By Email

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RE: Required Minimum Distributions from 403(b) Annuities and Custodial Accounts

Dear David, Stephen, and Carol:

On behalf of the **American Benefits Council, the American Council of Life Insurers, the American Retirement Association, the Investment Company Institute, and the SPARK Institute**, we are writing to request clarification regarding the application of the required minimum distribution (RMD) rules to 403(b) annuities and custodial accounts. The issue described in this letter has arisen, unfortunately, from some otherwise very helpful guidance regarding missing participants. Nonetheless, it has created confusion regarding the application of the RMD rules.

A February 23, 2018 memorandum for Employee Plans (EP) examination employees addresses missing participants and beneficiaries in 403(b) plans.[1] The memorandum directs EP examiners not to challenge a 403(b) contract for violation of the RMD standards for "the failure to commence or make a distribution to a participant or beneficiary to whom a payment is due, if the plan has taken" certain steps outlined in the memorandum. This February memorandum is nearly identical to a similar memorandum issued on October 19, 2017 for qualified plans under section 401(a).[2] These memorandums were both welcomed by the retirement plan community because they provide EP examiners, and therefore plans, a set of appropriate steps to take to locate missing participants and beneficiaries.

[1] TE/GE-04-0218-0011.

[2] TE/GE-04-1017-0033.

Unfortunately, the February 2018 memorandum related to 403(b) plans could be read as inconsistent with the Code and the 403(b) regulations, because it follows the October 19, 2017 memorandum for qualified plans nearly word for word. We think this was unintended and we ask the Service to clarify.

Background. Code section 403(b)(10) states that, under regulations issued by the Secretary, section 403(b) annuities and custodial accounts must meet requirements similar to the requirements of Code section 401(a)(9). These regulations state:

> "*Treatment as IRAs*.—For purposes of applying the distribution rules of section 401(a)(9) to section 403(b) contracts, the minimum distribution rules applicable to individual retirement annuities described in section 408(b) and individual retirement accounts described in section 408(a) apply to section 403(b) contracts. Consequently, except as otherwise provided in this paragraph (e), the distribution rules in section 401(a)(9) are applied to section 403(b) contracts in accordance with the provisions in §1.408-8 for purposes of determining required minimum distributions."[3]

The referenced IRA regulations state that the required minimum distribution must be calculated separately for each IRA; the separately calculated amounts are totaled and the required distribution taken from any one or more of the individual's IRAs.[4] Thus, the same is true for section 403(b) annuities and custodial accounts: the total RMD due is based on the aggregation of all 403(b) annuities and custodial accounts held by an individual but the required distribution may be taken from any one (or more) 403(b) annuity or custodial account.[5]

In accordance with the regulations, section 403(b) annuities and custodial accounts are administered like IRAs and not like qualified plans: the issuer of the annuity or the custodian informs the participant or beneficiary that an RMD is due but does not *force* the RMD to be taken from any particular annuity or custodial account.[6]

Legal issue. The February 2018 memorandum, while focusing on missing participants, could be read to contradict the regulations, which we do not believe was intended. For example, while the memorandum correctly points out that the "[Treas.] Reg. § 1.403(b)-6(e) provides that a 403(b) plan must meet the minimum distribution requirements of IRC § 401(a)(9) (in both form and operation)" it does not also quote the next subsection, which we quoted above, regarding treatment as an IRA. In addition, in referring to missing participants, it states that if "a 403(b) plan has not completed the steps above, EP examiners may challenge a 403(b) plan for

[3] Treas. Reg. § 1.403(b)-6(e)(2).

[4] Treas. Reg. § 1.408-8, Q&A-9.

[5] Treas. Reg. § 1.403(b)-6(e)(7); see also I.R.M. 4.72.13.15.2, § (7)(a) (Aug. 11, 2017).

[6] The Sample Plan Language for 403(b) plans similarly confirms that "each Investment Arrangement is treated as an individual retirement account (IRA) and distributions shall be made in accordance with the provisions of section 1.408-8 of the Treasury Regulations, except as provided in section 1.403(b)-6(e) of the Treasury Regulations." See Model Provision #41 in Sample Plan Provisions and Information Package (Revised March 2015).

violation of the RMD standards for the failure to commence or make a distribution to a participant or beneficiary to whom a payment is due."[7]

We have two concerns with the discussion in the memorandum. First, as stated above, it fails to recognize that 403(b) annuities and custodial accounts are to be treated as IRAs, not as qualified plans, for purposes of the RMD rules. Second, it implies that the entire *plan* may be challenged for a failure of a participant or beneficiary to distribute an RMD. This is not correct: the regulations are clear that an operational failure only affects the contracts issued by the employer to the employee or employees with respect to whom the operational failure occurred and does not adversely affect any other contract.[8]

We understand that IRS auditors have already begun relying on the memorandum in their audits. To the extent this is helpful in addressing missing participant issues in an effective manner, we applaud reliance on the helpful memorandum. We are concerned, however, that without clarification, IRS auditors will assert positions inconsistent with the regulations.

Recommendation. We recommend that the Service issue clarifying guidance that the discussion in the February 2018 memorandum is not intended to override the rule that 403(b) contracts and annuities are to be treated as IRAs for purposes of the RMD rules. At a minimum, this clarification should be included when the Internal Revenue Manual is updated. Because the memorandum states that an update of the Internal Revenue Manual may not happen until 2020, however, written clarification in a form at least as prominent as the February 2018 memorandum is needed sooner. Plan sponsors of both qualified plans and 403(b) plans are being placed under significant pressure by the Department of Labor, state unclaimed property departments, and other regulators regarding missing participants and RMDs. Confusion over legal requirements will create significant problems.

In addition, since annuity issuers and custodians administer 403(b) contracts as IRAs, a new legal regime would require major systems changes, document amendments, and likely filings with state regulators. That said, we do not believe the Service intended a change in the law, as the whole purpose of the memorandums was to provide helpful guidelines for EP examiners and, indirectly, plan administrators.

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We applaud the work the Service and Treasury have given recently to the issue of missing participants. The undersigned organizations look forward to continuing to work with you to make this guidance more effective. Thank you for your attention to this issue. We will follow up with a meeting request to discuss our recommendations.

American Benefits Council
American Council of Life Insurers

[7] This language is word for word the same as the language in the October 2007 memorandum for qualified plans, other than adding "403(b)" before "plan."

[8] Treas. Reg. § 1.403(b)-3(d)(1)(ii). There are certain exceptions, not relevant here.

American Retirement Association
Investment Company Institute
SPARK Institute

cc: Lou Leslie, Employee Plans
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