

## LEGAL DEVELOPMENTS

### *IRS 2011-2012 Guidance Plan: A Look at What's Coming*

*Every year the IRS issues a list of its top-priority guidance initiatives for the year, called the guidance plan.*

*The anticipated list of items was issued September 2, 2011, and sets forth the plan for issuing much-needed guidance for the July 2011–June 2012 year.*

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There are 37 qualified plan items on the top-priority guidance list, many of which are carryovers from prior years. The task for the IRS through June is to complete as many of these items as possible, while also being mindful that other priorities may arise to distract from this goal, such as the need to provide guidance for intervening legislation (such as the health care legislation that continues to demand large IRS resources to issue guidance). It is not uncommon for some issues to remain on the guidance plan for several years. A look at a number of provisions from the guidance plan, based on the type of plan, will give us an idea of what is in store for the coming year.

#### **General Guidance (Applicable to DC and DB Plans)**

**Employee Plans Compliance Resolution System (EPCRS).** The IRS routinely updates and expands its voluntary correction program, which is available to plan sponsors when there is an operational, document, or demographic failure with the plan, in order to preserve the tax-qualified status of the plan. The expansion this time around is likely to focus on 403(b) plan corrections.

**Determination/Opinion/Advisory Letter Process.** Long-anticipated Revenue Procedures are to be issued for (1) updating Revenue Procedure 2005-16 for determination, opinion and advisory letters for preapproved plans, and (2) updating Revenue Procedure 2007-44 for determination letters for individually designed plans. Much focus will be placed on the approach to be taken for interim amendments and other changes to the approval process following the IRS's EGTRRA experiences. It is notable that the pending revenue procedure for a new prototype 403(b) plan program was removed from the guidance plan. The guidance plan also includes a reference to guidance relating to determination letter user fee exemptions for certain retirement plans.

**Cycle B Cumulative List.** Each year (typically in October or November), the IRS issues its updated cumulative list, which is a Notice that reflects the list of changes in the requirements that should be reflected in the plan document for 401(a) plans. These items are expressly required for qualified plans that are being submitted for the Cycle "B" determination letter that opens February 1, 2012, through January 31, 2013. This Cycle is for plan sponsors that have an EIN ending in "2" or "7" or multiple employer plans. It is also recommended that all plans review this list for any IRS-required interim amendments, which typically need to be adopted by the tax filing deadline for the year in which the provision is effective.

#### **Defined Contribution Plans (401(k) Plans, Profit Sharing Plans, Money Purchase Pension Plans)**

**Safe Harbor Plans—Nonelective Contributions.** In reaction to the economic hardship facing many safe harbor plan sponsors, in 2009, the IRS issued proposed regulations that provided limited relief for

companies in financial hardship to suspend, reduce or stop employer nonelective contributions for safe harbor plans. Previously, there had only been guidance on the suspension of safe harbor matching contributions. The guidance plan includes finalization of these regulations. A number of practitioners have requested the plan sponsors be treated in the same manner regardless of the safe harbor design selected—either the safe harbor matching contributions or nonelective contributions—which would require advance participant notice and nondiscrimination testing in the event that such employer contributions were changed or suspended, but no requirement of employer financial hardship. Unfortunately, it does not appear that the guidance plan will address a related issue, which involves guidance on what changes are permissible mid-year to safe harbor plans.

**Lifetime Income from Defined Contribution Plans.** 401(k) and Profit Sharing Plans were initially designed to merely supplement a participant's retirement funds, with the participant's lifetime payments being made from his or her traditional defined benefit plan. As a supplemental plan, there was no requirement to offer lifetime benefits, and many 401(k) plans today do not offer such payments. Even when offered, they are rarely elected. But as 401(k) plans quickly become the sole retirement plan for many employees (as availability of defined benefit plans decreases), there is a growing need for lifetime payments, particularly with a guarantee that the payments will continue even if the market value of the account balance is reduced to zero.

However, there is little guidance on the treatment of these new guaranteed lifetime income products available for defined contribution plans. For example, if the guaranteed installment payments are treated as a life annuity, then the qualified joint and survivor annuity rules, and all the complexities that are entailed with additional spousal protections, are triggered. Ideally, the pending guidance will follow the legislative proposals and IRS directive to promote the use of lifetime payment streams, and not bring with them the various complexities such as spousal consent, nondiscrimination testing, anti-cutback, and nonforfeiture concerns. Moreover, guidance is needed with regard to the proper treatment of these payments for minimum required distributions, eligible rollover distributions, Code Section 72(t) treatment, and pension withholding.

**ESOPs.** The guidance plan includes guidance on rules applicable to ESOPs under Code Sections 409 and 4975, regarding prohibited transactions.

## Defined Benefit Plans

Set forth below are some of the guidance plan items for defined benefit plans, including cash balance plans and traditional final average pay type benefit formulas.

