

Retirement Plan Update

Reasons to Submit a Plan for an IRS Favorable Determination Letter

This Retirement Update details the reasons why our firms, Means & Associates, LLC and ERISA Compliance Associates, LLC, have recommended and continue to recommend that plan sponsors submit their retirement plans to the Internal Revenue Service (IRS) for a favorable determination letter (“FDL”). This Update defines what an FDL is, what it means to have an FDL, and who is protected by having an FDL. We share our responses to questions we received from clients and their advisors while we were submitting EGTRRA-restated 401(k), profit sharing, and other defined contribution plans to the IRS for FDLs earlier this year.

An FDL issued by the Internal Revenue Service is the Plan Sponsor’s “guarantee” that the plan document complies with current legal requirements. Obtaining an IRS FDL is a step that employers/plan sponsors should take to minimize the potential risk of plan disqualification; if the IRS later questions the way the plan’s provisions are described. Plan disqualification could result in severe fines, taxes, and penalties assessed against the employer, in addition to income taxes assessed against plan participants. The potential for such consequences makes plan disqualification one of the greatest risks fiduciaries can face.

Means & Associates uses Volume Submitter plan documents that have separate IRS Advisory Letters where the IRS pre-approved the plan documents for the most recent cycle of law changes. We then submit each client’s Volume Submitter plan document to the IRS for an FDL specific to that plan and that plan sponsor.

Reasons to Submit a Plan for an IRS FDL

1. **Reduces the need to maintain historical plan documents.** Most crucially, employers who do not obtain an IRS FDL have a greater burden with regard to maintenance of historical plan documents. This is important since maintaining plan documents is a fiduciary responsibility under ERISA; failing to maintain complete plan document records is a fiduciary liability under ERISA.

It has been our experience – and that of other practitioners – that, upon audit, the IRS agent requests proof of all timely amendments dating back to the immediately preceding FDL – i.e., the pre-approved plan’s opinion or advisory letter may not be sufficient. See the box below for details on “pre-approved” plans.

Pre-approved documents – “prototype” or “volume submitter” documents – are made available by providers and are an alternative to a “custom plan” or “individually designed plan.” Document sponsors submit their sample/generic plan documents to the IRS for approval and receive either an “Opinion Letter” (Prototype Plans) or an “Advisory Letter” (Volume Submitter Plans) for each plan type.

If a retirement plan has never received an individual FDL, then the IRS agent’s audit request goes back to the original effective date of the Plan. A plan adopted in 2003, for example, with a 401(k) elective Safe Harbor provision, will have at least 15 IRS-mandated amendments, plus any discretionary changes to plan provisions that the plan sponsor may have made.

Employers/plan sponsors who have obtained an IRS FDL at every critical juncture of plan or legislative changes are able to experience a “fresh start” *after each new FDL*. As a result, the important documents for record retention purposes are only those associated with the most recent FDL and any amendments (mandated or discretionary) adopted after that point in time.

2. **Extends the time for plan correction.** Any Employer that timely submits its plan for an FDL (during the “remedial amendment period” that the IRS assigns to each compliance amendment or new plan) can retroactively correct any missing or incorrect provisions found during the determination letter review process until 90 days *after* the plan’s receipt of the IRS FDL. This might relate to mistakes in filling out an adoption agreement with provisions that do not satisfy some pension laws, or alterations to the prototype or volume submitter document that go beyond the “standard language” anticipated by the IRS in the pre-approved document.

By the time the IRS might initiate any audit proceedings with respect to a particular plan year for a plan without an FDL, the remedial amendment period has typically elapsed and it is too late to go back and get an FDL or make the appropriate plan amendment to bring plan document provisions back into conformance with IRS tax qualification standards. It is better to have the IRS review the plan “upfront” and get an FDL.

For pre-approved 401(k), Profit Sharing, and Money Purchase plans, the current “remedial amendment period” ended on April 30, 2010. In anticipation of this deadline, Means & Associates submitted its clients’ plans to the IRS for FDLs prior to April 30, 2010. Many of our clients have already received their updated FDLs or are expecting them soon.

3. **Provides assurance with respect to plan effective dates and adoption dates.** Plan Sponsors who have obtained an IRS FDL at every critical juncture of plan or legislative changes can also feel secure that the plan’s multiple amendment or restatement effective dates and adoption dates are proper. The issuance of an IRS FDL provides closure by having satisfied IRS timing requirements for the plan's legal documents — and an employer can rely on the IRS' determination letter as proving timely adoption of amendments in any future IRS audit that may occur. Overall, this level of assurance can only be obtained through the IRS FDL submission program.
4. **Protects benefits in the case of personal bankruptcy.** The “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005” confirms the protection of benefits in a tax-exempt trust. A plan with an FDL is deemed to be tax-exempt. Plans without an FDL have a presumption that is not as strong and must show that the plan is in substantial compliance with the Internal Revenue Code’s tax-qualification rules or, if the plan is not in substantial compliance, that the debtor is not responsible for that plan failure. Owners, principal shareholders, corporate officers, and senior management may have a challenge in proving that the plan failure is not their responsibility.
5. **Facilitates Divestiture/Acquisition Transactions.** Employers involved in business acquisition/divestiture transactions will typically require confirmation that the plans sponsored by the businesses in transition have received IRS FDLs. This provides the necessary fiduciary assurance that any assets transferred during the transaction are from a “qualified plan,” thereby minimizing risk to the receiving plan, plan sponsor, or other fiduciaries.

Should you have any questions regarding this Retirement Plan Update, contact our consulting team at 619-696-7284.