

Understanding IRS Determination Letter Program Changes: How changes affect individually designed retirement plans

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Since the beginning of the year, sponsors of individually designed retirement plans generally have no longer been able to receive a periodic official regulatory compliance seal of approval from the IRS in the form of a routine determination letter. While this has been a source of concern to many plan sponsors and their advocates, options remain.

Why the change?

The IRS declared its decision to end its staggered five-year determination letter remedial amendment program in July 2015. Now, the IRS will approve individually designed plans only when they're first established, or on termination. Otherwise, plan sponsors generally must do their best to keep their plans compliant with required plan document changes prompted by new laws and regulations.

Why did the IRS adopt this new policy? One reason was that it lacked the resources necessary to keep its lawyers and other technical experts engaged in the process of reviewing customized plans.

What about mass submitter plans?

The change doesn't impact standardized, IRS preapproved and "mass submitter" plans offered to clients by professional plan providers. Those plans, however, may not meet the needs of sponsors who want customized plan provisions, or sponsors who simply have "legacy" nonstandard plan designs they've been operating for many years and don't wish to change.

Anticipating objections, the IRS asked the retirement plan community to outline its concerns. It's possible the IRS might ultimately modify its position and adopt some of the recommendations it received. (See "Industry recommendations for the IRS.")

What are the problems?

The problems that may result from the lack of routinely verified regulatory compliance are numerous. They serve as a "heads up" for plan sponsors with individually designed plans, alerting them to issues they need to be prepared to address. Here are just a few:

Issues with loans. *Lenders often require warranties that a borrower's benefit plans are certifiably compliant. Absent recent IRS approval, borrowers might need to jump through extra hoops to satisfy banks.*

Plan investment problems. *Securities laws might require that collective trusts and insurance company separate-account investments receive funds only from qualified retirement plans. These entities might become nervous about accepting dollars from plans that don't have a recent IRS determination letter.*

Accepting rollovers. *Some plan administrators require a determination letter to accept a rollover from another plan. While all individually designed plans will be in the same boat, "the risk of accepting a rollover from another plan is increased significantly; plan sponsors may decide to no longer accept rollovers," according to the American Benefits Council.*

Audited financials. *Retirement plans with at least 100 participants generally must be audited annually. Auditors must attest to the plan's qualification status. Without a recent IRS determination letter, auditors might need to obtain an opinion from the sponsor's counsel, adding cost to the audit process. It's not clear that law firms will be willing to issue legal opinions about a plan's qualification because of the scope and complexity of relevant Internal Revenue Code sections. Undoubtedly, some law firms specializing in ERISA matters will provide that service, adding to the costs of a plan.*

What next?

Last year, the IRS issued a follow-up statement that, among other things, informed sponsors that they have until April 30, 2017, to convert individually designed plans to a preapproved format. Whether that's a practical solution for sponsors affected by the demise of the periodic determination letter program will depend on individual considerations. Contact your ERISA professional to determine whether this is right for your plan.

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Industry Recommendations for the IRS

When the IRS announced that it was ending its routine determination letter program, it asked for suggestions from the retirement plan community on how this transition may work. The American Benefits Council (ABC) was among the many who responded.

The ABC urged the IRS to blunt the impact of its decision in several ways. For example, the ABC recommended that the IRS:

- Be more flexible about penalizing plans whose written documents don't reflect the latest regulations where the plan has consistently been administered according to legal requirements,
- Modify the audit closing agreement plan procedures to minimize the prospect that plans found in violation of some obscure rule will be penalized, and
- Offer determination letters for "significant plan amendments," such as when two plans merge, or a plan is converted from one type to another.

In addition, the ABC urges that the IRS factor a plan's size into decisions regarding the amount of any penalties imposed. It's possible the IRS ultimately will adopt one or more of the many suggestions it has received.