CLIENT ALERTS & INSIGHTS

IRS Retirement Plan Guidance Simplifies Pre-Approved Plans and Provides Roadmap for Individually Designed Plan Conversion

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In Revenue Procedure 2017-41, the IRS makes significant changes to the procedures that it will use in reviewing and approving "pre-approved" retirement plans. The revenue procedure applies to almost all types qualified retirement plan, including 401(k) plans, ESOPs, profit sharing plans, pension and cash balance plans. Although this revenue procedure does not apply to tax-sheltered annuity [Section 403(b)] plans, the IRS, in Revenue Procedure 2013-22 separately established a pre-approval program for Section 403(b) plans. By liberalizing the types of plans and the design options that will it will consider as pre-approved, the IRS is encouraging adopters of individually designed plans to consider the adoption of a pre-approved plan in the future.

Background

Last year, in Rev. Proc. 2016-37, the IRS announced that it was making significant changes to the determination letter program applicable to individually designed retirement plans. Individually designed plans are plans drafted by law firms or other employee benefit consultants to meet the specific needs of an employer. Such plans have not been pre-approved by the IRS. Previously, every five years, an employer that sponsors an individually designed plan was entitled to request a ruling from the IRS, called a "determination letter," that the current terms of the plan are tax-qualified. Although not mandatory, most employers maintaining individually designed plans applied for a determination letter from the IRS because the employer receives an assurance that the form of the plan is tax-qualified, as does the employer's auditors, lenders, and other third parties.

Effective January 1, 2017, Rev. Prov. 2016-37 substantially limited the ability of an employer that sponsors an individually designed plan to receive a determination letter on its ongoing plan. Rev. Proc. 2016-37 generally limited the issuance of determination letters to the following events:

- Initial plan qualification;
- Termination of the plan; or
- Other reasons to be specified by the IRS.

As a result, employers adopting individually designed plans are now required to, on an annual basis, review the Services' plan Required Amendment List and all optional and discretionary changes made to the operation and administration of its plan in order to ensure that the changes are tax-qualified and that all required or optional amendments to its plan are timely adopted.

In Revenue Procedure 2015-36, the Service previously expanded its pre-approval program to include cash balance plans and ESOPs, and in Revenue Procedure 2013-22, to include tax-sheltered annuities [Section 403(b)] plans.

The changes set forth in Rev. Proc. 2017-41 are designed to make it easier for:

- the Service to review and approve pre-approved plans; and for
- employers to adopt a pre-approved plan.

Summary of Changes set forth in Rev. Proc. 2017-41

A. Consolidation of Prototype and Volume Submitter Programs

Both the prototype and volume submitter programs enabled an employer in many cases to rely on the Opinion Letter issued to the sponsor of the plan by the IRS with regard to the tax-qualification of the plan. In the revised revenue procedure, the distinction between master and prototype plans and volume submitter plans has been eliminated. Instead, single opinion letter program is created in which the Service will approve the tax-qualification of two categories of a plan - either a standardized plan or a nonstandardized plan. An employer that adopts a standardized plan must adopt the plan on a word for word basis and may only select from pre-approved options in order for an employer to rely on the Opinion Letter. On the other hand, an adopting employer of a nonstandardized plan may adopt minor modifications to the Services' pre-approved language and can seek approval from the Service of the modifications.

B. Expansion of Plan Types and Features

The Service will now permit more types of plans and/or features within the plan to be covered by the pre-approved plan program. The significant changes are summarized below. Most defined contribution plan types will be permitted to use the same basic plan document. For example, the prohibition against combining a money purchase plan with a § 401(k) or profit-sharing plan in the same pre-approved plan document is eliminated. In general, provided that the provisions of a basic plan document are identical for all plans using that document, separate defined contribution adoption agreements may be associated with the same defined contribution basic plan document. As a result, a profit-sharing plan, a money purchase pension plan other than a target benefit plan, a target benefit plan, and an ESOP may all use the same defined contribution basic plan document.

The Service will now approve pre-approved plans dedicated to and solely covering non-electing church plans.

A nonstandardized form of plan may provide for non-safe harbor 401(k) hardship distributions if these distributions are subject to nondiscriminatory and objective criteria contained in the plan.

A nonstandardized plan that contains an ESOP may now include a Section 401(k) feature.

The procedures for a determination letter application by an adopting employer to obtain reliance under Internal Revenue Code Sections 415 and 416 have been modified to permit an application to be made on Form 5307, *Application for Determination for Adopters of Modified Volume Submitter Plans.*

Changes applicable to cash balance plans include:

- A nonstandardized plan that contains a cash balance formula may now permit the rate used to determine interest credits to be the actual return on plan assets, but not a subset of plan assets.
- Certain formulas under which benefits are determined by reference to the current value of an accumulated percentage of a participant's final average compensation are not permitted.
- Conversion amendments must provide that, after the effective date of the conversion amendment, a participant's accrued benefit is equal to the sum of accruals under the prior formula plus the benefit based on the Cash Balance Formula ("A+B Conversion").
- Cash balance plans that contain any structure of principal credits that increase with age, service, or any other measure during a participant's employment must be definitely determinable, operationally nondiscriminatory, and at all times in compliance with the "133 1/3 percent rule" of Internal Revenue Code Section 411(b)(1)(B) and the regulations thereunder.
- The revenue procedure specifies detailed rules that must be complied with if the cash balance plan formula will be offset benefits accrued under another plan.

C. Trust and Custodial Account Provisions

The trust agreement or custodial account agreement must be in a document separate from the rest of the plan. The IRS will no longer rule on the exempt status of a pre-approved plan's related trust or custodial account. A pre-approved plan must include a provision that the plan's terms override any conflicting provisions of the trust or custodial account used with the plan. Likewise, an adopting employer may not rely on an opinion letter to the extent that the trust or custodial account document contains a provision that states that the provisions of the trust override provisions of the plan. In addition, a pre-approved plan may permit each adopting employer to establish a separate trust document.

D. Effective Date

Adopters of prototype plans are required to amend and restate their plans every six years. Rev. Proc. 2017-41 is effective on October 2, 2017, and will apply to applications for opinion letters submitted by pre-approved providers with respect to a plan's third (and subsequent) 6-year remedial amendment cycles.

E. Next Steps

Although it will be several years before the third cycle is open and the plan provisions discussed above will be available for adoption by employers, the revenue procedure serves as a reminder to adopters of both prototype and individually designed plans that, on an annual basis, it must ensure that required or discretionary amendments are adopted by such plans. In addition, adopting employers should consider whether a pre-approved plan document may currently, or in the future, better serve its needs. Finally, many employers often neglect to review their trust agreements, or can even locate them. Now is a good time to review the trust agreement to ensure that it is up-to-date with regard to the designation of the trustees, adopting employers, current provisions, and elimination of any conflicting provisions.

If you have any questions, please contact a member of Benesch's Labor & Employment Practice Group.

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