

IRS MOVES FORWARD WITH PLAN TO CHANGE THE DETERMINATION LETTER PROCESS

Date: 14 July 2016

Employee Benefits Alert

By: Karrie Johnson Diaz, Jennifer S. Addis, Alyssa M. Fritz

In 2015, the Internal Revenue Service (IRS) announced that it would cut back the determination letter program for qualified retirement plans.^[1] In Revenue Procedure (Rev. Proc.) 2016-37, published June 29, 2016, the IRS has provided specific guidance on how the determination letter program will be cut back and how qualified plans should maintain their legal compliance.^[2]

Under the current determination letter process, a plan sponsor may periodically submit an application requesting the IRS to review and approve the form of its plan document. If the IRS approves the form of the plan document, it will issue a favorable determination letter as to the qualification of the plan. Companies with individually designed plans currently can submit a determination letter application on a regular, five-year cycle.^[3] If the IRS requests amendments to be made to the plan as part of its review on that regular cycle, such amendments can generally be made retroactively without penalty. A favorable determination letter can protect the company upon IRS audit if the IRS were later to challenge the qualified status of the plan based on its form or the operation of the plan consistent with its terms.

Effective January 1, 2017, Rev. Proc. 2016-37 will change the determination letter program significantly by removing the five-year remedial amendment cycle for individually designed plans and by establishing new remedial amendment periods for amendments necessary to avoid disqualification.^[4] Determination letters will still be available from the IRS, but only under limited circumstances.

CHANGES UNDER REV. PROC. 2016-37

Elimination of the Five year Amendment Cycle

Effective January 1, 2017, the IRS will eliminate the staggered five-year amendment cycle for individually designed plans and will not accept determination letter applications based on the five-year cycle. However, Cycle A plans^[5] may continue to submit determination letter applications during the period beginning February 1, 2016 and ending January 31, 2017.

New Compliance Features

Required Amendments List. To ensure that plan sponsors comply with new laws and regulations by adopting the amendments necessary for plan qualification, the IRS and the Department of the Treasury will publish annually a "Required Amendments List." The Required Amendments List will describe any changes in qualification

requirements published in the Internal Revenue Bulletin that become effective within the "remedial amendment period" covered by the list and will establish the expiration date for that remedial amendment period. The first Required Amendments List will generally describe plan qualification changes that become effective on or after January 1, 2016.^[6]

Remedial Amendment Period Extended. Rev. Proc. 2016-37 also extends the time that a plan sponsor will have to adopt qualification-related amendments.^[7] Under prior IRS guidance, plan sponsors had until the later of 1) the last day of the plan year in which a plan provision became disqualifying; or 2) the due date for filing the employer's tax return for the taxable year that includes the date the plan provision became disqualifying. Effective January 1, 2017, the new remedial amendment periods are:

- For a disqualifying provision in an existing plan (other than those in the Required Amendments List), the end of the second calendar year after the amendment is adopted or effective, whichever is later.
- For a disqualifying provision in an existing plan that is related to a change in the qualification requirements, the end of the second calendar year that begins after the issuance of the Required Amendments List in which the new qualification requirement appears.
- For new plans, the later of the (i) the 15th day of the 10th calendar month after the end of the plan's initial plan year; or (ii) the "modified § 401(b) expiration date".^[8]
- For governmental plans, the deadlines to amend the plan depend on the close of the legislative session of the legislative body with authority to amend the plan.^[9]
- For plans being submitted for a determination letter, the earlier of the otherwise applicable deadline or the date of application submission. See Part (d) below.

The time for making discretionary amendments to an individually designed plan is not changed by the new guidance; the deadline remains the end of the plan year in which the plan amendment is put into operation.

Operational Compliance List

While the remedial amendment period permits a plan document to be amended retroactively to comply with a change in plan qualification requirements, in practice a plan must be operated in compliance beginning with the effective date of the change. To assist plan sponsors of both individually designed and pre-approved plans with this operational compliance, the IRS intends to provide an annual Operational Compliance List to identify changes in qualification requirements effective during a calendar year.^[10]

Determination Letters Going Forward

There are three circumstances under which a plan sponsor may still submit an application for a determination letter:

1. *Initial Plan Qualification:* If a determination letter has never been issued with the respect to the plan, a plan administrator may submit the plan for initial plan qualification.
2. *Qualification upon Plan Termination:* An application will be considered filed in connection with plan termination only if it is filed by the later of (i) one year from the effective date of the termination, or (ii) one

year from the date on which the action terminating the plan is taken. An application may not be filed later than 12 months from the date of distribution of substantially all plan assets in connection with the plan termination.

3. *Other Circumstances:* The IRS will consider annually whether determination letter applications will be accepted for individually designed plans in specified circumstances. Such circumstances may include, but are not limited to significant law changes, new approaches to plan design, and the inability of certain types of plans to convert to pre-approved plan documents.

