IRS Expands Determination Letter Program for Two Groups of Plans – Considerations for Plan Recordkeepers

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In response to periodic requests to expand the determination letter program, the Internal Revenue Service ("IRS") recently issued welcome guidance in Revenue Procedure 2019-20 (May 1, 2019). The guidance opens up the determination letter program for statutory hybrid plans (e.g., cash balance plans) and merged plans, and provides helpful relief from document failures identified and corrected as part of those determination letter applications. As explained below, under the new IRS guidance, clients that maintain cash balance or other hybrid formula defined benefit plans (even frozen plans) have a unique opportunity to submit the plan to the IRS for a determination letter from September 1, 2019 through August 31, 2020.

Moreover, starting September 1, 2019 and on an ongoing basis, plan sponsors of merged plans (defined benefit or defined contribution) will be able to submit the merged plan for a determination letter application within a limited period after the corporate transaction and plan merger. This is an important due diligence step for the client to ensure that the form of the merged document complies with the complex plan qualification rules under the Internal Revenue Code of 1986, as amended.

KEY TAKEAWAYS FOR PLAN RECORDKEEPERS

In light of the expanded opportunities for plan sponsors to seek updated determination letters, third party recordkeepers (TPAs) that service individually designed plans should consider the following action steps:

- Client Education. Notify clients with individually designed plans about the new opportunities to obtain a Form 5300 determination letter for ongoing plans – see our plan sponsor alert by clicking here.

- Plan Changes. Consider the added protection provided for pending design changes/amendments that can be covered by the determination letter filing. For example, for defined benefit plans, the determination could cover (1) change in actuarial assumptions in light of the recent class action litigation, (2) retiree lump sum windows, (3) IRS market rate of return rules, and (4) conversion to a hybrid formula, etc.

- Plan Services. Expand the services that the TPA may want to offer in relation to the filings.

- Legal Protection. Consider whether additional representations or warranties should be sought if a client elects not to take advantage of the expanded program for which they are eligible, as this may create additional exposure for plan administration if the plan document is not qualified, and the plan's prior determination letter does not offer any protection for subsequent design or legal changes.

Background

In June 2016, the IRS announced that it was eliminating the long-standing five-year cycle determination letter program for individually designed tax-qualified retirement plans. [IRS Rev. Proc. 2016-37.] At the time, the IRS said that it would continue to accept determination letter applications from individually designed plans only for the purposes of initial qualification, qualification at plan termination, and in other "specified circumstances" that the IRS may announce in subsequent guidance.

In April 2018, the IRS asked the public to submit comments on specific types of individually designed plans for which the IRS should consider reopening the determination letter program. [IRS Announcement 2018-24.] After considering the comments it received from the regulated community, including two comment letters filed by Groom Law Group, the IRS issued Revenue Procedure 2019-20. This latest Revenue Procedure represents the IRS' first foray back into the determination letter program for individually designed plans in "specified circumstances", as contemplated by Revenue Procedure 2016-37.

Limited Expansion Under Revenue Procedure 2019-20

Effective September 1, 2019, Revenue Procedure 2019-20 expands the determination letter program in two ways. First, sponsors of defined benefit plans that use a statutory hybrid formula (*e.g.*, cash balance plans) will be eligible to apply for a new determination letter during a one-year period beginning September 1, 2019. Second, sponsors of "merged plans" (as defined below) will be eligible to

apply for determination letters on an ongoing basis, but only during a limited period following the date of the corporate merger and plan merger.

A. Statutory Hybrid Plans

Any plan that uses a statutory hybrid formula is eligible to apply for a new determination letter between September 1, 2019 and August 31, 2020. For this purpose, a statutory hybrid formula means a lump-sum-based formula, or any formula that has a similar effect to a lump-sum-based formula. Common examples of statutory hybrid plan designs include cash balance plans, pension equity plans, and certain variable annuity plans. Under Revenue Procedure 2019-20, a plan that uses a statutory hybrid formula is eligible to apply for a determination letter even if the plan also includes a "traditional" formula (*e.g.*, benefits based on final average pay and credited years of service), and even if the plan's statutory hybrid formula was already in place when the plan received a prior determination letter.

Sanctions Relief: The IRS will not impose any sanctions for plan document failures relating to implementation of the final hybrid plan regulations that are discovered by the IRS in reviewing a determination letter application submitted pursuant to Rev. Proc. 2019-20. If the IRS discovers any other plan document failures, then as long as the amendment that created the failure was adopted timely and in good faith with the intent of maintaining the plan's qualified status (or the plan sponsor reasonably and in good faith determined that no amendment was required in connection with a change in qualification requirements), a reduced sanction equal to the applicable user fee under EPCRS will apply (*e.g.*, the maximum user fee of $3,500 would apply if a large plan sponsor had self-reported the plan document failure by filing a VCP application). However, the IRS expressly states that the anti-cutback relief that expired before the 2017 plan year will not be extended for remedial amendments.

B. Merged Plans

Revenue Procedure 2019-20 also permits sponsors of merged plans to apply for a determination letter, starting September 1, 2019. For this purpose, a "merged plan" means a plan resulting from the merger or consolidation of two or more formerly separate plans into a single plan, which must have occurred in connection with a corporate merger, acquisition, or similar business transaction among unrelated entities. To be eligible, a plan merger must be completed within the required transition period under Code §410(b)(6)(C) (i.e., no later than the end of the plan year after the plan year that includes the date of the corporate transaction), and the determination letter application must be submitted by the last day of the first plan year (of the merged plan) that begins *after* the effective date of the plan merger.

For example, if a company acquires an unrelated entity in a corporate transaction as of July 1, 2019, and then merges the acquired company's plan into its plan as of January 1, 2020, then (assuming the merged plan uses a calendar year plan year) the deadline for submitting a determination letter application for the merged plan would be December 31, 2021. However, if the plan merger had been effective as of December 31, 2019 instead of January 1, 2020, the deadline for the merged plan's determination letter application would be December 31, 2020.

Sanctions Relief: The IRS will not impose any sanctions for plan document failures that relate to a plan provision included to effectuate the plan merger. If the IRS discovers any other plan document failures in reviewing the merged plan's determination letter application, then as long as the amendment that created the failure was adopted timely and in good faith with the intent of maintaining the plan's qualified status (or the plan sponsor reasonably and in good faith determined that no amendment was required in connection with a change in qualification requirements), a reduced sanction equal to the applicable user fee under EPCRS will apply (*e.g.*, the maximum user fee of $3,500 would apply if a large plan sponsor had self-reported the plan document failure by filing a VCP application).

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While these opportunities are very helpful, most qualified plans – such as 401(k) plans that have not been involved in a merger – will not be able to take advantage of them. These plan sponsors should consider obtaining a law firm opinion letter, which Groom offers as part of its Document Compliance Service, to confirm their plan's tax-qualified status.

If you have questions on the expansion of the determination letter program, or need assistance with preparing a determination letter application, please reach out to your regular Groom attorney.