

Employee Benefits Corner

By Elizabeth Thomas Dold and David N. Levine

The IRS 2011–2012 Priority Guidance Plan: A Long List for Employee Benefits

Each year, the Department of the Treasury, the IRS and the Chief Counsel at the IRS jointly issue a list of their guidance priorities for the year. Although the federal government generally operates on an October 1 fiscal year, the priority guidance plan is based on a July–June period. On September 2, 2011, the July 2011–June 2012 priority guidance plan was released (“the 2011–2012 Plan”).¹

The 2011–2012 Plan contains 66 projects in the context of “Employee Benefits” with 37 projects specifically focused on “Retirement Benefits.” As in prior years, many of the projects listed are carryover projects from the 2010–2011 priority guidance plan² that are still in the middle of the regulatory process. The inclusion of a number of carryover projects is not surprising in light of both the budgetary restrictions limiting the federal government’s ability to replace retiring workers or expand the size of its employee benefits workforce and the significant resources that have been shifted to implementing the various provisions of the Patient Protection and Affordable Care Act of 2010 (PPACA) (P.L. 111-148). The PPACA was enacted in 2010 and included a number of requirements necessitating significant guidance in the next few years. Below we review a number of significant Retirement Benefits items from the 2011–2012 Plan and attempt to review where these pieces of guidance may be heading.³



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Elizabeth Thomas Dold and **David N. Levine** are Principals at Groom Law Group, Chartered in Washington, D.C.

General Guidance

The following are examples of guidance listed on the 2011–2012 Plan that are likely to affect broad groups of plans:

■ **Employee Plans Compliance Resolution System.**

In the early 1990s, the IRS began establishing programs that allowed the correction of errors—both in plan form and operation—through voluntary correction methods that provided streamlines and less expensive remedies than would be available *via* the examination process. In the 2000s, these programs were consolidated into the Employee Plans Compliance Resolution System (EPCRS). Since this consolidation occurred, EPCRS has been updated from time-to-time to expand, enhance and improve its overall effectiveness and efficiency. The most recent update of EPCRS was in 2008.⁴ It has been widely reported that the key feature of the next update of the EPCRS program will be provisions allowing the correction of Code Sec. 403(b) “plan document” errors within the EPCRS framework. Currently, there is no correction method for Code Sec. 403(b) “plan document” errors.

■ **Prototype and Volume Submitter Plan Opinion Letter, Advisor Letter and Determination Letter Process.**

2011–2012 marks the start of a new six-year cycle for updating defined contribution pre-approved plans for legal changes and interim amendments adopted since these plans were submitted in 2005–2006. The 2011–2012 Plan indicates that a revised version of the prior guidance⁵ addressing these filings will be issued in the 2011–2012 period. We would hope that this procedure will be issued shortly or extensions of time to file will be provided as the deadline for “mass submitters” is currently October 31, 2011 (with other filers due by January 31, 2012).

■ **Individually Designed Plan Determination Letter Process.**

January 31, 2012, is the deadline for “Cycle A” plan sponsors (*i.e.*, generally those with employer identification numbers ending in 1 or 6) to submit “on cycle” for a new determination letter. After that date, existing “EGTRRA” Cycle A determination letters will cease to be valid. Since 2005, the IRS has received significant commentary on the periodic amendment requirements contained in

its existing guidance on determination letters for individually designed plans.⁶ Consistent with reported comments of IRS officials, the 2011–2012 Plan indicates that an update to this program is in process and will likely result in changes to the number and timing of required interim amendments.

■ **403(b) Plan Determination Letters.**

The 2010–2011 priority guidance plan specifically referenced “[g]uidance on prototype program for 403(b) plans.” However, on the 2012 guidance plan there is only a reference to “[g]uidance on §403(b) plans.” In that proposed model language was issued for Code Sec. 403(b) plans several years ago, we would expect that this more general Code Sec. 403(b) guidance could include the Code Sec. 403(b) prototype program. However, with limited resources available at this time, it is not certain exactly when this program would go into effect.

■ **Cycle B Cumulative List.**

In the last few months of each year, the IRS issues its updated “Cumulative List of Changes in Qualified Plan Requirements” (“Cumulative List”) to be utilized in connection with filings under its plan document approval programs discussed above.⁷ As expected, the 2011–2012 Plan provides for a new Cumulative List to be issued. Items on the new Cumulative List will be expressly required for qualified plans that are being submitted for the “Cycle B” determination letter cycle that runs from 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 of amendments for any required interim IRS amendment, which typically need to be adopted by the tax filing deadline for which the provision is effective, although this list is not always a comprehensive list that addresses all required changes because it is used to identify what amendments will be looked for by the IRS in a particular “Cycle” and does not provide a list of amendment deadlines.

