

Determination Letter Issues Regarding Employee Stock Ownership Plans

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Agenda / Topics to be Discussed

- Overview / background / current ESOP program
- Development of technical analysis memoranda
 - Available resources on website
- Recurring issues on current submissions
- Future program developments

Current ESOP Determination Letter Program

ESOP Determination Program

- Current progress
 - Reviewing Cycle C Form 5300 submissions up to September 2008
 - Forms 5310 submissions up to October 2010

Checking the Status of a DL Application

- Generally updated weekly
- Go to www.irs.gov
- Click on the Retirement Plans Community tab
- Click on “Benefits Practitioner” at the top left hand corner
- Click the fourth item down named “Determination, Opinion and Advisory Letters for Retirement Plans”
- Click the second item down named “Check the Status of your Letter”

Employee Plans

Form Number

Postmarked Date

Form 5307

December 2009

Form 5300

Cycle A and B – All cases assigned

Cycle C – February 2009

Cycle D – April 2009

Cycle E – February 2010

Cycle A (2/2/22) – February 2011

Form 5310

September 2010

Application for Group or Pooled Trust Ruling September 2010

ESOP – Form 5300

Cycle A – All cases assigned

Cycle B – All cases assigned

Cycle C – September 2008

Cycle D and E – No cases assigned

ESOP – Form 5310

October 2010

ESOP Determination Program

- Recent developments
 - Brought extra people into cadre
 - Trying some inventory / process refinements to expedite review time
 - Put out a newsletter explaining that
 - Can treat any request on any submitted plan as applying to all other plans by same practitioner with determination applications pending

ESOP Determination Program

- Previously work on these plans was considered “non-specialized” and they were assigned as general program work
- As a result, cases were blended into work streams, and average disposition time was averaged in with regular (i.e. non-ESOP case work)
- Did not necessarily separately track completion time for ESOPs as they were not subject to differentiated case management

ESOP Determination Program

- Then, in late 2000/2001, two developments ensued:
 - Detection of wide spread ESOP abuse (Management Corp. ESOPs, S-Corp issues, etc.)
 - With enactment of EGTRRA came addition of 409(p), and need to provide specialty training
- Cadre creation with purpose: To increase consistency and quality of ESOP reviews

ESOP Determination Program

- Work commenced on Cycle A applications, 73% of which were submitted within last two weeks preceding January 31, 2007, thus for all intents and purposes work did not full-scale until Cycle B
- In mid-cycle B, recognized need for substantial administrative and interpretive guidance, primarily related to 409(p) issues

ESOP Determination Program

- Suspended work on a substantial number of pending Cycle A submissions, from about mid-2008 until necessary guidance was received in late 2009 and early 2010
- When case processing could resume and guidance was able to be applied to work-in-progress we had equivalent of 1500 case backlog from two submission cycles

ESOP Determination Program

- In order to meet this challenge we have implemented expedited review process changes and added personnel to this cadre
- Streamlined ESOP checklist developed and posted on IRS website.
- Will take some time to see results

ESOP Determination Program

- 5 “Technical Assistance” memoranda developed
- Felt it important to share what otherwise would be internal advice only
 - Promote “transparency” of our thinking on plan design issues
 - Expedite review process if all on the same page
- Advice available at

<http://www.irs.gov/retirement/article/0,,id=225834,00.html>

Employee Plans



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Employee Stock Ownership Plans (ESOPs)

An employee stock ownership plan (ESOP) is a Code [§401\(a\)](#) qualified defined contribution plan that is a stock bonus plan or a stock bonus/ [money purchase plan](#). An ESOP must be designed to invest primarily in qualifying employer securities as defined by Code [§4975\(e\)\(8\)](#) and meet certain requirements of the Code and regulations. The IRS and [Department of Labor](#) share jurisdiction over some ESOP features.

Additional Resources:

- [Form 5300 Applications for Employee Stock Ownership Plans](#)
Explains changed procedures for reviewing Form 5300 ESOP determination letter applications during cycles C-E and a worksheet to review ESOPs in their initial review stage. Plan sponsors and practitioners may use the worksheet as a tool to design ESOP plan documents.
- [Response to Technical Assistance Request #1](#) (Nov. 3, 2009)
Concludes that ESOP provisions providing for a distribution of stock is subject to immediate, mandatory resale are consistent with Code [§409\(h\)](#).
- [Response to Technical Assistance Request #2](#) (Nov. 3, 2009)
Discusses plan language defining "qualified participant" under Code [§401\(a\)\(28\)\(B\)\(iii\)](#).
- [Response to Technical Assistance Request #3](#) (Dec. 9, 2009)
Discusses the required timing and substance of Code [§409\(p\)](#) amendments.
- [Response to Technical Assistance Request #4](#) (Feb. 23, 2010)
Discusses qualification issues presented by plan provisions concerning the mandatory transfer of employer securities to and from participant plan accounts.
- [Response to Technical Assistance Request #5](#) (October 8, 2010)
Discusses qualification issues presented by plan provisions concerning the mandatory transfer of employer securities to and from

