Legal Developments

Long-Standing IRS Determination Letter Program Takes a Big Hit

On July 21, 2015, the IRS released Announcement 2015-19, which stated massive changes to the Employee Plans determination letter (DL) program for qualified retirement plans under Section 401(a) of the Internal Revenue Code of 1986, as amended (the Code). This includes 401(k) plans, profit-sharing plans, ESOPs, and defined benefit plans that are individually designed. A brief look at the current program (and its uses) is set forth below, followed by a summary of the IRS Announcement and the upcoming changes.

By Elizabeth Thomas Dold

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The Historic Program

Under the current DL system, which has been around in some form or another for over 70 years, the IRS provides employers with the ability to submit their plan document for review, to ensure that the plan document, as to its form, complies with the complex rules required for a plan to maintain its tax-qualified status. Since the 2000s, the program provides a plan sponsor with the ability to submit its plan document for review every five years following a cycle program, generally based on the last digit of the plan sponsor's employer identification number (EIN). The applicable "remedial amendment period" during which a sponsor may correct the plan document for disqualifying provisions, runs through the end of this five-year period. This allows employers to correct the plan document and eliminate disqualifying provisions without an IRS sanction, and the favorable determination letter is valid until the end of the next five-year filing period. The favorable IRS letter also facilitates document review in plan audits and generally provides protection against retroactive plan disqualification.

The favorable DL is used as prima face evidence that the plan is tax-qualified, and therefore eligible for the very generous tax benefits. In general, participants are not taxed on their plan benefits until retirement, the trust that holds the plan assets is not subject to taxation (other than unrelated business income tax, if any), and employer contributions to the plan are not subject to employment taxes and are eligible for immediate deduction by the employer.

This IRS letter is used regularly in the benefits community to support the tax-favored status of the plan, including:

- *M&A Transactions*. In mergers and acquisitions of companies and their plans—where the seller represents that the plans are tax-qualified and the buyer must perform due diligence to verify that the plan is tax-qualified—having a current favorable determination letter goes a long way in this process.
- *Rollover Distributions*. Everyday plan distributions and eligible rollover amounts—if the plan is not qualified, these distributions will not be eligible for tax-free treatment, and the acceptance of these amounts by an IRA will trigger a 6 percent annual excise tax on the participant until the amounts are removed. The plan that accepts the rollover contribution must take steps to verify that the plan is qualified and, if it is not, the amounts must be promptly distributed to not taint the tax-qualified status of the receiving plan. To the extent the plans are no longer tax-qualified, the reporting and

withholding requirements will not be satisfied, and immediate taxation to participants results.

- *Form 5500 Auditor*. Auditor reports include a provision regarding the tax-qualified status of the plan. The determination letter and the plan sponsor's representation go a long way to satisfying this requirement. Without a DL, it is unclear what additional level of review the auditors will perform to be justified in issuing their opinion.
- *Investment Funds*. Certain funding vehicles are available only to tax-qualified plans (for example, 81-100 group trusts or unregistered investments); a favorable DL is typically used to justify inclusion into a particular investment fund. Without that determination, it is unclear how investment houses will satisfy their requirements.
- *Bankruptcy/Creditor Protection*. When benefits are held within a tax-qualified plan, they are largely protected from the participant's creditor's claims within and outside of bankruptcy. At a minimum, this protection will be more difficult to obtain without a favorable DL.

The New Program

Citing limited resources, effective January 1, 2017, the IRS will eliminate the staggered five-year determination letter remedial amendment cycles for individually designed plans. This means that plan sponsors will no longer be able to file for a determination from the IRS that the form of the plan document complies with the very complex qualification requirements of the Code.

Moreover, as of July 21, 2015, the IRS will no longer accept a DL application that is filed off-cycle (other than new or terminating plans). This effectively means that, unless covered by Cycle E (plan sponsor EIN ending in 5 or 0) or Cycle A (plan sponsor EIN ending in 1 or 6, or a Cycle A election applies for a controlled group or affiliated service group), you will likely no longer be able to file for a DL with the IRS. (Note that a Cycle A filer will have until January 31, 2017, to file for its potentially final DL.)

