AMERICAN ACADEMY of ACTUARIES

August 29, 2006

Mr. Donald L. Korb
Chief Counsel
Office of Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Mr. Korb:

The American Academy of Actuaries[1] has as membership 3,500 of the approximately 4,000 enrolled actuaries currently active. On behalf of the Academy's Pension Practice Council, I wrote you on May 10, 2005 and again on October 25, 2005 requesting technical advice on a number of issues that have been raised regarding Circular 230, revised as of February 2006. The council's questions relate to the application of Sections 10.33 and 10.35-10.37 to the customary practice of pension actuaries. Since the council has not received responses to those letters, I've outlined below the same issues previously raised in anticipation that matters have reached the point where you will be able to provide definitive guidance.

Confidentiality
Actuaries often provide engagement letters that require confidentiality of work product in order to limit circumstances in which a third party may obtain access to actuarial reports and use the information for unintended and unsuitable purposes. The confidentiality agreement protects actuaries and their firms from being held accountable if said third party were to misunderstand and rely on the numbers and then sue the firm or actuary because the numbers resulted in some problem with a business valuation.

This may occur in a number of cases, usually involving lending agreements with the plan sponsor or determination of the purchase price in an acquisition. In this connection, the confidentiality agreement is intended to protect the numbers and use of the data, not to address any legal issues involved. Circular 230 appears to classify all actuarial reports under such an engagement letter as "covered opinions," even though the rules relating to covered opinions serve no purpose with respect to such actuarial reports. We seek your guidance on whether the mere act of requiring confidentiality for the purpose we have stated causes a work product to become a "covered opinion."

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

Incomplete data
Circular 230 states that an unreasonable factual assumption is one the practitioner knows or should know is incorrect or incomplete. Use of unreasonable factual assumptions is prohibited in both covered opinions and other "written advice." There is no materiality threshold. Virtually no data set used in pension valuations is entirely complete and accurate.

For example, in any given data set received from a client, a portion of the individuals will be missing dates of birth, or the dates of hire may differ from one year to the next for a certain number of people. These omissions or changes are immaterial to the pension valuation, and to insist on complete data purity would create delays and incur additional costs for minimal additional accuracy. In some cases, insistence on elimination of immaterial errors in data would make it impossible for a pension plan to obtain legally required actuarial valuations.

We request guidance to clarify that the data used for actuarial valuations would not be subject to the prohibition of unreasonable factual assumptions, as long as the data satisfy applicable actuarial standards. These standards are codified in Actuarial Standard of Practice (ASOP) 23, "Data Quality."

Actuarial reports and Schedule B
Actuarial reports (including Schedule B to the Form 5500) are governed by an entirely different set of comprehensive rules of professional responsibility included in the regulations of the Joint Board for the Enrollment of Actuaries. For this reason, we feel it would be appropriate for the IRS to conclude that a Schedule B and the associated actuarial report does not constitute "written advice" with respect to a "federal tax issue" for purposes of Circular 230, and we hereby request written guidance to this effect.

Best practices
We also seek clarification of the provisions of Sec. 10.33 outlining "best practices." These provisions seem subject to a broad range of interpretations. For example, one observer might describe a given instance of client interaction as reflecting very clear communication. Another might describe the same instance as reflecting a significant lack of communication.

We do understand that practitioners will not be subject to discipline by the IRS for a real or perceived failure to follow the regulatory definition of "best practices." However, we have great concerns over the impact of these regulations on civil court actions. Plaintiffs' attorneys will interpret the already mentioned requirement of clear communications in the way that best serves their clients' interests. This results in an unfair disadvantage to potential defendants.

The inevitable result could be costly, inappropriate settlements and increased legal costs. In turn, these could lead to higher liability insurance premiums, resulting in higher fees to our members' clients. Employer-sponsored retirement plans already constitute an area beset by extremely complex rules and the high fees associated with compliance with the rules. The imposition of still higher fees could discourage the formation and maintenance of these plans.

One solution to this problem would be written advice from the IRS that any practice that does not constitute a material violation of the Code of Professional Conduct as adopted and amended from time to time will satisfy the definition of a best practice.

Effect of the qualified plan exception
We note written advice that "[c]oncerns the qualification of a qualified plan" would not constitute a covered opinion.

As a threshold issue, we understand that this exception applies to advice regarding the qualification status of a plan *that the practitioner believes to be qualified*, even if it is later determined that the plan was not qualified. In a telephone conversation several months ago, Ms. Heather Dostaler of your office confirmed that this understanding is correct.

Additionally, we would appreciate confirmation that the establishment or maintenance of a qualified retirement plan is never a transaction, "the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code (IRC)."

