National Association of State Retirement Administrators
National Conference on Public Employee Retirement Systems
National Council on Teacher Retirement

August 5, 2002

VIA Courrier
Internal Revenue Service
CC: ITA:RU (REG-105885-99)
Room 5226, POB 7604
Ben Franklin Station
Washington, DC 20044

RE: Proposed Regulations Under Internal Revenue Code Section 457

Dear Sir or Madam:

This letter is in response to the Internal Revenue Service's request for comments on the proposed regulations published in the Federal Register on May 8, 2002 concerning guidance on eligible deferred compensation plans (457 plans) described in section 457(b) of the Internal Revenue Code.

Overview

The above listed national organizations represent over 600 public sector pension funds, which administer pensions for nearly 15 million retirees and employees of state and local government plans, including police officers, firefighters, teachers and state and local government employees. These funds are responsible for over $2 trillion in assets and payout over $91 billion in benefits each year.

Although some of our members administer both a 457 plan and a defined benefit plan, the comments in this letter will focus only on those areas of the regulations that affect both 457 plans and governmental defined benefit plans.

Background

Before the changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), it was permissible to rollover funds from a plan qualified under 401(a) to a governmental defined benefit plan qualified under 401(a) to purchase service credit. Likewise, it was permissible for a participant to purchase service credit in a governmental defined benefit plan qualified under 401(a) by transferring funds from a qualified plan to the qualified governmental defined benefit plan in a trustee-to-trustee transfer which met the requirements of Rev. Rul. 67-213. Prior to the passage of EGTRRA, a participant in a governmental 457 plan could not rollover funds from the 457 plan to a governmental

defined benefit plan qualified under 401(a) to purchase service credit. Furthermore, this same participant was not permitted to transfer funds in a trustee-to-trustee transfer from a governmental 457 plan to a governmental defined benefit plan qualified under 401(a) to purchase service credit.

Because most state and local employees have the majority of their supplemental retirement savings in 457 plans, many state and local employees lack the financial resources necessary to purchase refunded service credit or other service credit in a governmental defined benefit plan to obtain increased retirement benefits from the plan.

Changes made by EGTRRA addressed the problems described above by permitting rollovers from 457 plans to qualified plans and by permitting in-service trustee-to-trustee transfers from a 457 plan to a governmental defined benefit plan to purchase refunded service credit or permissive service credit. The purpose of the changes, as stated in the committee reports, was to aid employees who work for multiple state or local employers during their careers. It was intended to produce more significant retirement benefits for state and local employees who would not have otherwise been able to afford such service credit purchases.

Requirement That Plan-To-Plan Transfers Be Between Plans In The Same State

Prop. Reg. § 1.457-10(b)(4) provides guidance for the purchase of permissive service credit by plan-to-plan transfers from an eligible governmental plan to a qualified plan. Prop. Reg. § 1.457-10(b)(4)(i) states the general rule that an eligible governmental plan of a state may provide for the transfer of amounts deferred by a participant or beneficiary to a governmental defined benefit plan of that state. The rule seems to suggest that a plan-to-plan transfer can only take place between plans within the same state. While many state and local employees will likely be transferring funds between plans in the same state, some state and local employees, because of job changes, may need to purchase service credit in a governmental defined benefit plan located in State A, but may have funds in a governmental 457 plan located in State B. As result of this proposed regulation, this employee will not be able to use a plan-to-plan transfer to purchase service credit in the governmental defined benefit plan.

Neither the plain language of Section 457(e)(17), nor the legislative history of EGTRRA suggest that the plan-to-plan transfer provisions of Section 457(e)(17) would be limited to plans within the same state. We can see no valid public policy reason for imposing such a restriction. In fact, this restriction is contrary to the stated purpose of Section 457(e)(17), which, as noted earlier in this letter, is to assist state and local employees in acquiring additional retirement benefits that the employee might not have otherwise been able to afford. Consequently, the final regulation should not require that plan-to-plan transfers only be between plans in the same state.

Requirement That Service Credit Purchased In Plan-to-Plan Transfer Be Limited To The Amount Of Service Credit Permitted Under Section 415(n)

Prop. Reg. § 1.457-10(b)(4)(ii) provides that a transfer may be made under paragraph (b)(4) if the transfer is for the purchase of permissive service credit as defined under Section 415(n)(3)(A) or for a repayment to which Section 415 does not apply by reason of Section 415(k)(3). Up to this point, the regulation merely tracks the language of Section 457(e)(17). However, the example under Prop. Reg. § 1.457-10(b)(4)(iii) imposes an additional requirement that the amount transferred may not exceed the amount of credit permitted under Section 415(n) and further requires that it meet the special requirements of Section 415(n)(3).

Neither the plain language of Section 457(e)(17), nor the legislative history of EGTRRA suggest that Congress intended to limit the amount of permissive service credit that can be purchased with a transfer under Section 457(e)(17) to the amount allowed under Section 415(n). Section 457(e)(10) specifically refers to permissive service credit as defined in Section 415(n)(3)(A), not Section 415(n)(3)(A) as modified by subparagraphs (B) and (C). If Congress had wanted service credit purchases under Section 457(e)(17) to be limited beyond permissive service credit as defined under Section 415(n)(3)(A), it could have easily done so by tying the definition of permissive service credit to Section 415(n)(3) generally and not Section 415(n)(3)(A) only. Imposing this additional requirement on this type of transfer will create confusion and is not consistent with service purchases that are permitted to be made with a rollover or through a trustee-to-trustee transfer that meets the requirements under Rev. Rule. 67-213. Finally, such a restriction is also contrary to the stated purpose of Section 457(e)(17) which was to aid state and local employees in obtaining retirement benefits that they might not have otherwise been able to afford. Therefore, the final regulation should not limit the amount of service credit that can be purchased under Section 457(e)(17) to the amount permitted under Section 415(n), nor require that the special requirements of Section 415(n)(3) be satisfied.

Conclusion

In conclusion, we respectfully request that the final regulations under Section 457 remove the requirement that a plan-to-plan transfer to purchase permissive service credit be between plans in the same state and also remove the requirement that such a transfer not exceed the amount of credit that is permitted under Section 415(n). Finally, the regulation should delete the requirement that the special requirements of Section 415(n)(3) be satisfied in connection with such a transfer.

If you have any additional questions or need more information, please contact our federal representatives:

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