Instead, the program will only provide an ability to file a Form 5300 DL application for initial plan qualification (see below) and qualification upon plan termination (via Form 5310), and in certain other limited circumstances that the IRS and Treasury may determine. An initial plan qualification is described as a plan for which a Form 5300 has not been filed or a plan for which a Form 5300 was filed but a DL was not issued with respect to the plan, regardless of when the plan was initially adopted. The IRS and Treasury intend to request comments periodically from the public regarding the other limited circumstances under which a plan sponsor will be eligible to apply for a DL, to be set forth in published guidance on a periodic basis.

As a result of the elimination of the five-year cycles, the extension of the remedial amendment period through the end of the applicable cycle will no longer be available after December 31, 2016, and the standard remedial amendment period definition under the Treasury Regulations Section 1.401(b)-1 shall apply. However, the Announcement indicates that the IRS intends to extend the remedial amendment period to a date that is expected to end no earlier than December 31, 2017. This means that the date on a DL that extends past December 31, 2017, will not be controlling. Therefore, plan sponsors may be well advised to perform a careful review of their plan documents by this announced remedial amendment period deadline and consider whether a VCP filing with the IRS under Revenue Procedure 2013-12 (as amended) or other corrective action is advisable to clean up the plan document, or if moving to a pre-approved plan document is appropriate.

Notably, no changes have been announced for the pre-approved plan program or its six-year remedial amendment period cycles. These plans are still able to rely on an IRS opinion and advisory letter for the tax-qualified status of their plans, and certain volume submitter plans are still eligible to file for a Form 5307 determination letter.

Other Related Changes

The Announcement indicates that the IRS and Treasury are considering other easier ways for plan sponsors to be able to comply with the qualified plan document requirements, such as:

- *Model IRS Amendments*. The IRS is considering issuing more regularly available model IRS amendments, which have been provided sporadically in the past to help plan sponsors anticipate the level of detail that the IRS is looking for in relation to a particular design or Code requirement (for example, Code Section 436 benefit restrictions, Roth 401(k) deferrals).
- *Inapplicable Provisions*. The IRS is considering not requiring certain plan provisions or amendments to be adopted if, and for so long as, the provision is not relevant to a particular plan. For example,

if the type of plan, employer, or benefits offered in the provision is not relevant, then no amendment will be required. Many of us remember Code Section 132(f)(4) pre-tax qualified transportation costs that all plans were required to include even if the benefit was not being offered. More recently, it seems that the IRS has been taking a similar position with respect to differential pay for employees working with the armed forces, and the employer stock diversification requirements of Code Section 401(a)(35).

- *Incorporation by Reference*. The IRS also is considering expanding plan sponsors' options in regard to document qualification requirements through incorporation by reference. For example, many were hopeful that an incorporation by reference to Code Section 436 would have been sufficient until the IRS issued its very lengthy model plan amendment. In the past, the IRS kept a list of Code provisions that were eligible for incorporation by reference, which could be dusted off and updated.

Moreover, the IRS requested comments in the following four areas, ideally to help balance out the risks and burdens that have now shifted heavily onto plan sponsors and their participants:

1. What changes should be made to the remedial amendment period that would otherwise apply to individually designed plans under Code Section 401(b)?
2. In view of these changes to the DL program, what additional considerations should be taken into account in connection with the current interim amendment requirement?
3. What guidance should be issued to assist plan sponsors that wish to convert an individually designed plan into a pre-approved plan?
4. What changes should be made to other IRS programs to facilitate the changes described in the Announcement, including revisions to the Employee Plans Compliance Resolution System set forth in Revenue Procedure 2013-12 (as amended)?

Conclusion

Stay tuned as the IRS makes drastic changes to long-standing protections that have historically facilitated the entire voluntary employer pension system, and helped to ensure compliance with very complex qualification rules. And if you are a Cycle E or A filer, please make sure you file for what may be your final DL for the plan (by January 31, 2016, or January 31, 2017, respectively). ■