ESOP Determination Guidance

- Memo 1: Distribution of stock subject to immediate, mandatory resale is consistent with Code Section 409(h).
- Memo 2: Acceptable plan language defining “qualified participant” for diversification requirement of Code 401(a)(28)
- Memo 3: Required timing and content of Section 409(p) amendments, including regulations under 409(p)

ESOP Determination Guidance

- Memo 4: “Reshuffling/Rebalancing” memo – acceptability of provisions for mandatory transfer of employer securities and other assets to and from participant plan accounts.
- Memo 5: Issues presented by provisions for mandatory transfer by reshuffling which are designed to prevent the occurrence of a nonallocation year for IRS 409(p) purposes

ESOP Determination Guidance

- Also have sample plan language for 409(p) transfers – this language can be accessed via IRS website
- Memo dated 1/5/10 from the ESOP Association meeting

New ESOP Processing Procedures

New Accelerated Processing Procedures

- Two cadre members are doing accelerating processing
- All applications (not previously assigned) under these new procedures – includes both Forms 5300 and 5310 applications
- Applications are generally being assigned in postmark date order
- Under accelerated processing contact will be made only on cases where resolution can be made with a single contact (i.e. issues not too complex)
- Otherwise applications will be reassigned to the rest of the ESOP cadre and held in inventory until work is requested by other cadre members

Multiple Application Submissions for the Same Plan

- Two applications submitted for same plan (i.e. one “deemed on-cycle” and one on-cycle)
- Example: ESOP with an EIN ending in “5”
 - Plan met new plan rules under Rev. Proc. 2007-44 to be “deemed on-cycle” and application submitted in Cycle C
 - Another application for the same plan submitted timely on-cycle in E
- In the past we have made contact as to what the practitioner wants to do with the “deemed on-cycle” filing – either continue the review or withdraw the application - starting November 1st we will no longer make contact and will continue to review the “deemed on-cycle” application

Multiple Application Submissions for the Same Plan

- The on-cycle application (i.e. Cycle E) will remain in the inventory until we start reviewing applications from that cycle
- You may contact us and withdraw the “deemed on-cycle” application – (i.e. submit letter requesting the application be withdrawn for cycle C)
- Fax your withdraw request that includes the plan name, EIN, DLN, and plan number to Julie Heckler at 513-263-3540

Note...

- If submitted an on-cycle application under 1st 5-year cycle (i.e. Cycle B application submitted by 1/31/08) and you haven't received the DL yet
- If you want a new DL - still need to submit an on-cycle application in 2nd 5-year cycle (i.e. Cycle B submission period ending 1/31/13)
- Indicate in the cover letter of the other pending DL application
- We do not “convert” any applications from one cycle to another

Note...

- We are currently in the process of reviewing Cycle C 5300 applications
- If there are any Cycle A or B applications from the 1st 5-year cycles (submitted on or prior to 1/31/08) and no contact has been made
- Fax information: plan name, EIN, DLN, and plan number to Julie Heckler at 513-263-3540

Some Recurring Issues in Determination Letter Submissions for ESOPs

All amendments for Cycle C applications are not being submitted

- EGTRRA good faith amendment
- IRC 401(a)(9) final regulations (if not already approved in GUST determination letter per section 3.06 of Rev. Proc. 2002-29)
- IRC 401(a)(31)(B) (aka Automatic Rollover amendment) - provided an amendment is needed (i.e. cash out limit already at \$1,000 would not need this amendment)

All amendments for Cycle C applications are not being submitted

- IRC 409(p) amendment, if employer is a S-Corp
- IRC 415 final regulations
- KSOP plans: IRC 401(k) and/or (m) final regulations
- KSOP plans: Roth 401(k) Contributions amendment under IRC 402A (if employer is electing this provision)

Documents

- Plan document, amendments and/or trust document submitted are signed but not dated
- Plan document, amendments and/or trust document submitted are dated but not signed

Forms 5300 and 5309

- Form 5300 application is not completed in its entirety
- Attachment(s) to line items on application not submitted
- Form 5309 missing

IRC 409(I)

- Cannot incorporate 409(1) by reference for the definition of “qualifying employer securities” (or other similar term such as company stock, stock, employer stock, etc.)

