

A Major Curtailment of the IRS Determination Letter Program Will Impose New Compliance Burdens on Sponsoring Employers

The Internal Revenue Service (“IRS”) announced, on July 21, 2015, a major curtailment of its determination letter program for individually designed qualified retirement plans (“Individually Designed Plans”) that will impose significant new compliance burdens on employers and other entities that sponsor Individually Designed Plans (“Sponsors”). Such determination letters inform Sponsors that the language in their Individually Designed Plans satisfies the applicable qualification requirements of the Internal Revenue Code (“Code”), and have been relied on by Sponsors for more than sixty years. The new changes to the IRS determination letter program, described in IRS Announcement 2015-19, will, among other things:

- eliminate the staggered 5-year determination letter remedial amendment cycles for Individually Designed Plans; and
- generally restrict the issuance of IRS determination letters for Individually Designed Plans to a request for an initial plan qualification, and to a request for a qualification determination when a plan terminates (the IRS also indicated that there could be “other limited circumstances” when such a letter might be issued, but it is unclear what those circumstances might be).

These changes will make it much more difficult for Sponsors to know that the language in their Individually Designed Plans satisfies applicable Code requirements, and will significantly increase the legal exposure of Sponsors with respect to such language. There are several steps Sponsors should take to address such increased exposure, including making sure that they have procedures in place requiring the language in their Individually Designed Plans to be reviewed periodically (no less frequently than annually) to ensure that all required amendments are timely and properly made.

When Are These Changes Effective?

The changes to the IRS’s determination letter program for Individually Designed Plans will be effective on the following dates:

- Starting on July 21, 2015, Applications For Most Off-Cycle Determination Letters Will No Longer Be Accepted – In its announcement on July 21, 2015, the IRS said it was immediately (i.e., effective as of July 21, 2015) eliminating the ability of a Sponsor to apply for an off-cycle determination letter (i.e., a determination letter application that is submitted at a time other than during the last 12-month period of a plan’s 5-year remedial amendment cycle) for an Individually Designed Plan, except as provided in the following sentence. An off-cycle determination letter application for an Individually Designed Plan can still be submitted from July 21, 2015 through December 31, 2016 for (1) new plans, and (2) terminating plans.
- The Staggered 5-Year Remedial Amendment Cycles Generally Will Be Eliminated On January 1, 2017 – In 2007, the IRS established staggered 5-year remedial amendment cycles for Individually Designed Plans that generally allow Sponsors to apply for determination letters once every five years. Starting on January 1, 2017, these staggered 5-year remedial amendment cycles for Individually Designed Plans generally will be eliminated. As an exception to the preceding sentence, Sponsors of Cycle A plans in the 5-year remedial amendment cycle will still be allowed to submit determination letter applications from February 1, 2016 to January 31, 2017.

- Starting On January 1, 2017, Determination Applications For Individually Designed Plans Generally Will Be Limited To Initial Plan Qualifications, Qualifications Upon Plan Termination, and “Certain Other Limited Circumstances” – When the staggered 5-year remedial amendment cycles generally expire on January 1, 2017, Sponsors of Individually Designed Plans who wish to obtain a determination letter on the qualified (i.e., tax-favored) status of the language in such Plans generally will only be able to do so in one of the following three circumstances: (1) for a qualification determination letter on an initial plan qualification (which is defined as an Individually Designed Plan for which an IRS Form 5300, *Application for Determination for Employee Benefit Plan*, has not been filed with the IRS, or for which an IRS Form 5300 was previously filed with the IRS but no determination letter was ever issued); (2) for a qualification determination letter when a plan is being terminated; and (3) for a qualification determination letter “in certain other limited circumstances” that may be determined by the United States Treasury Department and the IRS from time to time (it is not clear what those circumstances might be, or when they might be announced).

Why Did the IRS Make These Changes?

The IRS’s budget has been significantly reduced in recent years, and the IRS concluded that it had no choice but to substantially curtail its determination letter program for Individually Designed Plans in order to enable it to “more efficiently direct its limited resources.”

