EMPLOYEE BENEFITS

THE IRS OVERHAUL OF THE DETERMINATION LETTER PROCESS: WHAT PLAN SPONSORS NEED TO KNOW

by Eric W. Gregory

Last summer, the Internal Revenue Service (IRS) announced that its periodic review of individually designed retirement plans to determine the plans' qualified status will end effective January 31, 2017. In January 2016, the IRS issued Notice 2016-03, which provides further guidance for employers who:

- Rely on a determination letter issued prior to January 4, 2016;
- May establish or adopt a pre-approved defined contribution plan; and
- Are in a controlled group or affiliated service group and previously made "Cycle A" elections.

With these changes, plan sponsors need to review all of their qualified retirement plans and consider the best way to move forward.

Overview of the Determination Letter Process

A plan must comply with Section 401(a) of the Internal Revenue Code (Code) in order to remain qualified. The substantial advantages of maintaining tax qualification under Section 401(a) include:

- The current deductibility of employer contributions (subject to Code limitations);
- Tax-deferred growth of investments held in the plan's trust;
- Retirement plan funds generally not being subject to claims of creditors of either the plan sponsor or the plan participants; and
- Tax deferral of contributions continuing until amounts are actually received by employees, including the ability to make tax-free rollovers to other qualified plans or IRAs.

Qualification is of obvious importance to employers that maintain qualified plans, and just as crucial to third parties. Company and plan auditors, as well as investment managers, who rely on SEC exemptions will examine favorable determination letters. Also, companies involved in mergers or acquisitions will typically present a favorable determination letter to show that a retirement plan is qualified in form. Finally, bankruptcy courts view determination letters as evidence of qualification for the purposes of exempting a plan's assets from the bankruptcy estate of the sponsor.

For many years, plan sponsors could request determination letters at any time or the IRS would periodically require that a plan get an updated determination letter due to changes in the Code. This created an IRS staffing problem where requests for favorable determination letters would come in droves when the law changed.

In order to counteract that problem, the IRS implemented a five-year remedial amendment cycle for individually designed plans. These cycles were based on the last digit of the sponsor's EIN, as follows:

Last digit of sponsor's EIN	Cycle	Submission period opens and ends
1 or 6	A	02/01/2011 - 01/31/2012
2 or 7	B	02/01/2012 - 01/31/2013
3 or 8	C	02/01/2013 - 01/31/2014
4 or 9	D	02/01/2014 - 01/31/2015
5 or 0	E	02/01/2015 - 1/31/2016
1 or 6	A	02/01/2016 - 01/31/2017

The End of the Five-Year Cycle

The IRS announced the end of the five-year cycle in Announcement 2015-19. Cycle A sponsors, however, may submit determination letter applications until January 31, 2017. After that time, the IRS plans to no longer accept determination letter applications based on the five-year cycle and will only accept applications from plans on initial qualification and termination.

Currently, the IRS will no longer accept off-cycle applications unless the plan is terminating or it is a new plan. For these purposes, a plan qualifies as a "new plan" if it is submitted no later than the due date, including extensions, of the plan sponsor's tax return for the year the plan is first effective.

Expiration Dates on Determination Letters

Notice 2016-03 states that expiration dates on determination letters issued prior to January 4, 2016 may be disregarded. This means that plan sponsors can rely on current determination letters after the stated expiration date on the letter. Future guidance will clarify the extent to which a determination letter may be relied on after a subsequent change in law or plan amendment.

Changes for Pre-Approved Plans

The IRS will leave the determination letter program in place for "pre-approved plans" (referred to as "master," "prototype" and "volume submitter" plans). Pre-approved plans follow six-year cycles. Over the years, the IRS has made the pre-approved program more attractive for plan sponsors by lowering determination letter fees for these plans.

The IRS has extended various deadlines for first time adopters of pre-approved defined contribution plans. On and after January 1, 2016, if an employer with an individually designed defined contribution plan converts to a pre-approved defined contribution plan by April 30, 2017, the employer may rely on the pre-approved plan's opinion or advisory letter covering the six-year remedial amendment period ending January 31, 2017. The deadline to submit a determination letter for these plans is April 30, 2017. The previous deadline to adopt a plan and request a determination letter was April 30, 2016.