Waiver to Participate in Plan

- Election not to participate in the ESOP plan (or the ESOP portion of the plan) must be irrevocable
- Item #12 on Memo dated 1/5/10

Debt Forgiveness Language

- Elimination of debt forgiveness language which relieves the employer of the obligation to fully amortize exempt loan(s)
- Item #7 on Memo dated 1/5/10

Classification of Sale of Stock Proceeds

- Elimination of language which states proceeds from the sale of stock held in suspense account are earnings and not annual additions
- Considered a hypothetical future transaction and the Service will not rule on this type of transaction until it occurs (generally at the termination of the plan) per Rev. Proc. 2008-4
- Item #6 on Memo dated 1/5/10
- The plan can be amended to include this language once the transaction occurs

IRC 409(p)

- Include definitions for impermissible accrual under Treas. Regs. 1.409-1(b)(2)(ii) and impermissible allocation under Treas. Regs. 1.409-1(b)(2)(iii)
- Amendments for 409(p) not submitted when the employer is a S-Corporation
- IRC 409(p) transfer language to prevent non-allocation year is either not sufficient or not amended into plan

IRC 409(p)

- Incorporating any 409(p) language by reference is not allowed in the plan but is allowed in the 409(p) amendment
- Item #5 on Memo dated 1/5/10
- Technical Assistance Memo #3 dated 12/9/09

Segregation Language

- Sometimes referred to reshuffling or rebalancing
- Language must conform to Technical Assistance Memo #4 dated 2/23/10
- Remove language from the plan – preferred method
- If keeping language in the plan then need to eliminate the administrator's discretion in using this provision and to indicate how the stock/cash exchange will occur

Exempt Loan Language

- Exempt loan language is being incorporated by reference or not all provisions are compliant with the regulations under 4975
- Items listed in the ESOP Checklist
- Item #4 on Memo dated 1/5/10
- The release from encumbrance of qualifying employer securities under the general rule must be principle and interest in the numerator under 54.4975-7(b)(8)(i)

Final 415 Regulations Changes

- Post severance compensation – required vs. optional provisions
- Repeal of methods from 1981 regs. to eliminate excess annual additions

IRC 401(a)(31)(B)

- Sometimes named the “Automatic Rollover” amendment
- IRC 401(a)(31)(B) provision in plan is not always correct
- The plan must either (a) lower the involuntary cash out limit to \$1,000, (b) add provision for automatic IRA rollovers for involuntary cash out distributions between \$1,000 and \$5,000, or (c) eliminate involuntary cash out contributions from the plan

1042 Election

- 1042 election can only be made by a C-Corporation
- No portion of the stock can be allocated to the account of (a) the seller of the stock, (b) the seller's family, or (c) any other person who owns (after the application of the family attribution rules) **more than 25% of any class of outstanding stock or more than 25% of the total value of any class of outstanding stock** during the 10-year period beginning on the date of sale of the securities and ending on the later of 1) the date which is 10 years after the date of the sale, or 2) the date of the plan allocation attributable to the final payment of acquisition indebtedness incurred in connection with such sale

Valuation Date

- The valuation date in the case of a transaction between the plan and a disqualified person must be determined as of the date of the transaction
- Reg. 54.4975-11(d)(5)

Top Heavy Ratio

- IRC 416(g)(3)(A)(ii) changed the 5 year look back period to 1 year
- However, for any distribution made for a reason other than severance from employment, death or disability the five year look back period is still used (i.e. in-service distribution) per IRC 416(g)(3)(B)
- The words “severance from employment” replaced “separation from service” under JCWAA

Key Employee Definition

- The dollar amount of \$150,000 for the key employee definition under IRC 416(i)(1)(A)(iii) for a 1% owner is not indexed for cost of living increases

Future Developments Affecting ESOP Determination Letters

Future of ESOP Program

- Development of final regulations under Code section 4975 to supersede current regulations initially issued in the 1970's

Future of ESOP Program

- Development of ESOP pre-approved plans program
- Will not be implemented for second six-year remedial amendment cycle for defined contribution plans ending 4/30/18
- Will likely be in volume submitter format to allow for sufficient flexibility in plan design

ESOP Technical Questions

- Is 409(p) a qualification failure and resolvable under EPCRS?
- Did 409(p) language have to be included in an EGTRRA good faith amendment?
- Why has IRS seemingly reversed its position with regard to the acceptability of plan language providing that excess amounts are treated as investment earnings?

Questions ?

- Retirement.Plans.Questions@irs.gov or
1-877-829-5500
- Donald.J.Kieffer@irs.gov or
- Michele.L.Owen@irs.gov

On behalf of Employee Plans Customer Education and Outreach, we thank you for listening today!