IRAs and not to each IRA separately. While Announcement 2014-32 addressed certain issues relating to the section 408(d)(3)(B) one-per-year-limitation on IRA rollovers, as is further discussed below, we request additional guidance permitting waivers of inadvertent violations of the one-per-year-limit on IRA rollovers in circumstances where the inadvertent violations are beyond the control of the IRA holder. For example, as discussed below, such inadvertent violations may arise as a result of trailing dividends or in circumstances where the IRA holder has not taken an affirmative action to initiate a distribution.

With respect to trailing dividends, in circumstances where an IRA holder initiates an indirect rollover after the dividend record date, but prior to the dividend payment date, the dividend payment will likely be issued directly to the IRA holder as a subsequent payment. In a circumstance where the IRA holder effectuates a rollover to another IRA within the 60-day period required by section 408(d)(3)(a)(i), an attempt to roll the trailing dividend payment into the new IRA may be seen as violating section 408(d)(3)(B)'s one-per-year-limitation on IRA rollovers.

Another example involves circumstances where the decision to initiate a distribution is due to circumstances beyond the control of the IRA holder. Such a situation may occur, for example, where an investment product undergoes a structural change (such as a reorganization, merger, or closure) and as a result of the structural change, the IRA holder's investment in the investment product is liquidated and payment issued directly to the IRA holder. In the event that payment is issued to the IRA holder during a 12-month period in which he or she has previously made an indirect rollover, he or she will be precluded from making another indirect rollover with the funds received as a result of the investment product structural change.

Similarly, a distribution to the IRA holder may be reported under the circumstances described in Revenue Ruling 2018-17,[10] where assets in a traditional IRA are paid to a state unclaimed property

[9] T.C. Memo. 2014-21 (January 28, 2014).

[10] Revenue Ruling 2018-17 provides that, under the facts and circumstances described, an IRA trustee who pays amounts from a traditional IRA to a state unclaimed property fund must report the payment on Form 1099-R and withhold federal income tax (unless the taxpayer made a withholding election).

fund. If such assets are later recovered by the IRA owner, the one-rollover-per-year limitation could prevent the individual from returning the funds to an IRA.[11]

In light of these possible situations, it may be appropriate for the IRS to have a process for waiving inadvertent violations of the one-per-year limit on IRA rollovers, similar to the waiver process contained in Code section 408(d)(3)(I) for violations of the 60-day rule for indirect rollovers.

* * *

If we can provide you with any additional information regarding these issues, please do not hesitate to contact David Abbey at 202/326-5920 (david.abbey@ici.org) or Elena Chism at 202/326-5821 (elena.chism@ici.org).

Sincerely,

/s/ David Abbey

David Abbey
Deputy General Counsel – Retirement Policy

/s/ Elena Barone Chism

Elena Barone Chism
Associate General Counsel – Retirement Policy

cc: Carol Weiser, Benefits Tax Counsel

[11] Other outstanding issues related to Revenue Ruling 2018-17 include (1) a taxpayer's ability to make a late rollover of funds attributable to an escheated IRA, and (2) the lack of an applicable distribution code for box 7 of Form 1099-R to indicate that the distribution was made to a state unclaimed property fund.