

A Primer on Qualified Plan Document Maintenance

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The sponsor of a tax-qualified retirement plan and the plan's fiduciaries have a number of obligations once a plan is established. Many of these obligations relate to the day-to-day operation of a plan. However, plan document maintenance issues are sometimes overlooked.

This newsletter will summarize some of these issues and describe the consequences of not timely amending plan documents. It will also summarize the new IRS determination letter process.

Written Plan Document Requirement

Tax-qualified retirement plans are governed by the Employee Retirement Income Security Act of 1974 ("ERISA"). All ERISA-governed plans must be documented in a written plan document.

The IRS has the primary responsibility for the review of the terms and conditions of a tax-qualified plan. The IRS reviews the plan document when a determination letter is requested or during a plan audit.

Plan documents can take various forms including individually designed, volume submitter and prototype plans which are described below.

Individually Designed Plans

This type of plan document is custom designed to meet the employer's specific needs. The employer has the greatest variety of available options with this type of plan.

Volume Submitter Plans

Volume submitter plans generally look like individually designed plans, but the IRS has pre-approved much of the document language since it is expected they will see a large volume of these plans utilizing the document options.

Prototype Plans

Prototype plans are pre-approved by the IRS and come with two types of adoption agreements: standardized and non-standardized. Standardized adoption agreements have very limited choices which prevent the plan sponsor from designing a plan that will not satisfy discrimination tests.

Non-standardized plans offer additional flexibility to exclude certain forms of compensation for allocation purposes or exclude certain employees from the plan or contribution eligibility.

Plan provisions usually take the form of a fill-in-the-blank adoption agreement. The selection of available options varies by sponsor of the prototype document. These documents are generally sponsored by companies such as retirement consulting firms, brokerage firms, banks, insurance companies and mutual funds.

Determination Letter Applications

A first way that the IRS may wind up reviewing a plan document is when a determination letter application is submitted. A plan is voluntarily submitted to the IRS for a determination that its terms and conditions satisfy all applicable IRS tax-qualification requirements.

Plan sponsors are not required to submit pension, 401(k), money purchase or other tax-qualified plans for IRS approval. If, however, a plan sponsor does not submit a plan and the IRS later determines that the plan does not satisfy a legal requirement, the plan may be "disqualified" with negative tax consequences for the plan's participants.

When a determination letter request is submitted, the IRS reviews the submitted plan against a checklist of legally-required provisions derived from the Internal Revenue Code and related regulations. If the IRS concludes that the plan satisfies these requirements, the plan will be issued a favorable determination letter.

If the IRS concludes that the plan does not satisfy these requirements or has questions about plan terms and when they were adopted, it will contact the person submitting the determination letter request for more information.

The Internal Revenue Code and related IRS guidance allows a plan sponsor to adopt retroactive plan amendments in certain limited circumstances. If a retroactive amendment is not permitted, the IRS may refer a determination letter application to its

employee plans correction program which will trigger additional IRS fees.

Recent IRS Update of Determination Letter Process

The IRS recently issued guidance (Revenue Procedure 2005-66) updating the rules governing the determination letter process.

Although a plan sponsor may submit a determination letter application at any time, the IRS has historically been faced with periodic waves of determination letter applications. These waves have generally occurred at the end of an applicable "remedial amendment period." A remedial amendment period is a period of time during which a plan sponsor may amend a plan retroactively to comply with changes in applicable law.

The result of these waves was that the IRS often found itself needing to adjust its staff (including using audit staff) to review determination letter applications. The new determination letter application process attempts to smooth these waves.

Impact on Volume Submitter and Prototype Plans

The IRS has historically required that pre-approved plan documents, such as volume submitter and prototype plans, be amended from time-to-time to comply with applicable legal changes. If a pre-approved plan satisfies applicable IRS requirements, an opinion letter is issued to the sponsor of a pre-approved plan. Many individual plan sponsors rely on this opinion letter rather than submitting a request for their own determination letter.

Under the new determination letter process, pre-approved plans must be submitted once every six years for a new opinion letter. The timing of this six-year cycle depends on the type of plan involved--the cycle will differ for defined contribution and defined benefit plans.

