AMERICAN BENEFITS COUNCIL

Testimony of Robert A. Holcomb
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On Behalf of
The American Benefits Council

Before the
U.S. Department of the Treasury
And the
Internal Revenue Service

New Carrollton Federal Building
Lanham, Maryland
July 26, 2006

Good morning and thank you for the opportunity to appear today. I am Bob Holcomb, and I am the Vice President, Legislative and Industry Affairs for JP Morgan Retirement Plan Services. JPMorgan Retirement Plan Services provides full service retirement plan solutions to over 200 plan sponsors and over 1.2 million participants.

I am here representing the American Benefits Council, a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to employee benefit plans covering more than 100 million Americans. I serve on the Council's Board of Directors.

I would like to start by commending you for taking the first steps to address the legal and regulatory issues raised by the Roth 401(k)/403(b) that, as you know, was newly created in the Economic Growth and Tax Relief Reconciliation Act of 2001 (or EGTRRA). Many plan sponsors have or are considering adding designated Roth contributions to their plans, and much of the guidance you have provided has been very useful. However, there are some areas where additional clarification and/or a change in direction would be extremely helpful in the successful implementation of these arrangements.

At the onset, I note that the guidance reserves for future regulation a description of what would happen to previous designated contributions if Congress fails to make these arrangements permanent. My testimony does not focus on this issue because the Council hopes that Congress will shortly make this a moot point by making the retirement savings provisions of EGTRRA permanent in the pension reform bill currently being negotiated. However, if that does not happen, we strongly urge you to provide guidance in this area since, in many cases, the lack of guidance on the sunset issue may be the deciding factor for employers deciding not to implement these arrangements.

My testimony today will focus on particular issues in the following areas: (1) separate account issues (particularly with respect to automatic rollovers), (2) hardship distributions, (3) loans, (4) the five-year holding period, and (5) reporting requirements. In the interest of time, I cannot possibly address all of the issues raised in the Council's comment letter which was filed on April 26, many of which are also important issues. I encourage you to consider those written comments as you finalize your regulations.

Separate Account Issues

There are a number of practical issues raised by the separate account treatment for the designated Roth contributions and the Council's letter seeks clarification

on a number of issues. However, I would like to concentrate today on an especially troubling one – the treatment of the designated Roth contribution account in automatic rollovers. The regulation states that for purposes of the automatic rollover rules, which requires that amounts cashed out in excess of $1,000 be rolled into an IRA, the $1,000 limit for cash distributions cannot be applied separately to each portion of the account so that, for example, a distribution consisting of $800 attributable to pre-tax contributions and $250 attributable to designated Roth contributions must be rolled over separately into two IRAs.

This rule should be revised to allow separate treatment for the two amounts so that plan sponsors are not forced to try to find IRA institutions willing to take low-balance accounts. Finding IRA providers willing to accept IRA rollovers between $1,000 and $5,000 has proven challenging for many plan sponsors. Finding IRA providers for even smaller amounts would be even more difficult. This particular rule alone is a significant administrative burden which will preclude some plan sponsors from adopting designated Roth contributions.

Hardship Distributions

The proposed guidance has indicated that plans must separately determine the amount of elective deferrals available for hardship and the amount of designated Roth contributions for tax purposes because the limit on hardship distributions does not include earnings on employee contributions but a distribution from a Roth account must include a pro-rata portion of the earnings for tax purposes. This will cause an administrative nightmare unless modifications are made in the proposed treatment. Some plan administrators believe it is necessary to track pre-tax contributions available for hardship separately from Roth 401(k) contributions available for hardship and then debit each type of contribution separately at the time of the request because of the separate accounting treatment. Others believe that the tracking of the amount available for hardship is done across both types of contributions. This portion of the guidance has probably led to the most confusion (and disagreement) among plan administrators and recordkeepers, and significant clarification is needed.

The Council believes the calculation of the hardship distribution limit should be matched up with the amounts actually distributed by prohibiting distribution of earnings for a hardship. Although this would result in a tax-free distribution from the Roth portion, this tax treatment would be no different from the tax treatment the participant would have if the distribution (not exceeding basis) is taken from a Roth IRA

Loans

The separate account requirement also raises administrative questions in the area of participant loans. The regulations clearly indicate that the amortization requirements for loans apply separately to the Roth portion. However, it is not clear how far this "separate" treatment should be taken. Issues include whether Roth loans need separate loan agreements, promissory notes, Truth-in-Lending notices, checks and amortization schedules. Clarification is also needed on payment allocations.

Five-year Holding Period

The proposed regulations indicate that the five-taxable-year holding period (which is used to help determine whether a tax-free distribution can be made) does not start over if a participant receives a distribution and then subsequently makes additional Roth contributions. It is not clear whether this is an absolute rule and examples would help clarify the issue. For example, a participant may terminate employment, receive a full distribution of the Roth account, and be subsequently rehired 10 or 20 years later. Or a participant may have an account that is zeroed out because of excess deferrals, excess contributions or excess annual additions. Do those distributions count for purposes of starting the clock? How long does the employer have to keep track of the clock?

Examples would also be helpful in determining when the five-year holding period begins for unusual circumstances such as retroactive contributions under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), or an indirect rollover to an employer plan with an already established Roth account for that participant.

Reporting Requirements

The proposed regulations require the distributing plan to report to the recipient plan the amount of contributions or basis in the Roth account as well as the first year of the five-taxable year period (or that the distribution is a qualified distribution). The Council believes the total amount of the distribution should be reported as well. If a participant takes a $10,000 nonqualified distribution which consists of $7,000 basis and $3,000 earnings but elects a direct rollover of only $3,000, the recipient plan will not have sufficient information to determine what percentage of the $3,000 should be considered earnings. Under the proposed regulation, the plan will only receive a report that the basis was $7,000 and the first year of the five-year period.

Clarification is also needed to indicate the actions that should be taken if the recipient plan does not receive the report, and who is responsible for providing the report, including whether any penalties will apply for failing to provide it. If multiple parties are involved (such as a change in recordkeepers in connection with a corporate transaction), it may not be clear who has the primary responsibility for reporting.

For reporting the Roth distribution, it is very important that 1099-R reporting requirements and revised 1099-R forms be published as soon as possible and that Treasury permit good faith compliance for distributions made during 2006. Service providers routinely use automated computer systems that key the reporting requirement at the time of a distribution request. Although the proposed rule indicates a separate 1099-R will be issued for Roth distributions, issues remain such as whether the separate 1099-R can include all after-tax distributions or only the Roth.

Again, thank you for the opportunity to testify today. Although time did not permit us to discuss other important issues such as the distribution of employer stock and rollovers to other plans, these issues and others were addressed in the Council's comment letter of April 26. I welcome any questions you may have.