

MEMO# 3393

December 27, 1991

INSTITUTE LETTER TO TREASURY REGARDING QUALIFIED REPLACEMENT PROPERTY AND JOINT AND SURVIVOR ANNUITY RULES

December 27, 1991 TO: PENSION COMMITTEE NO. 41-91 RE: INSTITUTE LETTER TO TREASURY REGARDING QUALIFIED REPLACEMENT PROPERTY AND JOINT AND SURVIVOR ANNUITY RULES _____ Attached is a copy of the Institute's letter to the Treasury Department concerning two separate regulatory issues: (1) the definition of "qualified replacement property" under section 1042 of the Internal Revenue Code; and (2) joint and survivor annuity requirements under section 417 of the Code. Qualified Replacement Property Section 1042 of the Code provides that any gain on the sale of qualified securities to an employee stock ownership plan (ESOP) which would otherwise be recognized as long-term capital gain shall be recognized only to the extent that the amount realized on such sale exceeds the cost of any "qualified replacement property" purchased within a prescribed period of time with the proceeds of the sale. The definition of "qualified replacement property" is limited to a security issued by a domestic operating corporation; therefore, investment company shares may not constitute "qualified replacement property." On the other hand, the Code does not necessarily preclude the inclusion of investment company shares, and indeed expressly recognizes that taxpayers may create a pooled portfolio of qualified replacement property. The Institute's letter therefore urges the Treasury Department to amend its temporary regulations to provide that shares of a regulated investment company the assets of which primarily consist of securities of domestic operating corporations will be considered "qualified replacement property." Joint and Survivor Annuity Rules Sections 401(a)(11) and 417 of the Code require that certain defined contribution plans provide benefits in the form of a "qualified joint and survivor annuity" and a "qualified preretirement survivor annuity." The Internal Revenue Service has interpreted these provisions to require such plans to - 2 - purchase commercial annuity contracts from insurance companies, which may interfere with participant and employer investment choices. The Institute's letter therefore urges the Treasury Department to reconsider the commercial annuity contract requirement. Specifically, the letter recommends that the regulations under section 417 be amended to include within the definition of "qualified joint and survivor annuity" a benefit payment form under which the married participant's account would be divided into two accounts as of the participant's benefit commencement date. From that date forward, the participant's interest would be limited to the portion of the account that was allocated to the participant, and the spouse's interest would be limited to the portion allocated to the spouse. Benefits would be distributed from the participant's account in the form of substantially equal

payments over the participant's life expectancy, and the amount payable would be recalculated each year to reflect investment experience and changes in the participant's life expectancy. Upon the participant's death, the balance of the participant's account would be transferred to the account of the spouse and the spouse's benefits would be distributed in the same manner. * * * We will keep you informed of developments. Kathy D. Ireland Associate Counsel - Pension Attachment

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