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Client Alert

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What's Next for the Determination Letter Program?

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In prior Client Alerts, we reported on the changes to the Internal Revenue Service (IRS) Determination Letter Program described in IRS Announcement 2015-19 and IRS Notice 2016-03. Our January 2016 Client Alert included a reference to a public survey taken by the Employee Plans Subcommittee of the Advisory Committee on Tax Exempt and Government Entities (ACT) regarding these changes, as part of ACT's examination of the restructuring of the Determination Letter Program.

On June 8, 2016, ACT presented to the IRS its "Analysis and Recommendations Regarding Changes to the Determination Letter Program" (the "Report"). The Report (1) analyzes issues raised by members of the employee plans community concerning the IRS' announced changes to the Determination Letter Program, based on responses to the survey and Comment Letters sent to the IRS in response to Announcement 2015-19, and (2) makes three primary recommendations to the IRS regarding changes to the Determination Letter Program. This Client Alert describes the recommendations in the Report and related considerations for individually designed plan sponsors in light of these recommendations, which are currently under consideration by the IRS.

Why Is a Favorable Determination Letter Important?

Favorable determination letters provide plan sponsors with assurance that the IRS has determined that a plan document is legally compliant (i.e., all required and discretionary plan amendments since the prior determination letter have been timely adopted and are legally sound). As noted in the Report, having a favorable determination letter is important in many respects, including:

- As confirmation that the plan includes protections for participants', beneficiaries' and alternate payees' benefits.
- To provide assurance to a plan sponsor that an IRS audit will not reveal plan document compliance issues.
- To minimize potential liability to a plan that accepts rollover contributions from other tax-qualified retirement plans.
- To provide assurance to record keepers, custodians and auditors (for purposes of the Form 5500) that the plan document is legally compliant.
- To satisfy requirements related to Securities and Exchange Commission disclosures and registrations, Pension Benefit Guaranty Corporation terminations and guarantees and Department of Labor investigations.
- To assess plan compliance and minimize potential liabilities in corporate transactions and plan mergers.
- In application of tax treaties and dual plan qualification in Puerto Rico.
- To demonstrate tax-qualified status when investing plan assets in investment vehicles that limit eligibility of investors to tax-qualified plans.
- To comply with federal laws aimed at countering the funding of terrorism or the laundering of money.
- To protect plan assets in participant bankruptcy proceedings.

Accordingly, the decision made by the IRS last year to end the current staggered five-year remedial amendment cycle system for determination letters and to accept determination letter submissions only in connection with initial plan qualification and plan termination is very concerning to plan sponsors and others who work with tax-qualified retirement plans. Recognizing this widespread concern, ACT collected and analyzed data from plan sponsors and other members of the employee plans community, with the goal of presenting recommendations to the IRS regarding the Determination Letter Program.

What Did ACT Recommend to the IRS?

1. **Do Not Eliminate Interim Determination Letters as Previously Announced.** ACT strongly recommends that the IRS reverse course, calling the IRS' decision to eliminate most periodic determination letters a "mistake" and "shortsighted." The Report

emphasizes that interim determination letters are important to the IRS audit program and play a significant role in encouraging regular review and amendment of plan documents and plan operations in anticipation of IRS determination letter submissions.

2. **Adopt the Current IRS Position as a Transitional Rule While Considering the Issues.** A temporary suspension (e.g., two or three years) of the Determination Letter Program would allow time for the IRS to process the backlog of determination letter submissions and consider alternatives for allowing limited submissions for interim determination letters. The Report suggests that the IRS consider feedback from the employee plans community during this period. This recommendation would accept the fact that the current five-year cycle system is ending. However, it would allow for plans to apply for determination letters on a non-cycle, ad-hoc basis during this period (as determined by the IRS), until the IRS has considered fully the issues raised in the Report and identified by the employee plans community.

3. **Implement the Current IRS Position in the "Least Harmful Manner."** Acknowledging that, due to limited resources (e.g., budgetary constraints and staff turnover), the IRS is unlikely to rescind its previous decision to end the current five-year cycle system, the Report provides 10 key suggestions for how to implement the elimination (or significant reduction) of interim determination letters while minimizing harm to plan sponsors and participants.

   a. Provide certainty as to the future availability of determination letters to the extent possible. Some alternatives for this include adopting an extended cycle system, opening the determination letter program periodically to address changes in the law, allowing certain types of plans (e.g., large complex defined benefit plans) to apply for determination letters periodically or allowing plans to apply for determination letters when major design changes are implemented or business transactions occur.

   b. Make the pre-approved plan program more flexible and user friendly. This would include improving the flexibility of the pre-approved plan program by opening it up to plans with more varied features and reducing user fees for document sponsors of pre-approved plans.

   c. Modify EPCRS so it may be used even if a plan has only an initial IRS determination letter, and to provide more flexibility with respect to correcting plan document failures, for example:

      i. Permit self-correction of plan document failures, including self-correction (at a reduced fee schedule) for good faith plan document failures, even if found on IRS examination.

      ii. Provide that no sanctions or reduced sanctions apply for immaterial plan language defects unrelated to operational defects.

      iii. Provide that document flaws found during an IRS determination letter review on plan termination will be eligible for EPCRS.

   d. Expand the plan provisions that may be incorporated by reference to the Internal Revenue Code or the Treasury Regulations.

   e. Allow leniency for "immaterial" flaws in plan document language discovered on IRS examination, for example by adopting a nationwide IRS audit policy of not assessing retroactive penalties for "immaterial" plan document failures.

   f. Confirm that Code Section 7805(b) protection (i.e., protection against retroactive plan disqualification) continues for any plan document language that remains unchanged since the issuance of the prior determination letter. Also consider extending Code Section 7805(b) protection when a plan obtains a "private" opinion letter from legal counsel or an independent third-party certification as to plan document legal compliance.

   g. Consider a safe harbor approach to convert an individually designed plan to a pre-approved plan or a process to review the conversion on a one-time basis.

   h. Publish model amendments in addition to the Cumulative List and publish a list of required amendments that specifies which amendments are necessary for each type of plan.

   i. Provide adequate time to adopt amendments and coordinate amendment dates. A uniform date for amendment, such as utilized for the "GUST," "EGTRRA," or "PPA" remedial amendment periods, would be appropriate, giving plan sponsors ample time to amend their plans.

   j. Encourage the Treasury to increase the user fees for interim determination letter submissions and dedicate such amounts to the Determination Letter Program. ACT believes that plan sponsors would much rather pay an increased fee and have the ability to apply for interim determination letters than go without such a letter.

What Should Sponsors of Individually Designed Plans Do Now?

While the IRS and the employee plans community consider the information in the Report and the IRS contemplates the future of the Determination Letter Program, sponsors of individually designed plans should begin to think about alternatives for ensuring ongoing plan compliance in the absence of the interim Determination Letter Program. Up next, watch for our Client Alert on considerations for plan sponsors who are evaluating moving to a pre-approved plan format, including a discussion of reasons that plan sponsors may wish to keep their individually designed plans rather than move to a pre-approved plan format.

If you have any questions or would like assistance with any of the matters discussed in this Alert, contact any member of our Employee Benefits and Executive Compensation Practice Group.

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