**Hybrid Plan Guidance.** Final regulations addressing hybrid plans (including cash balance plans) that implement the Pension Protection Act (PPA) provisions under Code Sections 411(a)(13) and 411(B)(5) will provide further guidance on the rules that went into effect over the past several years. Of specific note in this upcoming guidance is the requirement that a hybrid plan provide for a "market rate of return." Practitioners have raised a number of concerns about the IRS's proposed guidance and have requested a wider range of permissible interest rates. Moreover, guidance relating to conforming plan amendments to be adopted in connection with these final regulations, and guidance on issues related to pension equity plans made the list.

**Participant Notice.** The guidance plan includes guidance under Code Section 4980F regarding 204(h) notice to participants and beneficiaries relating to certain plan amendments to hybrid plans (i.e., plan amendments that significantly reduce the rate of future benefit accruals). It also includes notice under Section 101(j) of ERISA regarding notice requirements applicable to single-employer plans that become subject to funding-based benefit limitations as added by PPA.

### Additional Guidance on Funding Rules.

Although the IRS has already issued a number of pieces of guidance addressing the various changes to the defined benefit plan funding rules under PPA, a number of additional pieces of guidance made the list: (1) final regulations under Code Section 430 minimum required contribution rules, (2) regulations on additional issues related to funding and related rules for single-employer plans under Code Sections 430 and 436, (3) the funding rules for multiemployer plans under Code Section 432, (4) long-anticipated sample plan amendment language for single-employer plans to reflect the benefit limitations under Code Section 436, which has been confirmed by recently issued Notice 2011-96, and (5) additional issues relating to funding and benefit limitation relief for single-employer plans under the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010.

## Other Guidance Projects

In addition to the guidance specific to defined contribution, defined benefit, and 403(b) plans, a number

of additional guidance projects are included in the guidance plan.

**Governmental Plans.** The guidance plan includes a significant piece of long-awaited guidance listed on the guidance plan—the definition of a “governmental plan” under Code Section 414(d). The IRS has been working with the Department of Labor and Pension Benefit Guaranty Corporation for several years to provide this guidance that is eagerly anticipated by governmental plan sponsors who have faced a number of questions relating to quasi-governmental and privatized governmental employees. The guidance plan also includes guidance on pick-up arrangements under Code Section 414(h)(2), and the application of “normal retirement age” for governmental plans, generally involving years of service, which has been an issue that has slowed down the determination letter process.

**Church Plans.** The guidance plan includes guidance on procedures for ruling requests under Code Section 414(e), which have been subject to a moratorium for some time. These procedures may include a notice requirement to participants and provide additional guidance on the definition of a church plan.

**DB(k) Plans.** Effective January 1, 2010, the Pension Protection Act of 2006 added a new type of hybrid defined benefit-defined contribution plan that combines a defined benefit plan with a 401(k) feature. The guidance plan states that regulations will be issued for these plans. Practitioners and sponsors of preapproved plans are hoping for detailed additional guidance that enables the implementation of these plans.

**Group Trusts.** The guidance plan includes additional guidance on group trusts under Revenue Rulings 81-100 and 2011-1. Hopefully, that guidance will permanently permit Puerto Rico-only plans to be able to participate in a group trust.

**Pension Distributions.** The list includes a number of items that impact the reporting of pension distributions and basis allocations. Specifically, the list indicates guidance on exceptions to additional 10 percent tax under Code Section 72(t) for early distributions from qualified plans and IRAs. This guidance may impact the coding on Box 7 on Form 1099-R.

Moreover, it indicates guidance under Code Sections 402(c) (eligible rollover distributions) and 402A (Roth distributions) for distributions that are disbursed to multiple destinations, which should address the concern raised in the sample 402(f) notice that a pro rata basis allocation must be made for partial/split rollovers.

**International Tax Issues Related to Tax-Favored Retirement Plans.** The 2009 report from the Advisory Committee on Tax Exempt and Government Entities had a specific focus on international employee benefits issues and recommended additional guidance on the tax treatment of retirement payments to non-resident aliens and citizens of Puerto Rico and other US territories. As part of a renewed focus on international benefits, the guidance plan includes guidance under Code Section 402 on transfers from foreign retirement plans.

**Other Areas of Guidance.** The guidance plan also includes:

- **Incidental Benefits.** Finalizing regulations that were initially issued in 2007 regarding Code Section 402(a) treatment of incidental benefits under a qualified plan.
- **Service Credit and Vesting Provisions.** Updating regulations for service credit and vesting provisions under Code Section 411, which may be mainly updating the regulations to reflect existing guidance.
- **Qualified Joint and Survivor Annuity.** Issuing qualified joint and survivor guidance for defined benefit and defined contribution plans. It is unclear if this guidance is related to the guaranteed lifetime income payments or similar products.
- **Rollovers to Defined Benefit Plans.** Issuing guidance on rollovers to defined benefit plans.
- **Form 5500 Reporting.** Issuing guidance relating to certain reporting requirements under Code Sections 6057, 6058, and 6058 for retirement plans, which includes Form 5500 reporting. It also includes a new voluntary compliance program for late filers of Form 5500-EZ. ■