When the review of a cycle of pre-approved plans (which is anticipated to last two years) has neared completion, the IRS will publish an announcement stating a uniform date by which all employers using a pre-approved plan must adopt the newly approved plans. It is expected that this date will give virtually all plan sponsors adopting a pre-approved plan a two-year window in which to adopt the updated plan and, if necessary, submit the plan for its own determination letter.

Impact on Individually Designed Plans

Under the new determination letter process, individually designed plans have a five-year remedial amendment period that, in most cases, is based on the last digit of a plan sponsor's federal employer identification number.

A plan sponsor may apply for an updated determination letter during the last twelve months of its five-year filing cycle. In general, a plan sponsor may submit either a restatement or a working copy that incorporates all amendments. The sponsor's favorable determination letter will include an expiration date, so the sponsor will need to

refile if it wants to preserve reliance.

Interim Amendments

Changes to a plan document, either due to Internal Revenue Code tax-qualification requirements or because of a discretionary plan design change, must be reflected in a timely adopted good-faith "interim" amendment. An interim amendment addressing a disqualifying plan provision will be treated as timely adopted if the plan amendment is adopted by the due date (including extensions) of the employer's tax return for the year in which the change is first effective. However, any discretionary change must be adopted by the end of the plan year in which the plan amendment is effective (unless earlier adoption is necessary to prevent a cutback under applicable IRS guidance).

Plans must always be operated in compliance with a new or changed tax-qualification requirement as of its effective date regardless of when an amendment is adopted.

Plan Audits

A second way that the IRS may wind up reviewing a plan document is when the IRS conducts an audit of a plan. The IRS, as part of its enforcement activities, may request the plan document and other information about the plan.

Although these activities have been relatively infrequent in recent years, the IRS has recently begun renewed enforcement activities. As part of its renewed efforts, the IRS is working to streamline the audit process to avoid "open ended" audits that consume significant amounts of time. Instead, many IRS auditors are likely to initially focus on a few core areas of concern when conducting an audit.

Of course certain audits, such as the IRS's new Employee Plans Team Audit program for large employers, may be far more comprehensive.

Timely plan amendments are key to avoiding problems when a plan is audited. Although the IRS may also focus on operational activities, a clear plan document helps to streamline the audit process. Plan sponsors who fail to timely adopt plan amendments to comply with law changes may utilize the IRS's Voluntary Correction Program ("VCP"), as long as the plan is not under examination by the IRS. Reduced filing fees apply if the VCP filing is within one year of the missed deadline.

If the IRS finds that a plan has not been timely amended during an audit, a plan and plan sponsor may be subject to significant IRS closing agreement fees and, in the worst case, a plan may lose its tax-qualified status.

Summary Plan Description and Summary of Material Modification

A summary plan description ("SPD") generally describes the material terms of a plan, including all contribution rules, distribution rules, fees and other participant rights under the plan in a manner designed to be understood by an average plan participant.

An updated summary plan description must be provided once every ten years if there

have been no plan amendments and every five years if plan amendments have been adopted. A plan administrator must provide a summary plan description to a participant or beneficiary within 90 days of becoming a participant or becoming eligible to receive benefits from a plan. Also, unless a new SPD is provided each time an amendment is adopted, a plan administrator must provide a summary of the amendment in a summary of material modifications to participants and beneficiaries within 210 days after the close of a plan year in which an amendment is adopted.

Conclusion

There are a number of ongoing plan document maintenance activities that are easily overlooked by plan sponsors and fiduciaries. Pre-approved and individually designed plan sponsors should keep in mind the need to timely amend their plan for discretionary and Internal Revenue Code-mandated changes and be aware of the new remedial amendment periods.

Complying with IRS requirements involve a commitment of time and effort. However, taking steps to comply with these requirements now can help to prevent the need for more time consuming and costly efforts to achieve after-the-fact compliance at a later date.

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The information contained in this newsletter is intended to provide general information on matters of interest in the area of qualified retirement plans and is provided with the understanding that our company is not engaged in rendering legal or tax advice. Legal or tax questions should always be referred to a qualified tax advisor such as an attorney or CPA.

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