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Employee Benefits Corner

IRS Determination Letter Program—Then and Now

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The IRS determination letter program (Form 5300) is a cornerstone of the favorable tax treatment for individually designed qualified plans. The program provides the IRS's opinion that the plan document, as to its form, meets the very complex requirements under Code Sec. 401(a). The program has undergone changes over the years, but it remains an invaluable benefit to plan sponsors that offer custom-designed tax-favored plans. Below we look back over the years at the importance of the program and take a look at the current program.

An Overview of the Program

The determination letter program has its genesis at least as far back as the early 1940s—over 80 years ago.¹ At that time, the predecessor to Code Sec. 401(a) contained only six paragraphs—essentially, just the “exclusive benefit” and written document rules, while requiring nondiscriminatory coverage and benefits.

As the law has grown in complexity—certainly in the over 45 years since ERISA's enactment—the need for a scheme where the IRS reviews a plan document to confirm that it satisfies applicable law has grown exponentially. Indeed, in drafting ERISA, the tax-writing committees recognized the importance of this system:

to assist employers in their development of plans or plan amendments, the Internal Revenue Service issues determination letters indicating whether or not proposed plans or amendments qualify for the special tax treatment. As a practical matter, since taxpayers generally want assurance in advance that their plans or amendments will qualify, in most cases they obtain prior determinations from the Internal Revenue Service when adopting a plan or modification.²

As the number of plan qualification requirements has proliferated, the regulations, rulings and other guidance have become voluminous. Clearly, the ability to obtain a determination letter is more important than ever, so that employers can have some degree of certainty not only about the qualified status of their plans, but also

about the appropriateness of any associated tax deductions and tax reporting and withholding. Without this certainty, employers may be pressured to establish significant tax reserves to prepare for the possibility of disqualification. Determination letters provide confirmation that, as legal requirements and, possibly, IRS interpretations change, a plan's design remains compliant. Given the volume of requirements and frequency and complexity of changes, the determination letter program enables employers to have close and frequent coordination with the IRS, thereby promoting compliance.

The program has undergone changes over the years, but it remains an invaluable benefit to plan sponsors that offer custom-designed tax-favored plans. Below we look back over the years at the importance of the program and take a look at the current program.

Notably, pursuant to Code Sec. 7805(b), a favorable determination letter protects plan sponsors against retroactive disqualification for plan provisions covered by a prior determination letter that remain materially unchanged.

The timing of the determination letter filings has changed over the years. For many years, determination letter applications could be filed at any time, with certain deadlines to file for major law changes. Then beginning in 2006, we had a five-year cycle program (Cycle A–E filing deadlines), which provided for routine filings every five years, along with an issuance of a cumulative list that listed the law changes that would be reviewed as part of the applicable cycle. Then, in 2017, the cycle system was eliminated, and determination letters were limited to initial qualification, for qualification on the plan's termination, and other circumstances identified in future guidance. Most recently, pursuant to Rev. Proc. 2019-20, the program was opened for certain M&A transactions (which remains open), and for cash balance/hybrid plans (which has since closed). Further expansion to the program is anticipated, which may depend on the IRS's available resources and the extent of the law changes.

The Latest Form 5300

The latest version of the Form 5300 is dated January 2017. The form is a streamlined version, compared to prior versions, which has been routinely updated and revised over the years.³ The instructions to the form provide helpful details of what should be included in the determination letter submission along with the completed Form 5300.⁴ The current determination letter submission generally includes the following:

- Form 8717 with the IRS filing fee (generally \$2,700),
- Form 2848 (power of attorney) if the plan sponsor is not filing on their own,
- Notice to interested parties, which is the notice that is provided to participants to tell them about the filing,
- Plan merger documents (and proof of qualification of such documents),
- Copies of the plan document and amendments (along with a plan restatement that includes prior plan amendments),
- Copies of VCP compliance statements that impact the plan and details on any litigation involving the plan,
- Copy of the trust document,
- A copy of the prior determination letter,
- Form 5309 if a determination regarding ESOP status is being requested, and
- An IRS checklist for a Code Sec. 401(h) account or Code Sec. 420 transfer determination letter (if applicable).

