Employee Benefits Corner

IRS Issues Its Annual Lineup of Legal Changes for Qualified Plans—The 2014 Cumulative List

By Elizabeth Thomas Dold and David N. Levine

The IRS recently issued Notice 2014-77 ("the Notice") which contains the "2014 Cumulative List of Changes" that sets forth a summary of the legal changes that plan sponsors are required to make to their plans in order to maintain the tax favored status of the plans. This list is particularly important for governmental plans that have chosen to be part of the "Cycle E" filing cycle and plan sponsors with individually designed plans who have an employer identification number ending in five or zero that are automatically part of Cycle E. All plan sponsors are well served to review the 2014 Cumulative List to ensure operational and document compliance with the legal requirements set forth therein.

Specifically, the Cycle E filing cycle, as established pursuant to the IRS's determination letter procedures,[1] will be open from February 1, 2015 through January 31, 2016. The IRS will review these Cycle E plans for legal changes listed on the recently issued 2014 Cumulative List. The favorable letters issued by the IRS on these plans will cover only the items listed on this Cumulative List (as well as discretionary amendments that are adopted within the five-year remedial amendment cycle established by Rev. Proc. 2007-44 and subsequent IRS guidance). Sponsors of Cycle E plans should file their plans with the IRS for review between February 1, 2015, and January 31, 2016, if they wish to maintain a current determination letter that can be cited in the event of an IRS challenge that their plans were not timely amended.

A summary of the key new items on the 2014 Cumulative List are set forth below. Notably, the 2014 Cumulative List deletes all items that were reviewed by the IRS during the prior Cycle E submission period. Notably, a newly established plan that does not have a prior determination letter will need to satisfy all tax-qualification requirements, even if not listed on the 2014 Cumulative List. Failure to timely amend a plan (and implement the provision in operations) on a timely basis raises plan qualification concerns that should be addressed under the Employee Plans Compliance Resolution System as set forth in Rev. Proc. 2013-12.

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All Plans (Defined Benefit and Defined Contribution Plans)

Windsor Decision (Same-Sex Marriages)

On June 26, 2013, the Supreme Court held that section 3 of the Defense of Marriage Act (DOMA)—which, for federal law purposes, required that only marriages between a man and woman be recognized—was unconstitutional.[2] Following the decision, the IRS initially issued Rev. Rul. 2013-17, which provided that the term "spouse" for all federal tax purposes includes individuals who entered into a legal marriage under the laws of the state or foreign country where the ceremony was performed, without regard to the place the participant resides or works. Thereafter, the IRS issued Notice 2014-19 that explained the impact of the change, the effective date of the change, and the need for (and timing of) plan amendments for qualified plans. Pursuant to Notice 2014-19, a spouse for qualified plan purposes includes a same-sex spouse, based on the place of celebration rule. This provision is generally effective June 26, 2013, and any qualified plan that defines "spouse" with a reference to Section 3 of DOMA (*e.g.,* the plan terms reference DOMA or one limited to a person of the opposite sex), or otherwise contains plan terms that are otherwise inconsistent with the outcome of *Windsor*, Rev. Rul. 2013-17 or Notice 2014-19 are exposed to tax-qualification risk. Notice 2014-19 also provides that a mid-year amendment of safe harbor 401(k) plans to reflect the *Windsor* decision is permissible.

All plan sponsors are well served to review the 2014 Cumulative List to ensure operational and document compliance with the legal requirements set forth therein.

Plan Distributions to Multiple Destinations

The IRS issued Notice 2014-54 and proposed regulations[3] that support the plain meaning of Code Sec. 402(c)(2)—permitting plan distributions made to multiple destinations to be treated as a single distribution (if otherwise scheduled to be made at the same time), with pre-tax amounts being rolled first. Accordingly, a participant can direct the pre-tax portion of his distribution to a traditional IRA, and the after-tax portion of his distribution to be paid to himself or a Roth IRA tax-free, as more fully described below: (Notably, the Notice does not change the long-standing allocation rules set forth in Code Sec. 408(e)(8).)

- **Pre-Tax Amount "Is Less Than" the Amount Directly Rolled to an Eligible Retirement Plan(s):** The entire pre-tax amount is treated as rolled over, and if directly rolled to more than one plan, the participant can select (prior to the time of the direct rollover) how the pre-tax amount is allocated among the plans.
- **Pre-Tax Amount "Equals or Exceeds" the Amount Directly Rolled to an Eligible Retirement Plan(s):** The pre-tax amount is first treated as directly rolled over (up to the direct rollover amount), then assigned to any 60-day rollovers (with the participant selecting the allocation among the plans if the remaining pre-tax amount is less than the indirect rollovers), and lastly any remaining amount is included in gross income. Therefore, only to the extent that the rollover exceeds the pre-tax amounts are after-tax amounts treated as rolled over.

