AMERICAN ACADEMY of ACTUARIES

October 28, 2005

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

Dear Mr. Korb:

Given the finalization of Circular 230 regulations on June 20, 2005, on behalf of the American Academy of Actuaries,[1] which represents 3500 of the approximately 4000 enrolled actuaries, I would like to take this opportunity to request a technical advice ruling on a number of issues that have been raised regarding the application of Sections 10.33 and 10.35-10.37 to actuarial practice.

Mr. Ed Burrows, a member of the Academy's pension committee, spoke with Ms. Heather Dostaler of the office of the Associate Chief Counsel of the Internal Revenue Service (IRS) on behalf of the committee earlier this year before we submitted our initial letter on May 10, 2005. At the time, Ms. Dostaler suggested that a certain number of the committee's questions would require some thought before receiving a detailed response. Those initial questions, as well as a few additional illustrations, are provided below.

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 has occurred in a number of cases, usually involving lending agreements with the plan sponsor or determination of the purchase price in an acquisition. As such, the confidentiality agreement is intended to protect the numbers and use of the data, not to address any legal issues involved. Circular 230 would appear 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.

[1] The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal and state elected officials, regulators and congressional staff, comments on proposed federal and state regulations and legislation, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualifications and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

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 dataset used in pension valuations is entirely complete and accurate.

For example, in any given dataset 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.

As such 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 satisfies applicable actuarial standards.

Actuarial reports and Schedule Bs
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. Especially with a subject as complex as taxes, it will often be impossible to demonstrate that one observer is right and the other wrong.

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. Where the regulations lend themselves to such a broad range of interpretation, it will be difficult (and expensive) for defendants to protect themselves against potential self-serving interpretations.

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.

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. Ms. Dostaler 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 most participants 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 a qualified plan 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 to differentiate.

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 Sections 410(b) and 401(a)(4).
- 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 of the sort found in the following list:

- The rules for calculating minimum funding requirements, maximum deductible contributions, Sec. 415 limits with respect to the individual participant, 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 Code 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. We seek guidance on whether written advice related to this work constitutes "written opinions."

Inability of most actuaries to practice law
Pension actuaries, who are not attorneys, are not authorized to practice law. Generally, 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.

Our primary activity related to the items we have listed involves making calculations and measurements based on our understanding of the law. In order to perform this activity, we must be broadly familiar with applicable legal concepts. For clarity, our written advice often discusses these concepts in addition to communicating the results of our computations. These discussions may touch on areas where attorneys differ in their views. However, this does not alter the fact that a pension actuary's responsibility is not to render opinions respecting application of tax laws. Instead, it is to make those calculations that must be made in order to apply these laws.

For this reason, if for no other, we do not believe performing computations related to any item on our lists — and communicating, in writing, the results of these computations — constitutes the rendering of a covered opinion. We seek guidance as to whether you agree. Ms. Dostaler indicated that this was a good question but one on which she would be unable to offer a response without further consideration.

We do acknowledge that our clients often expect to rely on our calculations for their tax purposes. For example, we would not expect to tell a client that our calculation of the amount to be contributed and deducted could not be used for the purpose of avoiding penalties that may be imposed in the event of a challenge. Nevertheless, we see a significant distinction between this form of reliance and reliance on a covered opinion. To a great extent, our clients' reliance is simply reliance on the accuracy of our mathematical calculations and the exercise of our professional judgment in selecting actuarial assumptions — an exercise that is required by tax law.

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.

We also find ourselves drafting provisions for inclusion in plan and related documents. However, these provisions typically include the warning that only an attorney acting in the role of a practicing attorney can opine on the appropriateness of such document language.

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 we have listed fall outside this well-defined authorization. We do not believe that computations and their written communication involving issues falling outside this area of authorization constitute covered opinions. We seek guidance on whether you agree. This, too, is a question that Ms. Dostaler indicated had merit, but on which she would be unable to offer a response without further consideration.

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. Treatment, in general, of tasks apparently not covered by the exception.
4. The status of the actuary not authorized to practice law.
5. 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 being able to follow-up with additional implementation questions.

Some of these questions will be quite mechanical, involving such rules as the placement of a caveat on a document, the requirements of type size, or any information required to be added to standard actuarial communications, such as the annual valuation report.

Others will be more substantive, such as the steps that practitioner A might need to take to control the work of practitioner B when practitioner B is a direct subordinate of practitioner A.

However, we would prefer to hold off on addressing solutions to these situations until we have a more complete understanding of the scope of the issue.

We appreciate the opportunity to provide these comments, and we look forward to any written guidance you may be able to provide. We are interested in discussing this matter with you further and would like to schedule a meeting at your earliest convenience. 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, Internal Revenue Service
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. Cono Namorato, Director of Office of Professional Responsibility, IRS
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