Recent IRS Development for Retirement Plans

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The world of retirement plan maintenance was upended last year when the Internal Revenue Service announced the near-abandonment of its determination letter program for ongoing individually designed qualified retirement plans. A favorable determination letter from the IRS has for several generations been *the* accepted indicator of a plan's tax qualification. ***For individually designed plans, new or updated letters will no longer be obtainable from the government, and the reliance value of the last letter received by a plan will begin to erode over time. For both tax law compliance and for business reasons, plan sponsors must now find a way to achieve continued tax-qualified status for their plans, and a means of documenting compliance, lacking IRS ruling letters.***

In response, Butzel Long is making available to its clients two optional ways, described below, by which plan sponsors may continue to gain reasonable assurance of ongoing plan qualification. Below we explain why this matters.

Background

Tax-qualified retirement plans provide significant benefits to employers and employees. However, the laws and regulations that apply to qualified plans are vast in number and are very complex. Yet if a plan fails to meet so much as a single requirement, there is generally only one result under the Tax Code: disqualification of the entire plan and hence loss of income tax deduction for the employer, loss of tax-exemption for the trust, and possible immediate tax inclusion by all the employees. As hard as it may be to believe, only two states are possible: full, compliance with all the rules, or the tax equivalent of the death penalty.

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The IRS determination letter program has been a linchpin in providing plan sponsors with assurances from the IRS that their plan meets qualification rules. Under this program, an employer could draft a plan or amendment and submit the proposed document to the IRS. If the IRS found qualification problems it would give the employer time to correct the flaw. If the IRS approved, it would issue a "favorable determination letter" which was binding on the IRS and was also of great value to employers in documenting the plan's compliance.

The IRS has instituted a program by which plan sponsors may act to avoid tax disqualification once a problem is identified, called the Employee Plans Compliance Resolution System, or EPCRS. However, using EPCRS for retroactive corrections is not a good compliance plan. The onus is on the plan sponsor to discover a plan problem before, for example, an IRS auditor does so. Meanwhile, the plan is potentially not qualified, with bad ramifications for employer and employees. Also, EPCRS carries fees to the IRS (some high) and generally high legal costs.

So making best efforts to keep a plan tax-qualified on a proactive basis is the only reasonable course.

What has changed?

The IRS has now eliminated its determination letter program for individually designed plans, except for rulings on newly-established or terminating plans. Henceforth, there will be no rulings on ongoing individually designed plans. The problem: ongoing plans face frequent changes in tax-law compliance statutes and regulations. Lacking the ruling program, plan sponsors are on their own in reviewing and complying with new rules, and in and achieving some reasonable level of assurance on compliance.

The IRS will assist plan sponsors by annually issuing a "required amendment list" (detailing the legally required changes that were first effective during that year for which amendments are generally due by the end of the second calendar year beginning after the date of the list) and an "operational compliance list" to identify changes that must be put into effect during the year even though the plan amendments may follow. Note that timely compliance with both the "official" words in a plan document, and how the plan is operated, are required in order to maintain tax-qualified status.

Why does this matter?

It is standard practice to ask an employer for a current IRS ruling letter as evidence of a plan's qualified status. This is important in many circumstances, including: (1) plan audits; (2) "due diligence" for corporate mergers and acquisitions; (3) for rollovers into or out of the plan; (4) to satisfy certain rules of EPCRS where a plan sponsor chooses to "self-correct" a problem; and (5) to obtain some ongoing assurance that potentially catastrophic tax consequences will be avoided for the plan, its sponsor, and all its participants.

The requirement that a sponsor keep its plan qualified, and the occasional need to demonstrate that qualification, have not gone away for individually designed plans. But the comfort of getting solid assurances of that qualification from the IRS has all but disappeared for such plans.

How can Butzel Long help?

We have identified three ways a plan sponsor can deal with the loss of the determination letter program (but only two of them seem prudent).

- The first is by obtaining a periodic legal opinion letter from a law firm that the plan is qualified as of a date in time.
- The second is by transitioning from an individually designed plan into an IRS pre-approved plan, as discussed below.
- The third is to continue to tend to the plan as in the past, but without the benefit of any updated confirmation of the plan's qualified status.

1. Legal Review.

As to the first option, Butzel Long is offering its clients an **individualized plan opinion letter, or "IPOL**," to provide assurance that a plan's documents meet the qualification requirements. Based on our review of the plan document (when and as needed, and in light of the available IRS guidance), a list of suggested or required changes would be provided to our client. Once we are able to conclude that all applicable requirements appear to have been met, Butzel would provide an opinion letter stating that as of a specified date, the plan has been timely amended for required changes and remains qualified in form.

As has been the case for IRS determination letters, Butzel's IPOL would pertain to the written terms of the plan, and would not include an opinion on the operational compliance of the plan. That said, Butzel often helps plan sponsors with periodic and proactive compliance reviews. If problems are identified, they can be addressed through the EPCRS program.

We anticipate the IPOL would generally be accepted as evidence of a plan's qualified status in circumstances where an IRS determination letter has historically been used. Unlike an IRS ruling letter, however, the IPOL would not prevent the IRS from challenging a plan's qualified status. But the IPOL process should alleviate tax-disqualification concerns.

As attorneys, and as recognized experts in the field, we are uniquely suited to providing this kind of assurance to you. However, the IPOL is in addition to the advice and service we already provide, and it must be affirmatively elected (we recommend that this be done on an annual basis).

2. Use of a pre-approved plan document, where feasible.

As to the second option, the IRS continues to issue approval letters on plan documents written by specialized vendors which provide comprehensive "format" plan documents for use by benefit attorneys. Such plans are frequently made available by investment providers or plan administration firms for use with their proprietary "platform" of investments and administration.

These kinds of pre-approved documents don't work in all cases. Some plans have provisions that are simply too specialized to fit into the limitations of "format" plans. In other cases, the translation might work, but may involve more cost or risk (risk of a "bad translation") than the exercise is worth. Where a pre-approved plan does not make sense, the first option (periodic legal review [IPOL]) is the best course.

(a) Butzel format documents. Where a pre-approved solution may be useful, Butzel offers a range of format plan options. We have a great deal of institutional experience, for example, with the SunGard Relius document suite, as well as documents provided by other vendors. Note that within certain IRS guidelines pre-approved plans may be customized by an adopting plan sponsor, even beyond the options/language offered in the pre-approved document, and in this situation, an individual IRS determination letter will continue to be available.

(b) Provider-prepared documents: Where a provider insists on using its proprietary plan documents, Butzel routinely works with plan sponsors to make sure the plan's terms are correctly adopted and to make sure ancillary documents are correct. We also review such things as administrative service agreements, trust agreements (which are really part of the plan document), investment agreements, and participant communications. Almost universally, we find material issues with provider-generated documents, and we correct them. **We strongly recommend legal review of provider-provided documents. They are difficult do-it-yourself projects and we routinely are called-on to correct errors that would better have been avoided.**

3. Do nothing.

The third option for dealing with the changes to the determination letter program–in essence, the "do nothing" option--results in risks in circumstances such as those discussed able in "Why does this matter?" We think that no prudent plan sponsor can ignore the loss of the IRS ruling letter program. Some new steps must be taken.

Follow Up Action:

As a general matter, some new means of addressing tax-compliance must be in place during 2018. However, if you are considering any discretionary changes to your plan, we should discuss those before the end of 2017.

We welcome your questions or thoughts about the way forward in your case. Please contact your Butzel benefits lawyer to discuss compliance and to let us know your plans.

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