

# CLIENT ALERT

## IRS ISSUES NEW DETERMINATION LETTER PROCEDURES

In Revenue Procedure 2005-66, the Internal Revenue Service (IRS) sets forth new procedures for sponsors of qualified retirement plans, including employee stock ownership plans, to obtain assurance from the IRS that their plans remain tax qualified after being amended to conform to changes in the tax laws. These new procedures are intended to simplify the determination letter filing process for plan sponsors by providing for 5-year staggered remedial amendment cycles for individually designed plans. In addition, by implementing a five-year staggered filing period the IRS hopes to eliminate the massive influx of plans it receives at the end of each remedial amend-

ment period and shorten the review period for plan submissions.

Rev. Proc. 2005-66 also extends the period for filing plan amendments to comply with the tax law changes brought about by the Economic Growth and Tax Recovery Reconciliation Act of 2001 ("EGTRRA"). Plan sponsors now have until the last day of their five-year cycle to file their plans with the IRS, complete with EGTRRA amendments.

The five-year remedial amendment period is determined based upon the employer identification number (EIN) of the plan sponsor. The chart below shows how a plan's remedial amendment period is deter-

mined under the new procedures.

Some special rules apply. Multiple employer plans, for example, must use Cycle B. In addition, plans maintained by multiple members of a controlled group or an affiliated service group fall under the cycle determined by the last digit of the EIN used for Form 5500 reporting. However, an election may be made for all plans maintained by members of a controlled group to use Cycle A for all plans (this election must be filed with the first determination letter application submitted under the new procedures).

*continued*

| <b>EIN of the Plan Sponsor ending in -</b> | <b>Plan Cycle</b> | <b>The last day of the EGTRRA remedial amendment period</b> | <b>The next five-year remedial amendment cycle ends on -</b> |
|--|-------------------|---|--|
| 1 or 6                                     | Cycle A           | 31-Jan-07   | 31-Jan-12  |
| 2 or 7                                     | Cycle B           | 31-Jan-08   | 31-Jan-13  |
| 3 or 8                                     | Cycle C           | 31-Jan-09   | 31-Jan-14  |
| 4 or 9                                     | Cycle D           | 31-Jan-10   | 31-Jan-15  |
| 5 or 0                                     | Cycle E           | 31-Jan-11   | 31-Jan-16  |

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(continued)

In the case of a terminating plan, retroactive remedial plan amendments will still be required in connection with the plan's termination.

As a result of the new procedures, ESOP sponsors will be able to rely upon a favorable determination letter for the duration of their five year cycle and will not need to apply for a new determination letter before the end of the last twelve month period of the cycle. At that time, any amendments necessary to comply with tax law changes during the cycle must be submitted to the IRS. The IRS will publish annually a Cumulative List of Changes in Plan Qualification Requirements identifying changes required by the end of a plan's cycle. For example, an ESOP sponsor with an EIN ending in 6 falls within Cycle A and has until January 31, 2007 to submit its plan for a determination letter. The plan submitted must include all required changes published in the Cumulative List applicable to the particular plan's cycle. For ESOP sponsors and administrators, the new determination letter procedures provide some relief because the end of each remedial amendment period is no longer a "moving target" – subject to uncertain extensions by the IRS.

However, Rev Proc. 2005-66 does NOT eliminate the requirement that qualified plans must be amended currently to comply with changes in the tax laws. Generally, the new rules require that good faith amendments must be adopted to meet changed tax qualification requirements not later than the due date (including extensions) for filing the plan sponsor's tax return for the year in which the change took effect. Therefore, even though a plan need not be submitted until the end of a plan sponsor's five-year cycle, the plan will still have to be amended periodically to comply with interim guidance.

## RECOMMENDED ACTION

ESOP sponsors should review the new determination letter procedures. It is important for plan sponsors to be aware of their remedial amendment cycle and to make sure that their plan is submitted before that cycle ends.

SES Advisors, Inc. will assist you in amending your ESOP plan documents under the new system described in Rev. Proc. 2005-66, and in submitting your amended ESOP documents to the IRS for a determination letter before the end of your

applicable five-year cycle. If you have any questions about how the new rules apply to your plan, please contact Sarah Ivy or Brian Wurpts at 215-508-1500.

## Coming Up in the Next Issue of the SFE&G Client Alert!

Steven Greenapple will discuss the "Tax Benefits of Using an ESOP in Your Next Merger or Acquisition."

ESOPs are extremely versatile financial planning tools. In addition to creating a market for privately held stock and incentivizing employees, ESOPs can be used to enhance a company's ability to acquire another company.

