

Request for Comments Regarding Protection of Annuity and Spousal Rights Under Section 205 of ERISA with Respect to a Terminating § 403(b) Plan Funded Through the Use of Custodial Accounts

Notice 2020-80

PURPOSE

This notice requests comments on the application of the annuity and spousal rights provisions of section 205 of the Employee Retirement Income Security Act of 1974, P.L. 93-406, 88 Stat. 829, as amended (ERISA), in connection with a distribution of an individual custodial account (ICA) in kind from a terminating § 403(b) plan. Although no § 403(b) plans are subject to the annuity and spousal rights provisions of §§ 401(a)(11) and 417 of the Internal Revenue Code (Code), some § 403(b) plans that are subject to ERISA (such as a plan of a non-church tax-exempt employer that provides for matching contributions) are subject to the parallel annuity and spousal rights provisions of section 205 of ERISA.¹ Revenue Ruling 2020-23, 2020-47 I.R.B., issued contemporaneously with this notice, provides guidance regarding termination of a § 403(b) plan that is funded through the use of § 403(b)(7) custodial accounts and distribution of an ICA in kind to a participant or beneficiary of the plan. The revenue ruling does not, however, address the application of the annuity and spousal rights provisions under section 205 of ERISA in connection with a distribution of an ICA in kind as part of a plan termination.

BACKGROUND

Treas. Reg. § 1.403(b)-10(a) provides that a § 403(b) plan may be terminated and establishes requirements for the plan termination. One of the requirements for a plan termination is that "all accumulated benefits under the plan must be distributed to all participants and beneficiaries as soon as administratively practicable after termination of the plan."

¹ The Internal Revenue Service (IRS) has interpretive authority over section 205 of ERISA pursuant to the Reorganization Plan No. 4 of 1978, 5 U.S.C. App.

Rev. Rul. 2011-7, 2011-10 I.R.B. 534, provides, in relevant part, that a plan may be terminated in accordance with the rules of § 1.403(b)-10(a) by delivery to participants and beneficiaries of a fully paid individual annuity contract or an individual certificate evidencing fully paid benefits under a group annuity contract, as further described in the ruling.

Section 110 of Division O of the Further Consolidated Appropriations Act, 2020, P.L. 116-94 , 133 Stat. 2534 (2019), known as the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), directs that guidance be issued providing that, if an employer terminates a plan under which amounts are contributed to a custodial account under § 403(b)(7), the plan administrator or custodian may distribute an ICA in kind to a participant or beneficiary of the plan. It also provides that the distributed ICA shall be maintained by the custodian on a tax-deferred basis as a § 403(b)(7) custodial account, similar to the treatment of fully paid individual annuity contracts under Rev. Rul. 2011-7, until amounts are actually paid to the participant or beneficiary.

Rev. Rul. 2020-23 provides that a plan is terminated in accordance with the rules of § 1.403(b)-10(a) in situations that involve the distribution of an ICA in kind. The revenue ruling further provides that a distribution of an ICA in kind to a participant or beneficiary is not includible in gross income until amounts are actually paid to the participant or beneficiary from the ICA, so long as the ICA maintains its status as a § 403(b)(7) custodial account. The revenue ruling explicitly does not, however, address a situation in which annuity and spousal rights under section 205 of ERISA apply.

Section 205(a) of ERISA generally provides that a distribution must be provided either as a qualified joint and survivor annuity (QJSA) in the case of a participant who does not die before the annuity starting date,² or as a qualified preretirement survivor annuity (QPSA) in the case of a participant who dies before the annuity starting date. However, section 205(b)(1)(C) of ERISA provides that section 205 of ERISA does not

² In general, for a married participant, a QJSA is an annuity for the life of the participant with a survivor annuity for the life of the spouse that meets certain requirements, and the participant's election to waive the QJSA cannot take effect unless the participant's spouse consents to the election. ERISA § 205(c)(2) and (d)(1). For an unmarried participant, the QJSA is an annuity for the life of the participant, and a single life annuity must be provided unless the participant elects another form of benefit. § 1.401(a)-20, Q&A-25(a).

apply to a participant under a plan that is not a defined benefit plan or money purchase pension plan if (i) a full death benefit is provided to the surviving spouse, (ii) no participant election of a distribution in the form of a life annuity is made (and a life annuity is not the normal form of benefit), and (iii) no part of the distribution is the result of a transfer from a defined benefit plan or a money purchase pension plan (this is sometimes called the “profit-sharing exception” or the “profit-sharing safe harbor”). Section 205(c) of ERISA provides that a participant may elect to waive the QJSA or QPSA form of benefit, but spousal consent is needed for a waiver by a married participant.