Qualified Defined Contribution Plans

The following are examples of guidance listed on the 2011–2012 Plan that are likely to affect defined contribution plans:

- **Mid-Year Modification of Safe Harbor Plan Formulas.** The final Treasury regulations issued in 2004 permit the suspension of safe-harbor matching contributions in certain specified conditions.⁸ However, these Treasury regulations do not contain similar rules permitting the suspension of safe-harbor nonelective contributions. In reaction to the economic hardship facing many safe harbor plan sponsors, in 2009, the IRS issued proposed Treasury regulations⁹ that provided limited relief for companies in financial hardship to suspend, reduce or stop employer nonelective contributions for safe-harbor plans. Numerous comments have been made that safe-harbor matching contributions and nonelective contributions should be treated consistently. The 2011–2012 Plan indicates that these proposed regulations are expected to be finalized.
- **Lifetime Income from Defined Contribution Plans.** When Code Sec. 401(k) plans emerged in the late 1970s, many employers provided both defined benefit pension plans as well as “supplemental” Code Sec. 401(k) plans that allowed their employees to save for retirement. However, since that time, the number of ongoing defined benefit plans and the percentage of the workforce covered by these plans has declined significantly, leaving many employees with a Code Sec. 401(k) plan as their primary retirement savings vehicle. Pursuant to initial plan design and the utilization of changes to the Internal Revenue Code made pursuant to Treasury regulations and the Economic Growth and Tax Relief Reconciliation Act of 2001, many defined contribution plans do not provide for payment options other than a lump-sum payment of benefits. However, recently, because of concerns about the ability of retirees to provide for themselves in retirement, there has been significant focus at the IRS, Department of Labor and in the benefits community on how lifetime income programs can be added and encouraged in defined contribution plans.
- Currently, there is very little guidance on how guaranteed lifetime income products can be implemented in defined contribution plans while minimizing administrative burden. Many plan sponsors have elected to stay away from lifetime income stream designs in their defined contribution plans because they do not want

to handle the administration of the Code Sec. 417 qualified joint and survivor annuity rules (including spousal consent requirements), administration of the Code Sec. 402(c) rollover rules applicable to periodic payments of 10 years or more, nondiscrimination testing, anti-cutback, required minimum distribution rules under Code Sec. 401(a)(9), treatment under Code Sec. 72(t) and reporting and withholding requirements. Hopefully, this guidance will provide regulatory flexibility that encourages the use of lifetime income options in defined contribution plans with a minimum of regulatory burden or complexity.

- **Employee Stock Ownership Plans.** The 2011–2012 Plan indicates that guidance will be forthcoming on the rules applicable to Employee Stock Ownership Plans (ESOPs) under Code Secs. 409 and 4975.

Defined Benefit Plans

The following are examples of guidance listed on the 2011–2012 Plan that are likely to affect defined benefit plans:

- **Hybrid Plan Guidance.** After nearly a decade of proposed, withdrawn, repropoed, final and additional proposed guidance, as well as Congressional, the IRS is still working to complete its “initial” set of comprehensive regulations on hybrid plans. Final regulations were issued in October 2010¹⁰ with a general effective date of plan years beginning on or after January 1, 2011. However, certain key items, such as guidance about what is a permissible “market rate of return” under Code Sec. 411(b)(5) and how hybrid plans may come into compliance with these new regulations were not addressed in final regulations at that time. Instead, proposed regulations were issued along with a request for comments on additional hybrid-plan related items. The 2011–2012 Plan indicates that final regulations on some or all of these issues (as well as pension equity plans) will be issued. In addition, hopefully these regulations will also provide further delayed regulatory effective dates so that there is sufficient time for hybrid plans to be brought into compliance.
- **Participant Notices.** In recent years, there has been a proliferation of notices—from automatic enrollment, to safe harbor, to funding notices,

to more complex “204(h)” notice requirements. Consistent with this trend, the 2011–2012 Plan includes two items of relevance: (1) guidance under Code Sec. 4980F regarding Code Sec. 204(h) notices for participants and beneficiaries relating to certain plan amendments to hybrid plans (*i.e.*, plan amendments that significantly reduce the rate of future benefit accruals), and (2) the funding notice requirements under ERISA section 101(j) that apply to single-employer plans that become subject to funding-based benefit limitations as set forth in Code Sec. 436.

- **Additional Guidance on Funding Rules.** The IRS has previously issued numerous pieces of guidance implementing the revisions to the Code’s defined benefit funding rules made by the Pension Protection Act of 2006. The 2011–2012 Plan includes a number of additional pieces of guidance in this area: (1) final Treasury regulations under Code Sec. 430 minimum required contribution rules, (2) Treasury regulations on additional issues related to funding and related rules for single-employer plans under Code Secs. 430 and 436, (3) funding rules for multiemployer plans under Code Sec. 432, (4) sample plan amendment language for single-employer plans to reflect the benefit limitations under Code Sec. 436 (which the IRS has been informally stating that a simple cross-reference to the provisions may not be sufficient), 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

The following are examples of guidance listed on the 2011–2012 Plan that are likely to affect specific sectors of the retirement plans community:

- **Governmental Plan Issues.** There are three key areas for governmental plans:
 - **Governmental Plan Definition.** For many years, there have been inconsistencies in how the IRS, Department of Labor and Pension Benefit Guaranty Corporation determine whether an entity is a “governmental plan,” and thus exempt from ERISA as well as many Code provisions. Over

the past several years, the three agencies have been consulting with each other to develop new guidance on the definition of a “governmental plan” under Code Sec. 414(d). This item continues to be of importance as the number of “privatized” governmental employees continues to rise. The 2011–2012 Plan indicates that guidance will be forthcoming.