Looking back at the 1975 Form 5300 return, it was focused on defined benefit plans and the questions requested more detailed information regarding the plan provisions and plan qualification. It was four pages of various questions, including, for example, eligibility, coverage testing, vesting schedule, employee and employer contributions, benefit formula, forms of distribution, timing of benefits, death benefits, disability benefits, anti-alienation provisions, controlled group, and actuarial reports.⁵

Regardless of the changes in the submission form and process over the years, the resulting determination letter from the IRS indicates that the plan, as to its form (and not operations), is tax-qualified. Moreover, the process of submitting a plan for a determination letter operates as an enhancement to qualified plan compliance regarding plan operations. The process of preparing to submit a plan for review typically engages a team of in-house and external experts to focus on the plan document, recent transactions, plan records, *etc.* This process, in

and of itself, has the salutary effect of identifying possible errors that the parties can then remedy, as needed, through the Employee Plans Compliance Resolution System (“EPCRS”).⁶

Impact of a Favorable Determination Letter

During the 80 years of its existence, the IRS determination letter has become an integral part of the retirement plan universe in a host of critical areas and indeed has been woven into the fabric of retirement-plan-related transactions. Some of these areas reflect legal, business and accounting standards and practices. Others reflect areas of law and regulation that build on the existence of an IRS determination letter to support legal compliance and confer other economic benefits on plan sponsors and/or participants.

An entire framework has been established that relies on the IRS determination letter as *prima facie* evidence of a plan’s qualified status. Many thousands of transactions that effectively rely on a plan’s determination letter occur every single day, whether as support for (i) purchases and sales of companies that sponsor plans, (ii) participant rollover contributions (where the recipient plan must confirm the rollover contribution comes from a qualified plan), (iii) plan investments, including in lower cost vehicles like collective trusts or insurance company separate accounts, whose legal status as a group trust or unregistered investment depends on the plan’s qualified status, or (iv) participant bankruptcies. Some of these important areas are briefly summarized below:

- **Mergers and Acquisitions**—It has become standard practice for a party acquiring an entity with one or more qualified plans to require “representations and warranties” concerning the tax qualification of the acquired entity’s plan(s). The existence of a current determination letter is *prima facie* support for this practice.
- **Accounting Standards**—Plan auditors must address potential tax liabilities of entities being audited as part of their audits and financial statement preparation. A current determination letter provides the best support for the auditors not requiring a “tax reserve” for the plan/trust under review.
- **Corporate Legal Compliance Functions**—In the wake of Sarbanes-Oxley and Dodd-Frank, many larger companies have established “chief compliance” (or similar) officers to oversee and support the entire

organization’s legal compliance function. Again, current determination letters provide the necessary support for this important function as it relates to the company’s plans.

- **Plan Custodians/Recordkeepers**—As a matter of practice, plan custodians and recordkeepers customarily request evidence that incoming retirement plan customers are “tax-qualified.” Among other reasons, this is necessary to ensure that tax reporting and withholding is done properly (*e.g.*, reporting and withholding for qualified plans under Code Secs. 6047 and 3405, instead of general reporting under Code Sec. 6041 and wage withholding under Code Sec. 6051), to ascertain that available reporting exemptions for qualified plans (*e.g.*, for Form 1099-INT) are available, *etc.*

Whenever there is an opportunity to receive an updated determination for an existing plan, or when establishing a new plan, remember that the benefits of a favorable determination letter are priceless.

- **Tax-Related Areas**—Tax-qualified plans give rise to valuable tax benefits including current deductibility of employer contributions, tax exemption of trust investment earnings, and, of course, tax-deferral/rollover opportunities for participants. Other benefits include:
 - **Social Security Tax Rules**—For decades, employer contributions to qualified plans on behalf of employees have been exempt from Social Security taxes.⁷
 - **Insurance Company Pension Contracts**—Under Subchapter L of the Code, life insurance companies are not subject to tax on reserves held under qualified “pension plan contracts.”⁸ Determination letters provide the necessary support for insurers’ reserve tax treatment.
 - **Tax Treaties**—Qualified plan trusts typically are eligible for exemptions from foreign withholding taxes under tax treaties between the United States

and foreign countries. The determination letter is the best evidence of a trust's entitlement to claim such exemptions *via* Form 6166.