REQUEST FOR COMMENTS

For a § 403(b) plan that does not have a participant to whom the annuity and spousal rights provisions of section 205 of ERISA apply, Rev. Rul. 2020-23 provides guidance allowing the distribution of an ICA in kind as part of the termination of the plan. However, issues remain regarding the application of section 205 of ERISA in connection with a distribution of an ICA in kind under section 110 of the SECURE Act for a § 403(b) plan with at least one participant to whom section 205 of ERISA applies, including if a participant cannot be reached, a participant does not elect to waive the QJSA and QPSA form of benefit, or a married participant elects to waive the QJSA and QPSA form of benefit but the participant’s spouse does not consent to the waiver.

The Department of the Treasury (Treasury Department) and the IRS request comments on the application of ERISA section 205 annuity and spousal rights provisions in connection with a distribution in kind of an ICA under section 110 of the SECURE Act, including any administrative or other burdens that may arise and potential methods or rules that could minimize or eliminate those burdens.

The Treasury Department and the IRS are particularly interested in--

- Information on current practices and arrangements (including sample language from custodial account agreements and § 403(b) plan documents, if relevant) that may affect the termination of § 403(b) plans that are funded through § 403(b)(7) custodial accounts and that are subject to section 205 of ERISA;

- Views regarding the administrability of alternative dates (which continue to be evaluated by the Treasury Department and the IRS for consistency with applicable law) for when rights under section 205 of ERISA might be required to be protected, for example, at the time of the termination of a § 403(b) plan (by obtaining the participant's waiver and the spouse's consent, pursuant to section 205(c) of ERISA, to a distribution in kind of an ICA), or at the time payments are made from the ICA (analogous to § 1.401(a)-20, Q&A-2, which provides that the requirements of §§ 401(a)(11) and 417 of the Code are applied to payments under distributed annuity contracts);
- Views on whether the Pension Benefit Guaranty Corporation's missing participants program for defined contribution plans (29 CFR Part 4050 Subpart B)³ might be a destination for transferring, without participant and spousal consent, the cash value of custodial accounts that are subject to section 205 of ERISA; and
- Views on the type(s) of transition relief, if any, that would assist with the termination of an existing § 403(b) plan that is funded through the use of § 403(b)(7) custodial accounts in a way that protects rights under section 205 of ERISA.

Comments should be submitted in writing on or before February 3, 2021, and should include a reference to Notice 2020-80. Comments may be submitted in one of two ways:

- (1) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type "IRS IRS-2020-0032" in the search field on the regulations.gov homepage to find this notice and submit comments).
- (2) Alternatively, by mail to: Internal Revenue Service, Attn: CC:PA:LPD:PR (Notice 2020-80), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

³ Pension Benefit Guaranty Corporation (PBGC) staff advised the Treasury Department and the IRS that, under the missing participants program, (i) PBGC generally pays a 50-percent joint and survivor annuity to participants who are married and claim benefits (although de minimis amounts transferred into the program are paid as a lump sum), (ii) married participants may elect with spousal consent a lump sum or another type of annuity, and (iii) terminating plans transferring benefits into the program must liquidate accounts and send money to the PGBC (as PBGC cannot accept in-kind account transfers).

All commenters are strongly encouraged to submit comments electronically, as access to mail may be limited. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Treasury Department and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

DRAFTING INFORMATION

The principal author of this notice is Patrick T. Gutierrez of the Office of Associate Chief Counsel, Employee Benefits, Exempt Organizations, and Employment Taxes. For further information regarding this notice, please contact Patrick T. Gutierrez at (202) 317-4148 (not toll-free).