This change is generally effective January 1, 2015. However, for distributions on or after September 18, 2014, through December 31, 2014, taxpayers may apply a reasonable interpretation of Code Sec. 402(c)(2) to allocate after-tax and pre-tax amounts among multiple destinations (*e.g.,* use the *pro rata* approach or the single distribution approach). Moreover, for distributions prior to September 18, 2014, taxpayers can apply this same reasonable interpretation standard (except for distributions made from a designated Roth account, which must have complied with applicable IRS regulations).

Valid Rollover Contributions

Rev. Rul. 2014-9 provides new safe harbor procedures for a plan administrator to use in order to validate a direct rollover contribution into a plan.

Group Trusts with Puerto Rico Plans

Rev. Rul. 2014-14 allows certain retirement plans qualified only under the Puerto Rico Code in a group trust with certain United States tax-advantaged plans and IRAs, as well as the investment in a group trust of

assets held by certain separate accounts maintained by insurance companies.

Defined Contribution Plans

DC Plans Offering Deferred Annuities

The IRS will review a plan with regard to a special nondiscrimination rule for a defined contribution plan that provides lifetime income by offering, as investment options, a series of target date funds that include deferred annuities among their assets pursuant to Notice 2014-66.

Minimum Required Distribution Relief for QLACs

The Notice reflects the modification of the required minimum distribution rules for defined contribution plans holding qualifying longevity annuity contracts pursuant to final regulations.[4]

Defined Contribution Plans with Accident or Health Insurance Benefits

Last year, the IRS published final regulations under Code Sec. 402 (and related provisions) that generally preclude defined contribution plans from purporting to fund or otherwise provide tax-free accident and health benefits (except under Code Sec. 401(h) accounts and governmental plan 402(l) arrangements) after 2014.[5] For example, if an employer has been paying premiums on a disability income policy to fund ongoing allocations for disabled employees, such allocations may generate taxable income to the disabled participant and they may only be made to participants in accordance with the special disability pay rule in Reg. §1.415(c)-2(g)(4).

Defined Benefit Plans

PPA's Vesting, Accruals and Market Rate of Return Rules for Cash Balance/ Hybrid Plans

Last year, the IRS and Treasury released final regulations addressing the market rate of return limitations and other aspects of cash balance and other hybrid pension plans.[6] Associated proposed regulations would provide transitional, anti-cutback relief for plans that must reduce the rate of interest in order to comply with the new limits. The new final rules and the proposed transitional relief would generally be effective as of the first day of the plan year that begins in 2016. Amendments that may be required to comply with these rules generally will not be required to be adopted until the end of the plan year that begins in 2015.

Accordingly, similar to prior Cumulative Lists, the Notice states that the IRS "will not consider the 2014 final hybrid plan regulations (other than the delay in the effective date of certain provisions in the 2010 final hybrid plan regulations set forth in Reg. section 1.411(b)(5)-1(f)(2)(i)(B)) unless (1) the plan has been amended to satisfy the 2014 final regulations and (2) the determination letter application indicates that a determination is requested that the plan complies with those final regulations."

Moreover, regarding proposed regulations, the IRS's review of matters addressed by proposed regulations will be based on a "reasonable interpretation" of the underlying statute, final regulations, or other the IRS guidance. The IRS notes that compliance with proposed regulations meets this standard, but a favorable IRS letter "cannot be relied on with respect to whether the plan complies with the proposed regulations." The Cumulative List expressly refers to proposed regulations under the following Code sections: the 2010 proposed regulations under Code Sec. 411(a)(13), 411(b)(1) and 411(b)(5), which can be relied on until the 2014 regulations are effective.

Nondiscrimination Relief for Certain Closed Plans

Notice 2014-5 provides rather limited, temporary nondiscrimination relief for certain frozen plans.

Action Steps

Therefore, each plan sponsor should:

- Review the plan document (and existing amendments) against the 2014 Cumulative List and ensure that the document has been updated for all required and optional plan changes (including legal and design changes). In the event of any missed amendment, an EPCRS filing should be considered.
- Adopt any needed amendments (and use EPCRS as applicable).
- File a determination letter application by the January 31, 2016 deadline for any Cycle E individually designed plans (*e.g.,* plan sponsor EIN ends in five or zero)—as follows:
  - *Step 1:* Prepare a restatement of the plan that incorporates all plan amendments to date, and updates the plan as necessary to comply with the 2014 Cumulative List.

- *Step 2:* Review all prior required interim amendments to determine if they complied with the IRS requirements and were adopted no later than the applicable IRS deadline.
- *Step 3:* Prepare and file the Form 5300 *Determination Letter* application, and consider filing a stream-lined VCP filing simultaneously for any late or inadequate interim amendments, by the January 31, 2016, deadline.

ENDNTOES

1 Rev. Proc. 2007-44, 2007-2 CB 54.
2 *E.S. Windsor*, SCt, 2013-2 USTC ¶50,400, 133 SCt 2675.
3 79 FR 56310 (Sept. 19, 2014).
4 79 FR 37633.
5 79 FR 26838 (May 12, 2014).
6 79 FR 56442 (Sept. 16, 2014).