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Blueprint for Maintaining Individually Designed Qualified Plan after IRS's Determination Letter Program Cutback

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On June 29, 2016, the ***Internal Revenue Service (IRS)*** officially sounded the death knell for the five-year remedial amendment cycle with its release of Revenue Procedure 2016-37. Effective January 1, 2017, employers that sponsor an individually designed qualified retirement plan—a group that includes most large retirement plans—may no longer request periodic determination letters. Cycle A, which closes on January 31, 2017, will be the final remedial amendment cycle under the determination letter program. Employers that have an Employer Identification Number ending in '1' or '6' or that made a timely Cycle A controlled group election, may request a final determination letter during Cycle A. On and after January 1, 2017, the IRS will only issue determination letters to individually designed plans that are either newly established or terminating plans.

The IRS will continue to conduct random audits to assess plan compliance with plan document operational requirements. Beginning in 2017, the IRS expects plan sponsors to amend written plan documents in accordance with Revenue Procedure 2016-37 and without reliance on a determination letter. In the context of an audit, a plan sponsor may rely on a plan's last favorable determination letter, but only with

respect to provisions that have not been amended since the last issued determination letter. Sponsors of individually designed plans must develop new means for assuring they comply with the qualification requirements in the wake of Revenue Procedure 2016-37.

Background

Last year the IRS sent shockwaves through the retirement industry by announcing plans to eliminate the determination letter program for individually designed plans. The announcement came on the heels of years of annual reductions in the IRS budget. The IRS determined that significantly cutting back its longstanding determination letter program was necessary because the IRS does not have sufficient resources to properly review determination requests from all retirement plans. The IRS has informally reported that the average length of time spent reviewing a determination letter request had fallen to approximately three hours by 2015.

A determination letter is a written ruling on whether an employer-sponsored retirement plan's document complies with the Tax Code's qualification requirements. Although the IRS has never required plan sponsors to request a determination letter, the program has become an integral part of maintaining a retirement plan. Favorable IRS determination letters are relied on for many purposes. Companies deduct contributions to retirement plans when made, and participants are not taxed until they receive a distribution so long as the plan is qualified. Auditors request determination letters as part of closing the annual plan audit for the Form 5500 annual report. Prospective buyers request determination letters for assurance that they are not acquiring a company with a plan that contains costly plan document compliance defects. Banks that lend to Employee Stock Ownership Plans request determination letters as part of assessing credit risk. Any time two or more plans are merged together, a determination letter provides assurance that the plan resulting from the merger is not infected by a plan with disqualifying provisions in its plan document prior to the merger.

For over ten years, the retirement industry has grown accustomed to requesting a favorable determination letter from the IRS once every five years. The scope of the IRS's plan review considered all qualification requirements, and a plan receiving a determination letter was treated as meeting all plan document requirements for five years.

Determination Letter Program Cutback for Existing Plans

Beginning in 2017, plans that previously received a determination letter will no longer be automatically eligible to request a determination letter. While the IRS stated a willingness to consider reopening the determination letter program to existing plans "in certain other circumstances," the likelihood of this happening is relatively low. Circumstances that might result in a reopening include significant law changes, new approaches to plan design and a plan's inability to convert to a pre-approved plan document. The IRS emphasizes that its current case load and resources—*i.e.*, its extraordinary budgetary constraints—will be significant factors in deciding whether to reopen the program to additional plans or for certain types of

amendments.

Even if the IRS were to accept applications from existing plans after January 1, 2017, determination letters will be significantly limited. The IRS will not consider all qualification requirements; instead, it would only review a plan for compliance with the "Required Amendments List" that the IRS issued during the second calendar year preceding the submission of the determination letter application and the Cumulative Lists of Required Changes that the IRS published annually since 2005. The Required Amendments List is a newly created, annually published list of changes in the qualification requirements (as discussed in greater detail below).

Reliance on the Final Favorable Determination Letter

Under Revenue Procedure 2016-37, a plan sponsor may only rely on a determination letter with respect to a plan provision that is not subsequently amended or that is not subsequently affected by a change in law. Put another way, a favorable determination letter permits reliance with respect to plan provisions that are identical to the terms reviewed by the IRS. The plan sponsor — and other industry players — cannot rely on a plan's final determination letter with respect to any provision modified by amendment.