With the exception of the last Cycle A filing due January 31, 2017, the IRS will review determination letter applications for individually designed plans based on the Required Amendments List issued two calendar years prior to the date the determination letter application is submitted.

Example: For a plan submitted for a determination letter on January 1, 2020, the IRS will base its review on the Required Amendments List issued in 2018. Note that the plan must adopt all amendments required by the 2018 Required Amendments List, even though the remedial amendment period does not end until December 31, 2020.

The IRS review will consider all previously issued Required Amendments Lists as well as Cumulative Lists issued prior to 2016.^[11] Plans submitted for initial qualification during the 2017 calendar year will be reviewed based on the 2015 Cumulative List.

Changes for Pre-approved Plans

Pre-approved plans will generally continue to have the same six-year remedial amendment cycle that applied previously, with a few changes.^[12] Rev. Proc. 2016-37 extends the deadline for pre-approved defined benefit plan sponsors to apply for a determination letter until April 30, 2017 if the plan was adopted before January 1, 2016. The beginning of the 12-month submission period for plan sponsors to submit pre-approved defined contribution plans for opinion or advisory letters during the third six-year amendment cycle is delayed until August 1, 2017.^[13]

WHAT DOES THIS MEAN FOR PLAN SPONSORS?

For companies adopting pre-approved plans, the changes in the determination letter program will likely have little or no impact.

In contrast, for companies sponsoring individually designed plans, the changes may create both opportunities and challenges. On the plus side, the new, annually updated Operational Compliance List and Required Amendments List to be provided by the IRS may provide a more effective roadmap for plan sponsors to annually review their plans for both operational and documentary compliance, as compared to the current Cumulative List published annually. The changes to the determination letter program will make it more imperative than ever that plan sponsors routinely monitor the operational and documentary compliance of their qualified retirement plans.

The elimination of regular, on-going determination letters for individually designed plans will likely add a degree of uncertainty to the qualified plan compliance regime. Plan sponsors of individually designed plans have historically relied on the determination letter process to confirm that the plan's provisions comply with the detailed and technical requirements applicable to tax-qualified plans. Many times in that process, IRS agents reviewing determination letter applications will require retroactive plan amendments, even though the plan sponsor adopted amendments that it believed, in good faith, met the applicable qualification requirements. By ending the regular, ongoing review process for individually designed plans, plan sponsors will not have an avenue to receive formal blessing from the IRS about the qualified status of the written terms of their plans. The elimination of this option may result in an increased risk of disputes with the IRS on plan audit. It may also change the approach for plan sponsors in making representations about the qualified status of the plan in connection with business transactions or plan mergers and may impact practices around plan audits.

It is unclear whether this change will have longer term impacts, such as moving more plans from individually designed to pre-approved plan formats or greater reliance by plan sponsors on model amendment language from the IRS. We will continue to monitor developments related to the determination letter program.

Notes:

[1] <https://www.irs.gov/pub/irs-drop/a-15-19.pdf>

[2] <https://www.irs.gov/pub/irs-drop/rp-16-37.pdf>

[3] There are five such cycles, labelled "Cycle A" through "Cycle E." The cycle applicable to a particular plan sponsor generally depends on the last digit of the plan sponsor's taxpayer identification number (or EIN).

[4] With an exception for Cycle A plans. This exception will be discussed further below.

[5] Those whose plan sponsor's EINs end with a 1 or a 6, or those whose plan sponsor is a member of a controlled group or affiliated service group that made a Cycle A election by January 31, 2012.

[6] Rev. Proc. 2016-37, at §9.01.

[7] Rev. Proc. 2016-37, at § 5.05.

[8] Rev. Proc. 2016-37, § 5.05(1). The Code Section 401(b) the expiration date of a plan that is not maintained by a tax exempt employer is the last day of the remedial amendment period. See Rev. Proc. § 5.05(1)(a). The Code Section 401(b) expiration date maintained by a tax-exempt employer is generally the due date for the form 990 series, if no form 990 series filing is required, the 15th day of the 10th month after the end of the employer's tax year. See Rev. Proc. 2016-37, at §5.05(1)(b).

[9] Rev. Proc. 2016-37, at §5.06

[10] Rev. Proc. 2016-37, at §§ 10 and 17.05

[11] Rev. Proc. 2016-37, at § 12.

[12] Rev. Proc. 2016-37, at § 14.01.

[13] Rev. Proc. 2016-37, at § 16.02.

KEY CONTACTS



KARRIE JOHNSON DIAZ
PARTNER

SEATTLE
+1.206.370.6649
KARRIE.DIAZ@KLGATES.COM



JENNIFER S. ADDIS
ASSOCIATE

SEATTLE
+1.206.370.8068
JENNIFER.ADDIS@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.