With respect to this second threshold issue, one must examine the principal purpose of establishing any qualified plan. One could argue that most of the benefits of a qualified plan, other than favorable tax treatment, could be obtained by a plan that does not satisfy qualified plan rules. Thus, according to this reasoning, the principal purpose of establishing that the plan is qualified is to avoid or postpone taxes — for the plan sponsor, for participants, or for the trust. However, we believe that contention misses the mark. The primary reason for the provision of pensions to employees is to provide them with the financial ability to retire. Policy-makers have supported that objective by providing tax incentives to encourage the participation in retirement plans by sponsors and participants. The wording of subparagraph 10.35(b)(2)(ii)(B)(1) (the exception) suggests that in at least some cases the drafters agree that the principal purpose of a qualified plan is not tax avoidance. We believe that if, in general, the principal purpose of *some* qualified plans is not tax avoidance or evasion, then the principal purpose of *any* qualified plan is not tax avoidance or evasion. We seek guidance as to whether you agree, and if not, what criteria should be used in defining "principal purpose."

Activities that appear to be covered by the exception
We would like to confirm that a number of activities are covered by the exception for qualified plans. These activities include written communications regarding:

- The rules governing the extent to which the use of insurance company contracts and various other investments will adversely affect a plan's qualified status.
- The rules governing the extent to which honoring a judicial domestic relations order will adversely affect a plan's qualified status.
- The rules respecting benefit distributions and rollovers that must be followed in order to avoid adversely affecting a plan's qualified status.
- Nondiscrimination testing under IRC Secs. 410(b) and 401(a)(4) and their related sections.
- Any rule whose incorrect application would cause an otherwise qualified plan to lose its qualified status.

Unaddressed activities that would logically be covered by the exception
Another important issue involves other written results and advice pension actuaries often provide in the normal course of their activities. Often, this information has nothing to do with conclusions regarding a plan's qualification status. Rather, this information is typically related to maintaining a plan's compliance with ERISA and various tax-related laws and rules of the sort found in the following list:

- The rules for calculating minimum funding requirements, maximum deductible contributions, Sec. 415 limits with respect to individual participants, Sec. 417(e) minimum lump sums, the top 25 restricted distributions, and Sec. 420 asset transfers.
- The rules for calculating excise taxes and similar miscellaneous taxes incidental to the establishment, administration, and termination of qualified plans.
- The rules for determining the extent to which plan participant loans are taxable as current distributions.
- The tax rules related to group life insurance, uninsured health plans, cafeteria plans, fringe benefit arrangements, dependent care plans, cash or deferred arrangements embedded in

qualified plans, non-qualified deferred benefits, VEBAs, ESOP loans, and other compensation and benefits issues.
- The rules for determining whether distributions constitute a series of substantially equal payments for the purposes of IRC Sec. 72(q) and similar sections.
- The timing and content rules of reporting and disclosure requirements related to qualified plans and the other employee benefit plans we have mentioned.

In the balance of this letter, we discuss some of the pension actuary's work involving the items we have listed in this section. We seek guidance on whether written advice related to this work constitutes a "written opinion."

Inability of most actuaries to practice law
Pension actuaries who are not attorneys are not authorized to practice law. Even those few actuaries who are licensed attorneys are generally functioning as employees of firms that are not law firms and thus do not practice law. Consequently, pension actuaries do not opine on interpretation of tax law, and do not render covered opinions. We request confirmation that the reasoning in the preceding sentence is valid.

Other Activities of Pension Actuaries and their Associates
In addition to the activities this letter has already described, plan actuaries often become involved in day-to-day plan administration. It seems clear to us that such administrative activities do not approach the level of preparing covered opinions.

Limits on enrolled actuary's authority to practice before IRS
An enrolled actuary's authorization to practice before the IRS is limited to well-defined sections of Title 26 of the United States Code. Many of the activities discussed in this letter fall outside this well-defined authorization. We do not believe that computations and their written communication involving issues falling outside these areas of authorization constitute covered opinions. We seek guidance on whether you agree.

Summary
We seek guidance on:
1. The meaning of the exception regarding the qualification of a qualified plan.
2. The meaning of "written advice" with respect to a "federal tax issue."
3. A definitive interpretation of the expression "best practices."
4. The treatment, in general, of tasks apparently not covered by the exception.
5. The application to an actuary of the phrase "not authorized to practice law."
6. The applicability of the circular to issues in areas where the enrolled actuary is not authorized to practice before the IRS.

Follow-up guidance
If your guidance indicates that some of the normal activities of the pension actuary do involve covered opinions, we would appreciate the opportunity to follow-up with additional implementation questions.

We appreciate the opportunity to provide these comments, and we look forward to your written guidance.

Please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org), if you have any questions.

Sincerely,

Donald J. Segal, MAAA, EA, FCA, FSA
Vice President, Pension Practice Council
American Academy of Actuaries

Cc: Ms. Heather L. Dostaler, Office of the Associate Chief Counsel, IRS
Mr. Mark W. Everson, Commissioner, IRS
Ms. Carol Gold, Director of Employee Plans, IRS
Mr. Richard Goldstein, Office of the Associate Chief Counsel, IRS
Mr. Patrick W. McDonough, Director, JBEA
Mr. Steve Miller, Commissioner, Tax Exempt and Government Entities Division, IRS
Mr. Martin Pippins, Technical Guidance and Quality Assurance Manager, IRS
Mr. W. Thomas Reeder, Deputy Benefits Tax Counsel, Dept. of Treasury
Mr. Brinton T. Warren, Office of the Associate Chief Counsel, IRS
Mr. Stephen Whitlock, Director of Office of Professional Responsibility, IRS