

April 15, 2010

MEMORANDUM TO CLIENTS

RE: IRS Priority List Indicates Increase in International Employee Benefits Compliance Efforts

Among the nine items listed by the IRS as key Employee Plans Division (EP) priorities for Fiscal Year 2010 (see the attached IRS priority list), two target the employee benefit plans of multinational companies and plans with international investments. The very first item on the list indicates the Service will "develop strategies and capabilities to address key international issues impacting the Employee Plans sector", and another states that the Employee Plans Team Audit (EPTA - Large Case) is expanding enforcement in "targeted risk areas, including international and abusive emerging issues".

But what is the Service really talking about?

Although the Service is still figuring that out themselves and they view these listed items as flexible concepts, we understand that they have begun to raise some specific issues.

First are issues surrounding Puerto Rico plans and "dual status" plans. In addition to the US tax treatment of distributions (see, e.g., Rev. Proc. 2004-37) and deductions for contributions, the IRS has been working with the Hacienda in Puerto Rico to train plan auditors (which apparently they did not previously have) and help the Hacienda develop its own EPCRS-style correction program. This was also mentioned in the Winter 2010 Employee Plans News from the IRS.

In that regard, plan sponsors may also want to keep in mind that if they want to make changes involving plan transfers, the transition relief under Rev. Rul. 2008-40 for transfers to section 1022(i)(1) transferee plans (qualified in Puerto Rico only) from US qualified plans ends on December 31, 2010.

Another area appears to be the valuation of foreign plan investments and disclosures. Apparently, particular concern has been raised that investments in nonperforming non-US debt instruments are not being properly valued. Another has been in the valuation of alternative investments such as foreign private equity and hedge funds. Of course, if valuations are incorrect, there are 5500 issues and perhaps plan funding issues as well. The IRS has also expressed concern that GAAP/IAS conversion of information may be resulting in some incorrect accounting and reporting by US qualified plans.

With respect to mobile employees, the IRS is apparently concerned that multinational employers may not be properly sourcing the income of employees as well as the benefit arrangements of employees. This may affect US expenses or transfer pricing when reflecting costs with respect to expatriate employees.

The IRS is also understood to be concerned that plans are not following the 401(k) loan and hardship distribution rules when employees leave the US on an assignment-- for example, the related foreign employing unit may not be imposing the US plan rules for repayments and contribution restrictions.

Further, the IRS believes that it has not made sufficient efforts in the past to enforce Code section 402(b) (and presumably 72(w) as added by AJCA in 2004), which can result in taxation of funded foreign plans to US taxpayer participants (subject to tax treaty), and they want to change that.

Also, at some point, enforcement of Code section 457A, intended to curtail deferred compensation offshore, and a provision very broad in scope, will follow in the footsteps of enforcement of 409A.

Forewarned is forearmed, so multinational companies with US plans and US plan sponsors with non-US plan investments may wish to review their plans for these issues (and any other issues the IRS starts to raise) before the IRS, or possibly outside auditors, start asking questions.

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Key EP Priorities in FY 2010

EP Hot Topics Include: International Issues; 401(k) Initiative, Raising Awareness in Government Plan Sector; Addressing Abusive Transactions and Emerging Issue/ Identifying and Targeting Non-Compliant Behavior; Implementation of a program for IRC 403(b) arrangements; Expanding our Employee Plans Compliance Units (EPCU); Employee Plans Team Audit (EPTA); Modernize the Retirement Plans Community Web page); and the EP determination process.

- Develop strategies and capabilities to address key international issues impacting the Employee Plans sector. Enhance coordination within the IRS and with international organizations to proactively target areas of significant risk through education and outreach, determinations, guidance, voluntary compliance, and enforcement activities.
- Analyze the 401(k) Questionnaire Compliance Check responses and prepare a report and other materials to share findings with EP stakeholders. Use the findings to address non-compliant behaviors in the 401(k) market segment through education and outreach, determinations, guidance, voluntary compliance, and enforcement activities.
- In collaboration with the TE/GE Federal, State & Local Governments and Indian Tribal Governments offices, work with the governmental plans community to:
 - improve communication through outreach, education, guidance, and self-help tools; and
 - share data from the questionnaire pilot, other EP sources and Governmental Plans web page at www.irs.gov/ep.
- Continue to proactively address and deter abusive transactions by:
 - Utilizing Promoter Investigations as an enforcement strategy to deter the marketing of abusive promoter schemes involving retirement plans;
 - Increasing cross-functional collaboration to evaluate emerging compliance issues and identify additional complex international transactions;
 - Developing strategies for identifying and addressing new abusive schemes while considering civil or criminal fraud where applicable; and, Sharing with the general public new potentially abusive schemes and emerging issues of interest/concern to the IRS as they are identified.
- Complete implementation of a program for IRC 403(b) arrangements by:
 - Opening the pre-approved plan program, and
 - Issuing draft revenue procedure on a program for individually designed 403(b) arrangements.
 - To proactively assist in clarifying the new rules, EP Exam is adding an outreach component to two new EPCU 403(b) Universal Availability Projects that will be started in FY2010. You may have heard that the recently completed 403(b) Universal Availability Project was the highest

Key EP Priorities in FY 2010

volume and most visible EPCU Project to date. The EPCU contacted over 5000 school Districts in over 40 states and more than 20% had universal availability problems that were voluntarily corrected. This resulted in not only teachers, but also school bus drivers, cafeteria workers, janitors and substitute teachers being included in these plans. Look for the report on the findings on the EPCU web site soon. EPCU will be doing the same Universal Availability Compliance Check Project for colleges and universities and will perform a follow-up Compliance Check Project on the public schools to ensure that corrective actions were taken as appropriate.

- Using EP Compliance Unit (EPCU) resources to leverage coverage and expand compliance contacts in areas where analysis has indicated potential abuses, data inconsistencies, and/or areas of non-compliance. The EPCU has proved to be an extremely successful innovation that allows us to leverage our resources and expand our compliance contacts. Impressive EPCU projects (such as the 403(b) Universal Availability Project) and excellent overall results led to the decision to expand EPCU approach. In FY 2010 we started a second and third EPCU Unit and EP Exam now has three EPCU Groups in EP Great Lakes.
- Employee Plans Team Audit (EPTA - Large Case) is expanding enforcement in targeted risk areas, including international and abusive emerging issues.
- Modernize the Retirement Plans Community web page (www.irs.gov/ep), making all CE&O web-based information and products, including the Fix-It Guides, more accessible for our customers and easier to find and use.
- Ensure the staggered determination process stays on schedule by:
 - Proactively addressing the implications of the expected surge in Form 5307 receipts by working cross-functionally with EO, BSP and W&I to design business rules and workarounds to ensure effective case processing for all TE/GE work streams and timely processing applications without disrupting EO work streams;
 - Completing work on defined benefit pre-approved lead plans by issuing opinion and advisory letters;
 - Analyzing previous cycle data and filing patterns and implement effective changes to the staggered process; and,
 - Implementing methods designed to increase efficiency and more timely issued determination letters.