- **Plan Investments**—Defined benefit plans often invest through limited partnerships and other passthrough entities where the general partner/manager needs to know the tax status of the various parties. Again, the determination letter is commonly used to support exempt status.

- **"Group Trusts"**—Under longstanding IRS policy, group trusts that consist of qualified plan investors may themselves be treated as "tax-exempt/qualified" trusts.⁹ A review of the specific requirements for such trusts under Rev. Rul. 2011-1 clearly shows the heavy reliance on IRS qualification. Typically, investment in a group or collective trust is expressly conditioned on the existence of a current determination letter. In this regard, collective trust investments have garnered favorable attention in recent years because they typically offer less expensive investment options than mutual funds for 401(k) plans, thereby helping to bring down the cost of 401(k) investments for plan participants.

- **Other Agencies/Laws**—Federal and state agencies and applicable law relate to tax-favored retirement plans, such as:

- **Department of Labor ("DOL")**—Under ERISA's "division of labor," the IRS has primary jurisdiction over the regulation and interpretation of Part II of ERISA, *i.e.*, the participation, vesting and benefit accrual standards. As a result, the DOL typically defers to IRS in the most critical areas directly affecting plan participants and beneficiaries. The IRS's determination letter program goes a long way to ensure uniformity and consistency in the interpretation and administration of these benefit provisions.

- **Pension Benefit Guaranty Corporation ("PBGC")**—Under Title IV of ERISA, the PBGC insures benefits accrued under an ERISA-covered plan "which has, in practice, met" the plan qualification rules of the Code for the preceding five plan years, or "is, or has been

determined" by Treasury to be "a plan described in chapter 1" of the Code. Thus, the PBGC relies on determination letters as part of its insurance coverage determinations.

- **Securities and Exchange Commission ("SEC")**—Longstanding statutory and administrative rules establish that qualified plans—and commingled investment vehicles involving primarily qualified plans—are exempt from SEC registration, as "securities" under the Securities Exchange Act of 1933 and as "investment companies" under the Investment Company Act of 1940. Indeed, it is customary for the financial institutions that sponsor and maintain these vehicles to require current determination letters as part of the investor admission process.

- **Federal Bankruptcy Laws**—Under 2005 amendments to the federal bankruptcy laws (Section 224), participants' interests in funds that are "exempt from taxation under section 401" (and certain other Code provisions) are protected from creditors in individual bankruptcy proceedings. In addition, rollover contributions to IRAs from such funds are exempt. For example, the law specifically provides that—

(A) If the retirement funds are in a retirement fund that has received a favorable determination under Code Sec. 7805, and that determination is in effect as of the date of the filing of the petition in a case under this title, those funds shall be presumed to be exempt from the estate.

In addition, loans under plans established under Code Sec. 401 are expressly exempt from discharge in bankruptcy (*i.e.*, they are not extinguished). Thus, current determination letters are critical to the protection of participants' retirement benefits.

Conclusion

Whenever there is an opportunity to receive an updated determination for an existing plan, or when establishing a new plan, remember that the benefits of a favorable determination letter are priceless.

ENDNOTES

¹ See Deputy Commissioner Cann, *How the Commissioner Handles Pension Plans*, TAXES, October 1945, at 918-24 (noting that, by 1945, over 7,500 plans had been submitted for advance rulings).

² H.R. Rep. 807, 93d Cong. 2d Sess., p. 105.

³ Form 5300 (Rev. January 2017) (*irs.gov*).

⁴ Instructions for Form 5300 (Rev. January 2017) (*irs.gov*).

⁵ Form 5300 (Rev. 10-1975) (*irs.gov*).

⁶ Rev. Proc. 2021-30.

⁷ Code Sec. 3121.

⁸ Code Sec. 818(a).

⁹ Rev. Rul. 81-100, 1981-1 CB 326 (Jan. 1, 1981) and Rev. Rul. 2011-1, IRB 2011-2 (Jan. 10, 2011).

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