SHEARMAN & STERLING LLP

EXECUTIVE COMPENSATION & EMPLOYEE BENEFITS

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IRS Determination Letters No Longer Available After 2016

The IRS recently announced significant changes to its determination letter program that will become effective January 1, 2017 (the "Announcement").[1] These changes essentially eliminate determination letters for individually designed plans that are intended to be qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended ("Plans"), except for new Plans and terminating Plans (the "New Program"). While the New Program will relieve Plan sponsors from the burden of preparing and filing determination letter applications, it will create other burdens for sponsors. Additionally, the New Program will impact service providers to the Plans and other parties. These providers and other parties should begin to consider how they will address this change.

This client publication will first summarize the current determination letter program and the changes under the New Program and will then discuss the potential impact of these changes.

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[1] Announcement 2015-19, "Revisions to the Employee Plans Determination Letter Program." The Announcement can be found at http://www.irs.gov/pub/irs-drop/a-15-19.pdf.

Current IRS Determination Letter Program

Under the current IRS determination letter program, Plan sponsors submit applications for determination letters once every five years, under a staggered system of five one-year cycles (each running from February 1 to the following January 31), referred to as Cycles A through E (the "Current Program"). The particular cycle for a Plan is determined based on the Plan sponsor's employer identification number. The cycle currently in effect is Cycle E, which runs from February 1, 2015 through January 31, 2016.

A key feature of the Current Program is that it extends the remedial amendment period for Plans to the end of the applicable 12-month cycle. The remedial amendment period is the period during which a Plan may, under certain circumstances, be amended retroactively to comply with the requirements of the Internal Revenue Code of 1986, as amended (the "Code"). For example, the remedial amendment period for a timely adopted amendment adopted and effective in 2013 by a Plan that is a Cycle E filer is January 31, 2016.[2] If the Current Program did not provide for the extended remedial amendment period described above, Plan sponsors would be subject to the shorter remedial amendment period provided for in the Treasury regulations.[3] The length of the remedial amendment period in the regulations varies, depending on the type of disqualifying provision and whether the plan is a new or existing plan.[4]

Changes to Current Determination Letter Program

Effective January 1, 2017, the IRS is eliminating the staggered five-year remedial amendment cycles for Plans (the "New Program"). As of the effective date, the IRS will no longer accept determination letter applications based on the five-year cycle and will only accept applications for Plans on initial plan qualification and for qualification upon plan termination.[5] However, the Announcement states that the IRS and the Treasury Department will issue guidance identifying certain other limited circumstances in which Plan sponsors will be permitted to submit determination letter applications.

Due to the implementation of the New Program, the extended remedial amendment period provided in the Current Program will not be available after December 31, 2016. However, to assist Plan sponsors with the transition to the New Program, the Announcement provides that the remedial amendment period for Plans will be extended to at least December 31, 2017.

[2] Moreover, if the IRS determines, through review of the determination letter application, that a Plan requires additional amendment, the Plan sponsor will have 91 days following its receipt of the determination letter.

[3] Treas. Reg. Section 1.401(b)-1(d).

[4] Under the Treasury regulation, the remedial amendment period for certain disqualifying provisions begins on the date on which the change becomes effective with respect to the Plan, or, in certain cases, the first day on which the Plan is operated in accordance with the provision as amended, and ends on the later of (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins and (2) the last day of the Plan year that includes the date on which the remedial amendment period begins. So, for a Plan that is a Cycle E filer, the remedial amendment period with respect to the amendment adopted in 2013 would end on October 15, 2014 (assuming: the amendment is a disqualifying provision, the employer's taxable year is the calendar year and the employer extended the date on which its tax return is due).

[5] Initial plan qualification means a plan for which a determination letter application has not been filed, or a plan for which an application has been filed but for which a determination letter was not issued.

While the Announcement states that the effective date of the New Program is more than a year away, certain changes to the Current Program are already effective. For the period beginning July 21, 2015 through December 31, 2016, the IRS has stopped accepting off-cycle determination letter applications, except for applications for new Plans and terminating Plans. For this purpose, a new Plan is a Plan that, as of the date the application is submitted, is within the remedial amendment period provided under the Treasury regulations.[6] If a sponsor wants to file a determination letter application for a new Plan that does not satisfy this definition, the sponsor will need to wait until after December 31, 2016 to file the application.

Impact of the New Program

On Plans and Sponsors

- While the New Program will eliminate IRS review of on-going Plan documents, the New Program will not eliminate Plan audits by the IRS. Therefore, Plan sponsors will want to implement procedures to ensure that their Plans are timely and properly amended. ERISA counsel may be able to assist by drafting and tracking required amendments and providing opinion letters as to the qualified status of the plan.
- Plan sponsors must, from time to time, make representations and warranties regarding the qualified status of their Plans (for example, in connection with Plan investments or as a seller in an M&A transaction). With the elimination of the Current Program, Plan sponsors will, over time, cease to have a current determination letter as the basis for these representations.

On Service Providers and Other Parties

- Investment managers and other parties that provide services to, or enter into transactions with, Plans (collectively, the "Service Providers") typically require the Plan sponsor to represent that the Plan is qualified. Once the Current Program is phased out, the Service Providers will need to consider the type of evidence of qualification they will require to support the representations. The Service Providers may also want to review indemnification provisions in investment management, subscription and other agreements to ensure that they provide sufficient protection in the event of a breach of the representation. Such review may be especially important for trustees and managers of collective trusts, whose qualified status could be jeopardized by Plan investors that are not qualified.
- Purchasers doing diligence in connection with M&A transactions will also need to consider the evidence that they will require to verify the qualified status of the Plans involved in the transaction. Under the Current Program, the seller's representations are typically framed with reference to the status of the Plan's determination letter. Once the New Program becomes effective, that type of representation will need to be replaced.
- Plan auditors generally require Plan sponsors to provide a copy of a Plan's most recent determination letter. The New Program will require auditors to develop other representations and audit procedures. Such procedures could include an audit of the Plan.

[6] Treasury Regulations provide that the remedial amendment period for a new Plan is the period beginning on the date the Plan is put into effect and ending on the later of the due date (including extensions) for filing the employer's tax return for the taxable year in which the Plan is put into effect and the last day of the Plan year in which the Plan is put into effect.

Conclusion

As summarized above, while the New Program may relieve Plan sponsors from filing determination letter applications, it is likely to result in the imposition of other requirements on Plan sponsors and the service providers to their Plans. Please feel free to contact us if you would like additional information regarding the impact of the New Program.

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