- **Guidance on Pick-up Arrangements.** Many governmental plans are funded by mandatory employee contributions that are “picked up” and treated as employer contributions under Code Sec. 414(h)(2). Recently, due to significant financial difficulties, concern has been expressed about whether an employee may be allowed to elect between tiers of benefits that provide for different member contributions and benefit levels. We anticipate that the 2011–2012 Plan reference to Code Sec. 414(h)(2) will result in guidance on this issue.
- **Normal Retirement Age.** In May 2007, the IRS issued final regulations governing a plan’s definition of “normal retirement age.”¹¹ In Notice 2009-86, the IRS delayed the effective date of these regulations for governmental plans to plan years beginning on or after January 1, 2013, to address the potentially lower and/or service based normal retirement ages used by many governmental plans. The 2011–2012 Plan indicates that guidance on this issue is anticipated.
- **Church Plans.** The 2011–2012 Plan indicates that a revenue procedure relating to ruling requests under Code Sec. 414(e) for church plans will be issued. Rev. Proc. 2011-44 was recently issued that adds a notice requirement (similar to the Notice to Interested Parties for determination letter applications) for church plan sponsors that apply for a private letter ruling in whether the plan is a “church plan” under Code Sec. 414(e). Further guidance on church plans is expected.
- **DB(k) Plans.** In August 2009, the IRS requested comments¹² on the requirements of Code Sec. 414(x), a Code provision added by the Pension Protection Act of 2006 that provides for a new type of hybrid defined benefit-defined contribution plan that combines a defined benefit plan with a 401(k) feature effective January 1, 2010.

The 2011–2012 Plan provides that guidance on Code Sec. 414(x) will be forthcoming. Hopefully it will provide some regulatory clarity for those interested in implementing these plans.

- **Group Trusts and Puerto Rico Plan Participation.** In Rev. Rul. 2011-1,¹³ the IRS updated its guidance on group trusts as well as an extension of the transition relief for separating U.S. and Puerto Rico plans provided in Rev. Rul. 2008-40.¹⁴ The 2011–2012 Plan indicates that further group trust guidance will be forthcoming. Hopefully this guidance will provide further transition relief and guidance on the inclusion of Puerto Rico–only plans in group trusts.
- **Pension Distributions.** The 2011–2012 Plan includes a number of items that impact the reporting of pension distributions, and basis allocations as follows:
 - **Code Sec. 72(t) Exceptions.** Guidance on exceptions to additional 10-percent tax

under Code Sec. 72(t) for early distributions from qualified plans and IRAs. This guidance may impact the coding on box 7 on Form 1099-R.

- **Distributions to Multiple Distributions and Basis Allocation.** Guidance under Code Secs. 402(c) (eligible rollover distributions) and 402A (Roth distributions) for distributions that are disbursed to multiple destinations. Hopefully this guidance will address the concerns raised about the language in the IRS' sample Code Sec. 402(f) notice¹⁵ that indicates a *pro rata* basis allocation must be made for partial/split rollovers.
- **International Tax Issues Related to Tax-Favored Retirement Plans.** In recent years, the IRS has been focusing on international employee benefits issues. As part of this focus, the 2011–2012 Plan includes guidance under Code Sec. 402 on transfers from foreign retirement plans.

ENDNOTES

¹ www.irs.gov/pub/irs-utl/2011-2012_pgp.pdf.

² www.irs.gov/pub/irs-utl/2010-2011_pgp.pdf.

³ Many of the guidance items are worded generally. As such, the commentary in this article is a “best-guess” effort to add detail to these short descriptions.

⁴ Rev. Proc. 2008-50, IRB 2008-35, 464.

⁵ Rev. Proc. 2005-16, IRB 2005-10, 674.

⁶ See Rev. Proc. 2007-44, 2007-2 CB 54

(superseding Rev. Proc. 2005-66, IRB 2005-37, 509). See also www.irs.gov/pub/irs-tege/tege_act_rpt9.pdf.

⁷ The 2010 Cumulative List for “Cycle A” can be found at www.irs.gov/pub/irs-drop/n-10-90.pdf.

⁸ Reg. §1.401(k)-3(g).

⁹ Proposed Reg. §1.401(k)-3(e) and (g).

¹⁰ T.D. 9505, Oct. 18, 2010.

¹¹ T.D. 9325, 2007-1 CB 1386.

¹² Notice 2009-71, IRB 2009-35, 262.

¹³ Rev. Rul. 2011-1, IRB 2011-2, January 10, 2011.

¹⁴ Rev. Rul. 2008-40, IRB 2008-30, July 1, 2008. Previous guidance was found at Rev. Rul. 81-100, 1981-1 CB 326, and Rev. Rul. 2004-67, IRB 2004-50, 967.

¹⁵ Notice 2009-68, IRB 2009-39, 423.

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