Employers that have adopted a pre-approved defined contribution plan prior to January 1, 2016 must still adopt a restated plan document and may file for an IRS determination letter by April 30, 2016.

Limitations on Pre-Approved Plans

Pre-approved plans have their limitations, however. Plan sponsors with numerous business lines may find that pre-approved plans do not have sufficient flexibility. Also, plans with both union and non-union employees, some ESOPs, and cash balance plans may necessitate individual design. There are no multiemployer pre-approved plans. Many defined benefit pension plans frequently maintain multiple benefit formulas and grandfathered rights and features that cannot be accommodated by pre-approved plans.

Cycle A Determination Letter Submission for Controlled Groups and Affiliated Service Groups

Under previous guidance, if more than one plan is maintained by members of a controlled group or an affiliated service group, an election could be made so that all plans sponsored by members of the controlled group or affiliated service group can be submitted under Cycle A. The IRS has confirmed that sponsors who made this election prior to January 1, 2012, may submit plans during Cycle A ending on January 31, 2017.

Possible Future IRS Compliance Programs

The IRS has indicated that it may: (1) provide model amendments; (2) not require certain amendments to be adopted if they are not relevant to a particular plan; or (3) expand plan sponsors' ability to document qualification requirements through "incorporation by reference." Also, the IRS has requested comments on: (1) requirements for the adoption of interim amendments; (2) guidance to assist plans in converting from an individually designed plan to a pre-approved plan; and (3) modifications to other IRS programs to facilitate changes to the determination letter process including the Employee Plans Compliance Resolution System (EPCRS).

In addition to the above, the IRS has informally floated other ideas to assist plan sponsors in maintaining a plan's qualified status. At a recent American Bar Association meeting, an IRS representative discussed: (1) making it easier to correct plan document failures using EPCRS; (2) expanding the determination letter program for pre-approved plans; and (3) allowing sponsors to make minor changes to model amendments.

Unanswered Questions

Despite the IRS guidance, numerous issues have yet to be clarified regarding the determination letter program going forward.

The IRS has yet to provide any specific formal guidance detailing how a plan sponsor might be able to rely on a determination letter after it adopts a plan amendment. Informal guidance from the IRS has indicated that once a plan is amended, only the language in the plan as of the issuance of the determination letter will still be considered as a part of the determination letter. Future IRS guidance is expected to address this issue.

The boundaries of what will constitute a "new" plan for determination letter purposes are not clear. For instance, would a spin-off plan from a qualified plan in connection with a merger constitute a new plan?

Finally, it is unclear how these changes will impact the filing of an S-8 registration statement with the Securities and Exchange Commission, which requests either an opinion of counsel or a determination letter on the qualified status of a plan that offers employer stock as an investment option.

Steps to Take

At this time, plan sponsors should take a number of steps to ensure continued compliance of retirement plans:

- Sponsors of individually designed plans in Cycle A should file in their current cycle;
- Cycle C and D plans with letter submissions currently pending should check the status of their determination letters with the IRS;
- When feasible, plan sponsors may consider transitioning to a pre-approved plan. Employers considering a transition to a pre-approved plan should be mindful of the April 30, 2017 deadlines;
- Newly adopted individually designed plans should be submitted to the IRS for a determination letter no later than the due date, including extensions, of the sponsor's tax return for the year the new plan is effective; and
- Any plan that is terminated should be submitted to the IRS for a determination letter upon termination.

Conclusion

These announcements are merely the first step in a long process.

Plan sponsors should watch for additional guidance from the IRS. In the meantime, it is imperative that sponsors ensure that individually designed plans are regularly reviewed by counsel to ensure document compliance. The absence of future determination letters will only make maintaining compliance more difficult for individually designed plans, and may give rise to serious consequences should the plan be subject to IRS audit.

Please contact the author of this Alert or any member of the Dickinson Wright employee benefits practice team if you have a Cycle A, newly adopted or terminating plan that should be submitted to the IRS for a determination letter. Also, please contact us if you would like to discuss transitioning to or from a pre-approved plan, or if you should have any other questions concerning this new IRS guidance.

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