Favorable Determination Letter

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Introduction

This publication explains the significance of a favorable determination letter, points out some features that may affect the qualified status of an employee retirement plan and nullify the determination letter without specific notice from us, and provides general information on the reporting requirements for the plan.

Significance of a Favorable Determination Letter

An employee retirement plan qualified under Internal Revenue Code (Code) Section 401(a) (qualified plan) is entitled to favorable tax treatment. For example, contributions made in accordance with the plan document are generally currently deductible. However, participants will not include these contributions in income until the time they receive a distribution from the plan. In some cases, taxation may be further deferred by rollover to another qualified plan or individual retirement arrangement. (See Publication 575, *Pension and Annuity Income,* for further details.) Finally, plan earnings may accumulate tax free. Employee retirement plans that fail to satisfy the requirements under Code Section 401(a) are not entitled to favorable tax treatment. Therefore, many employers desire advance assurance that the terms of their plans satisfy the qualification requirements.

The Internal Revenue Service (IRS) provides this advance assurance through the determination letter program. A favorable determination letter indicates that, in the opinion of the IRS, the terms of the plan conform to the requirements of Code Section 401(a). A favorable determination letter expresses the IRS opinion on the form of the plan document. However, to be a qualified plan under Code Section 401(a) entitled to favorable tax treatment, a plan must satisfy, in both form and operation, the requirements of Code Section 401(a), including nondiscrimination and coverage requirements. If elected, a favorable determination letter may also provide assurance that the plan satisfies certain of these nondiscrimination requirements in form.

Limitations and Scope of a Favorable Determination Letter

A favorable determination letter is limited in scope. A determination letter generally applies to qualification requirements on the form of the plan.

Generally no reliance for nondiscrimination requirements. Generally, a favorable determination letter does not consider, and may not be relied on about whether a plan satisfies the nondiscrimination requirements of Code Section 401(a)(4).

However, if elected by the applicant, a determination letter may be relied on with respect to whether the terms of the plan satisfy one of the design-based safe harbors in Regulation Sections 1.401(a)(4)-2(b) and 1.401(a)(4)-3(b), on the requirement that either the contributions or the benefits under a qualified plan be nondiscriminatory in amount.

No reliance for coverage requirements. A favorable determination letter does not consider, and may not be relied on about whether a plan satisfies the minimum participation requirements of Code Section 401(a)(26) and the minimum coverage requirements of Code Section 410(b). **No reliance for changes in law and guidance subsequent to publication of the applicable Required Amendments List (RA List)/Cumulative List (CL).**

The Required Amendments List identifies changes in qualification requirements for individually designed plans (IDP) and Section 5 of Rev. Proc. 2016-37 establishes the deadline for IDPs to be amended to comply with the requirements.

A determination letter for an on-going individually designed plan is based on the RA List issued during the second calendar year preceding the submission of the determination letter application.

The Cumulative List of Changes in Plan Qualification Requirements, identifies the qualification requirements that the IRS will consider in reviewing opinion and advisory letter applications that are filed during the 12-month “submission period” that begins following publication of the “applicable Cumulative List.”

Generally, a determination letter issued to an adopting employer of a pre-approved volume submitter plan with minor modifications is based on the Cumulative List for which the volume submitter practitioner filed its application for an advisory letter for the specimen plan.

A favorable determination letter issued to a pre-approved plan generally may not be relied on for any guidance published, or any statutes enacted, after the issuance of the applicable Cumulative List. See Revenue Procedure 2016-37 section 17.03.

A plan sponsor that maintains a qualified plan for which a favorable determination letter has been issued generally may not be relied on for any plan provision that is subsequently amended or that is subsequently affected by a change in law. However, a plan sponsor may continue to rely on a determination letter with respect to plan provisions that are not amended or affected by a change in law.

For terminating plans, a determination letter is based on the law in effect at the time of the plan’s proposed termination date. See section 7 of Rev. Proc. 2016-37.

Other limitations. In addition, the following apply generally to all determination letters:

• If the employer maintains two or more retirement plans, certain limitations and requirements will not have been considered on an aggregate basis. Therefore, the employer may not rely on the determination letter regarding the plans when considered as a total package.

• A determination letter does not:
  - Consider the special requirements relating to: (a) Code Section 414(m) (affiliated service groups), (b) Code Section 414(n) (leased employees), or (c) a partial termination of a plan unless the application includes requests that the letter consider these requirements.
  - Consider whether actuarial assumptions are reasonable for funding or deduction purposes or whether a specific contribution is deductible.

- Express an opinion whether disability benefits or medical care benefits are accident and health plan benefits under Code Section 105 or whether contributions are contributions by an employer to accident and health plans under Code Section 106.
- Express an opinion on whether the plan is a governmental plan defined in Code Section 414(d).
- Express an opinion on whether contributions made to a plan treated as a governmental plan defined in Code Section 414(d) constitute employer contributions under Code Section 414(h)(2), nor on whether a governmental excess benefit arrangement satisfies the requirements of Code Section 415(m).
- Express an opinion on whether the plan is a church plan within the meaning of Code Section 414(e).

Become familiar with the terms of the determination letter. Call the contact person listed on the determination letter if you do not understand any of the terms in your determination letter.