Are Changes Being Made To the Determination Letter Programs For Prototype and Volume-Submitter Plans?

The IRS has not announced any changes to the determination letter programs for prototype and volume-submitter plans, and clearly is hoping that more sponsors of qualified retirement plans will start to use such pre-approved plans, as opposed to Individually Designed Plans. However, many Sponsors of Individually Designed Plans will have difficulty converting their Individually Designed Plans to a pre-approved prototype plan or volume-submitter plan, as the options available under a prototype plan or a volume-submitter plan often are not flexible enough to include special design features that an Individually Designed Plan may have.

Is the IRS Considering Other Changes To Assist Sponsors of Qualified Retirement Plans?

The IRS said that it is considering other changes to try to assist sponsors of qualified retirement plans, including:

- providing IRS model amendments that could be used by sponsors of qualified retirement plans;
- allowing sponsors of qualified retirement plans to not adopt certain plan provisions or amendments if they are not relevant to a particular plan; and
- making it easier for sponsors of qualified retirement plans to incorporate by reference into their plan documents certain Code qualification requirements.

The IRS also asked for comments on whether changes should be made to the current requirements for interim amendments, the steps required to convert an Individually Designed Plan to a pre-approved prototype or volume-submitter plan, and the requirements for correcting qualified retirement plan errors under the Employee Plans Compliance Resolution System. Depending on what future changes are ultimately approved, they could make it easier for Sponsors of Individually Designed Plans to comply with the changes to the determination letter program.

What Steps Should Sponsors of Individually Designed Plans Take As a Result of These Determination Letter Program Changes?

Steps that Sponsors of Individually Designed Plans should take to help address the issues raised by the changes to the determination letter program include the following:

- Review the Latest Determination Letter Issued For the Individually Designed Plan, and Determine Whether There is Another Determination Letter Submission Deadline Before the 5-Year Remedial Amendment Cycles Expire – A Sponsor of an Individually Designed Plan should review the latest determination letter issued by the IRS with respect to that plan, and should determine whether there is another IRS determination letter submission deadline for that Plan prior to the general expiration of the staggered 5-year remedial amendment cycles on January 1, 2017. If there is another such deadline (e.g., if the Individually Designed Plan is a Cycle A plan, or if the Individually Designed Plan satisfies certain other requirements), the Sponsor should take advantage of that opportunity and request an additional determination letter for that Individually Designed Plan.
- Make Sure the Individually Designed Plan is Reviewed Periodically For Any Required Plan Amendments – If not already in place, procedures should be implemented to ensure that an Individually Designed Plan is reviewed periodically to ensure that any amendments required by the Code or IRS guidance are timely and properly done. Such periodic review should occur no less frequently than annually. Apart from these plan language compliance issues, Sponsors should also make sure their Individually Designed Plans are administered in accordance with all applicable Code, IRS and other legal requirements.
- Consideration Should Be Given To Whether the Individually Designed Plan Can Be Converted to a Prototype or Volume-Submitter Plan – Each Sponsor of an Individually Designed Plan should analyze whether it is feasible to convert the Individually Designed Plan to a pre-approved prototype or volume-submitter plan. Although the special design features in many Individually Designed Plans will make any such conversion hard to achieve, there may be some Individually Designed Plans that could make such a conversion with relatively few design modifications.
- Identify Situations Where a Determination Letter Might Be Needed, and Consider Alternatives For Addressing That Need – Sponsors of Individually Designed Plans should identify situations where a determination letter may be needed or requested, and should consider what alternatives might be available to help address such a need or request. Examples of such a need or request are certain types of business transactions (e.g., determination letters are often requested as part of a due diligence investigation in a business acquisition or merger, and a party in such a transaction often will be required to make representations about the qualified status of its qualified retirement plans), certain plan audits (e.g., some auditors ask for a copy of the latest IRS determination letter), and plan rollovers (information regarding a plan's qualified status is sometimes requested when benefits are being rolled over). Sponsors should review the options available to address such needs or requests, and determine how best to address them.

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