Remedial Amendment Period for Disqualifying Provisions

A plan's tax-qualified status—and the tax benefits received by employers and employees—is conditioned on complying with the qualification requirements. A plan provision that, on any day, fails to comply with the tax qualification requirements is a disqualifying provision.

Section 401(b) of the Internal Revenue Code provides a grace period to correct a disqualifying provision in a plan document. This grace period is known as the remedial amendment period. A disqualifying provision can be corrected during the remedial amendment period by adopting a retroactive amendment that is effective as of the date the provision caused the plan to fail the tax qualification requirements. A disqualifying provision cannot be corrected after the remedial amendment period ends or if it would violate the Section 411(d)(6) anti-cutback rule. Treasury regulations prescribe the beginning and end dates of the remedial amendment period and give the IRS discretion to extend the remedial amendment period.

As discussed below, Revenue Procedure 2016-37 extends the remedial amendment period to allow additional time for compliance reviews and corrective amendments. The IRS has extended the remedial amendment period in order to provide more opportunities for self-correction without penalty despite not having a determination letter that covers subsequent plan amendments. It appears that the ability to correct during the remedial amendment period would also be available even during an IRS audit.

Change in Tax Qualification Requirements

A change in the qualification requirements—whether by statute, regulation or other guidance—can cause a plan to have a disqualifying provision. The IRS will annually

publish a “Required Amendments List” for qualification requirement changes. Plans must be amended as required by (or, if applicable, integral to) a qualification requirement change before the last day of the second calendar year that begins after the year of its initial inclusion on the Required Amendments List. Later this year, the IRS will release the first Required Amendments List and it generally will apply to changes in qualification requirements first effective during the 2016 calendar year.

Amendment to Existing Plan

Discretionary amendments—*i.e.*, amendments that are not legally required for plan qualification—can create qualification issues if they include a disqualifying provision. The deadline for adopting an amendment for a discretionary plan change is the last day of the plan year in which the plan amendment is operationally put into effect. Plans, however, have until the last day of the second calendar year after the calendar year in which the disqualifying provision is adopted or effective, whichever is later, to correct a disqualifying provision.

Provision in a New Plan

A new plan can include a disqualifying provision. A provision—or the absence of a provision—in a new plan that does not satisfy the qualification requirements is a disqualifying provision. The remedial amendment period ends on the later of (1) the 15th day of the 10th calendar month after the end of the initial plan year or (2) the “modified expiration date.” The modified expiration date for a new plan that is not maintained by a tax exempt employer is generally the time prescribed by law for filing the employer’s income tax return (applied as though the employer received a filing extension). The modified expiration date for a new plan that is maintained by a tax exempt employer is generally the due date for the Form 990 series return (applied as though the employer received a filing extension), or, if the employer is not required to file a Form 990 series return, the 15th day of the 10th month after the end of the employer’s tax year. However, given that new plans may file for a determination letter, this extended relief may not be utilized frequently.

Transition Rule

The IRS has provided rules allowing plan sponsors to transition from the now disbanded five-year remedial amendment cycle system to the new remedial amendment period under Revenue Procedure 2016-37. This transition relief, however, shortens the time period for remedial amendments. Under the five-year remedial amendment cycle system, a disqualifying provision’s remedial amendment period was extended to the end of the plan’s remedial amendment cycle. For example, a Cycle B plan had until January 31, 2018 (*i.e.*, the end of the plan’s remedial amendment cycle) to correct a disqualifying provision. Due to the elimination of the five-year remedial amendment cycle system, the remedial amendment period for a Cycle B plan ends on December 31, 2016 instead of January 31, 2018. The transition rule, however, extends the remedial amendment period for a disqualifying provision with an open remedial amendment period as of January 1, 2017 (as determined under the rules for the five-year remedial amendment cycle system) until December 31, 2017. This extension does not apply to disqualifying

provisions included in the forthcoming 2016 Required Amendments List.

Final Thoughts & Next Steps

The days of scheduled, periodic IRS determination letters will soon end. Sponsors of individually designed plans, other than new or terminating plans, must address what steps should be taken to assure compliance with the plan document requirements given the unavailability of determination letter rulings going forward. New procedures will be needed to monitor compliance with plan document requirements. It is also reasonable to expect that auditors and purchasers in M&A transactions will seek assurances from plan sponsors about plan documents in the absence of a determination letter.

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