Here are some benefits of using an ESOP in a Merger or Acquisition:

- The acquiring company can use pre-tax earnings to purchase the target company;
- The shareholders of the target company can elect to defer recognition of gain on the sale, pursuant to Section 1042;
- The employees of the target company can also participate in the ESOP; and
- The ESOP can obtain additional shares to allocate among the employees of both the acquiring company and the target company

# Understanding QDROs

*Guest Column by Diane Fanelli,  
Sr. ESOP Administrator—  
SES Advisors, Inc.*

As the point person for your company's ESOP, you no doubt have encountered the dreaded Qualified Domestic Relations Order or QDRO and immediately called your TPA for advice. Good move! Although ERISA rules relating to QDROs are relatively simple, actually dealing with one can be time-consuming.

Let's review the why of QDRO legislation: qualified plans were historically only permitted to pay plan assets to participants (or their beneficiaries). When courts began to issue orders in divorce cases intending to split plan assets, Plan Administrators had to risk the plan's qualified status in order to comply. Congress amended ERISA to permit the division of assets within the plan provided the domestic relations order (DRO) met certain requirements. If met, the DRO becomes a Qualified Domestic Relations Order or QDRO and the plan's trustees can safely distribute a benefit to a non-participant known as the alternate payee, typically the participant's spouse.

Besides meeting the basic require-

ments of current names, addresses and social security numbers and birth dates for both the participant and the alternate payee, the order, in a defined contribution plan like an ESOP, must state precisely the amount of the account to be segregated and the timing of the distribution. In an ESOP it makes sense to specify the amount to be segregated either in number of shares or as a percentage of the account as of a specified date.

Our experience in reviewing QDROs has been that the following points are the most common reasons we must reject the initial version of suggested QDRO:

Believe it or not, often the name of the plan is incorrect. The DOL has stated that if the Plan Administrator can reasonably be sure of what the intended plan is, the QDRO should not be rejected solely on account of the incorrect plan name. We have also recently seen one order that attempted to address benefits under several of the company's plans. We suggest a separate QDRO for each plan.

While it is important for a QDRO in a defined contribution plan to include all types of accounts, when a percentage of the account is speci-

fied, we have seen references to the total account balance rather than the total *vested* account balance. Obviously this needs to be precise when the participant is not fully vested.

When the date as of which the account is to be separated does not fall on an allocation date, in a non-publicly held company the balance will, as a practical matter, generally be determined as of the allocation date preceding the segregation date. Often the order refers to the nearest valuation date, which may be the next valuation date (plan year end). If so, then the order should specify if the segregation should occur before or after any allocations for the year.

We sometimes see references to an alternate payee's right to choose a beneficiary even if the plan does not allow for this. Some plans simply state that the alternate payee's estate is the beneficiary with no provision for an alternate designation.

Finally, the timing and method of distribution should only describe what the plan allows. For example, in many non-ESOP plans an immediate distribution is possible whereas an ESOP may be more restrictive.

As more QDROs go into effect, Plan Administrators may decide

# Understanding QDROs *(continued)*

keeping track of alternate payees' accounts for many years may warrant the strain on current cash flow that immediate distributions might cause.

If you are the Plan Administrator it's important that you go ahead and assume the authority to dictate to the drafter of the proposed QDRO

what is acceptable. In fact, the Plan Administrator has every right to specify, if he so chooses, the criteria to be followed or how the order should be worded in order to ensure qualification.

In any event, each Plan Administrator is required to have a set of written procedures to be followed when

a request for qualification of a Domestic Relations Order arrives. If you don't currently have such a procedure, contact your TPA for suggestions.

*\*If you have questions regarding this article, please contact Diane Fanelli at (215)508-1600 ext. 225 or [dfanelli@sesadvisors.com](mailto:dfanelli@sesadvisors.com).*

## New Faces @ SFE&G!

Join us in welcoming three new attorneys to Steiker, Fischer, Edwards & Greenapple, P.C.

In August, Mary Beth Gray joined SFE&G as a Partner. She is resident in the firm's Philadelphia office.

Mary Beth received her law degree *cum laude* in 1993 from Boston University School of Law, where she was an Editor of the *American Journal of Law & Medicine*. She received her undergraduate degree *cum laude* in 1988 from Harvard University. Mary Beth is admitted to the Bars of Pennsylvania and

Massachusetts. She was previously a partner in the business law department of Kleinbard Bell & Brecker LLP in Philadelphia.

Two new legal associates also joined SFE&G this year. Steven Bowers brings a wide range of ERISA experience to the firm from the perspectives of big firm private practice, the federal government and the benefits consulting world.

Steve received his law degree, *cum laude*, from the Boston University School of Law in 1999 and his BA from the University of Scranton.

Sarah K. Ivy brings a comprehen-

sive ERISA background to SFE&G, having been an employee benefits and executive compensation specialist in well known East Coast law firms since 1998.

Sarah received her law degree from the Dickinson Law School of Pennsylvania State University and her Bachelors of Science degree in Accounting, *cum laude*, from Frostburg State University.

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