Retention of information. Whether a plan meets the qualification requirements is determined from the information in the written plan document, the application form and the supporting information submitted by the employer. **Therefore, the employer must retain a copy of the application, information submitted with the application and all other correspondence.**

Other conditions for reliance. We have not verified the information submitted with the application. The determination letter will not provide reliance if:

(1) there has been a misstatement or omission of material facts, (for example, the application indicated that the plan was a governmental plan and it was not a governmental plan);

(2) the facts subsequently developed are materially different than the facts on which the determination was made; or

(3) there is a change in applicable law.

Amendments to the plan for changes in law and guidance. A favorable determination letter issued for an individually designed plan provides reliance for the specified required amendments list identified on the determination letter. Rev. Proc. 2016-37.

A favorable determination letter issued to an adopting employer of a pre-approved volume submitter plan with minor modifications provides reliance up to and including the last day of the six-year remedial amendment cycle, conditioned upon the timely adoption of any necessary interim amendments as required by Rev. Proc. 2016-37. Also see Rev. Proc. 2015-36.

Plan Must Qualify in Operation

Generally, a plan qualifies in operation if it satisfies the coverage and nondiscrimination requirements and is maintained according to its terms. However, a plan generally must be operated in a manner that satisfies any change in the qualification requirements for the period beginning when the change is effective, even if the plan has not yet been amended for the change. Changes in facts on which the determination letter was issued may mean that the determination letter may no longer be relied upon.

Some examples of the effect of a plan's operation on a favorable determination are:

Contributions or benefits in excess of the limitations under Code Section 415. A retirement plan may not provide retirement benefits or, in the case of a defined contribution plan, contributions and other annual additions, that exceed the limitations specified in Code Section 415. The plan contains provisions designed to provide benefits within these limitations. The plan is disqualified if these limitations are exceeded.

Top heavy minimums under Code Section 416. If the plan is top heavy in accordance with Code Section 416, the plan must provide certain minimum benefits and vesting for non-key employees. If the plan document provides for minimum benefits and accelerated vesting only for years during which the plan is top heavy, failure to identify these top heavy years and to provide the accelerated vesting and benefits in operation of the plan will disqualify the plan.

Actual deferral percentage or contribution percentage tests. If the plan provides for cash or deferred arrangements, employer matching contributions or employee contributions, the determination letter considers whether the plan terms satisfy the requirements of Code Section 401(k)(3) or 401(m)(2), in form. However the determination letter does not consider whether special nondiscrimination tests described in Code Section 401(k)(3) or 401(m)(2) have been satisfied in operation.

Reporting Requirements

Most plan administrators or plan sponsors/employers who maintain an employee benefit plan must file a Form 5500 series annual return/report.

A "Final" Form 5500 series annual return/report must be filed if the plan is terminated.

Form 5330 for prohibited transactions. Transactions between a plan and someone having a relationship to the plan (disqualified person) are prohibited, unless specifically exempted from this requirement. A few examples are loans, sales and exchanges of property, leasing of property, furnishing goods or services, and use of plan assets by the disqualified person. Disqualified persons who engage in a prohibited transaction for which there is no exception must file Form 5330 by the last day of the seventh month after the end of the disqualified person's tax year.

Form 5330 for tax on nondeductible employer contributions to qualified plans. If contributions are made to the plan in excess of the amount deductible, a tax may be imposed on the excess contribution. Form 5330 must be filed by the last day of the seventh month after the end of the employer's tax year.

Form 5330 for tax on excess contributions to cash or deferred arrangements or excess employee contributions or employer matching contributions. If a plan includes a cash or deferred arrangement (Code Section 401(k)) or provides for employee contributions or employer matching contributions (Code Section 401(m)), then excess contributions that would cause the plan to fail the actual deferral percentage or the actual contribution percentage test are subject to a tax unless the excess is eliminated within 2½ months after the end of the plan year. Form 5330 must be filed by the due date of the employer's tax return for the plan year in which the tax was incurred.

Form 5330 for tax on reversions of plan assets. Under Code Section 4980, a tax is payable on the amount of almost any employer reversion of plan assets. Form 5330 must be filed by the last day of the month following the month in which the reversion occurred.

Form 5310-A for certain transactions. Under Code Section 6058(b), an actuarial statement is required at least 30 days before a merger, consolidation or transfer (including spin-off) of assets to another plan. This statement is required for all plans. However, penalties for non-filing will not apply to defined contribution plans for which:

(1) The sum of the account balances in each plan equals the fair market value of all plan assets,

(2) The assets of each plan are combined to form the assets of the plan as merged,

(3) Immediately after a merger, the account balance of each participant is equal to the sum of the account balances of the participant immediately before the merger, and

(4) The plans must not have an unamortized waiver or unallocated suspense account.

Penalties will also not apply if the assets transferred are less than three percent of the assets of the plan involved in the transfer (spinoff), and the transaction is not one of a series of two or more transfers (spinoff transactions) that are, in substance, one transaction.

The purpose of the above discussions is to illustrate some of the principal filing requirements that apply to pension plans. This is not an exclusive listing of all returns and schedules that must be filed.