



IRS Expands Pre-Approved Plan Program to Include Cash Balance Plans and ESOPs

Guidance Also Extends Application Deadline for Defined Benefit Plans

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With great anticipation, the Internal Revenue Service finally issued a revised procedure that adds cash balance plans and employee stock ownership plans (ESOPs) under its pre-approved master & prototype (M&P) and volume submitter plan programs. In addition, under Revenue Procedure 2015-36, the IRS extends the second-cycle application deadline for pre-approved defined benefit plans from June 30, 2015 to October 30, 2015. Coincident with the new procedure, the IRS released its sample language – List of Required Modifications (LRMs) – for pre-approved cash balance plans and ESOPs.

The IRS also has clarified that employers currently maintaining individually designed plans that intend to adopt pre-approved cash balance plans or ESOPs may complete Form 8905, *Certification of Intent to Adopt a Pre-Approved Plan*, and avoid the requirement to restate their individually designed plans and submit for determination letters by the end of the current 5-year remedial amendment cycle.

ASci Insight: The IRS's announced reason for expanding the pre-approved plan program to include cash balance plans and ESOPs is that it "... promotes the IRS's ongoing objective of increasing the availability of pre-approved plans to small and mid-sized employers." While this certainly is true, the IRS also will benefit from fewer individually designed plans to review through its determination letter program. Informally, the IRS has announced it will impose significant restrictions on the ability of employers to obtain determination letters in the future. The expansion of the pre-approved program is a step in that direction.

document #1, it will need an additional 10 adopting employers for basic plan document #2.) Revenue Procedure 2015-36 does not change the 30-unaffiliated sponsors requirement for mass submitters.

- Revenue Procedure 2015-36 continues the IRS trend of making the requirements for M&P plans and volume submitter plans more similar. Both types of pre-approved plans now may include cash balance plan and ESOP features. As previously allowed for volume submitter defined benefit plans, M&P defined benefit plans may include integrated and nonintegrated features in the same filing. Qualification requirements for mass submitters and the approval process for separate trust agreements are now consistent between the M&P and volume submitter programs. One change that the IRS did not make is allowing governmental M&P plans. Only volume submitter plans may be designed as governmental plans.

ASci Insight: Since the inception of the pre-approved plan program over 30 years ago, the IRS has tweaked its pre-approved program to encourage the use of pre-approved plans. Revenue Procedure 2015-36 continues this trend. Adding cash balance plans and ESOPs to the program will be beneficial to many employers (e.g., by reducing the cost of adopting a qualified plan for employees) and to the IRS (e.g., pre-approved program will result in fewer individually designed plans to review for determination letters). While ASci believes that the IRS could have made additional improvements to the program (e.g., by removing all distinctions between M&P and volume submitter plans), we are pleased with the direction the IRS continues to take.

Complete Replacement of Pre-Approved Plan Procedures

Revenue Procedure 2015-36 modifies and supersedes Revenue Procedure 2011-49, the prior procedure applicable to both pre-approved defined benefit plans and defined contribution plans. In addition to allowing cash balance plans and ESOPs under the pre-approved plan program, the new revenue procedure makes the following changes:

- Non-mass submitter pre-approved plan sponsors will need only 15 (rather than 30) adopting employers for its first basic plan document to qualify as a sponsor. If it wishes to submit more than one basic plan document, the non-mass submitter must have at least 30 adopting employers in the aggregate. (For example, if a sponsor wishes to submit two defined benefit pre-approved basic plan documents for approval and the sponsor has 20 adopting employers for basic plan

Addition of Cash Balance Plan Features under the Pre-Approved Defined Benefit Plan Program

Currently, a cash balance plan must take the form of an individually designed plan. In Announcement 2014-4, the IRS announced its intent to allow pre-approved defined benefit plans to include cash balance provisions. The IRS delayed the application deadline for second-cycle pre-approved defined benefit plans several times as it formulated the parameters for the new program. Revenue Procedure 2015-36, along with the new cash balance plan LRMs, sets forth those parameters.

In addition to satisfying the requirements for any pre-approved defined benefit plan, pre-approved cash balance plans will need to satisfy other requirements. One, a cash balance plan must provide that, at all times,

prior accrued benefits (and other benefits protected under Code §411(d)(6)) are protected. Two, cash balance plans that contain any structure of principal credits that increase with age, service or other measure during a participant's employment must be definitely determinable, operationally nondiscriminatory and at all times be in compliance with the "133 1/3 percent" accrual rule.

Pre-approved cash balance plans **may not** include certain features, including:

- A statutory hybrid benefit formula that is not a cash balance formula (e.g., pension equity plans);
- Provisions that allow for hypothetical interest crediting based on rates of return that are subject to participant choice;
- Provisions that allow a rate used to determine hypothetical interest to be based on actual return on plan assets or a subset of plan assets or the rate of return on certain RICs;
- A conversion amendment, except for plans providing 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");
- Provisions that use the 3-percent accrual rule or the fractional accrual rule to satisfy the accrued benefit requirements under §411(b)(1);
- Provisions that provide for funding exclusively through insurance contracts as described in §412(e)(3); and

Provisions that provide for offsets of benefits accrued under another plan, unless certain conditions are satisfied.

ASCI Insight: ASCi currently is reviewing the new procedure and the cash balance plan LRM. At this time, we expect to add a separate cash balance adoption agreement to our PPA defined benefit volume submitter plan. If you are interested in providing suggestions or comments on the design of the cash balance adoption agreement, please address them to clockwood@asc-net.com. ASCi will begin the enrollment process in the next few months. We will be contacting clients who previously enrolled for our PPA volume submitter defined benefit plan to clarify the status of fees.

Extension of Application Deadline for Defined Benefit Plans

Revenue Procedure 2015-36 provides the second deadline extension for filing second-cycle applications for pre-approved defined benefit plans. Previously, the IRS announced its intent to allow pre-approved defined benefit plans to include cash balance provisions and delayed the opening of the program until it issued the appropriate guidance. The original application deadline of February 2, 2014 was first extended to June 30, 2015 and now to October 30, 2015. Document providers can now draft their pre-approved defined benefit plans consistent with the parameters of the new program.

ASCI Insight: If history is any indication, IRS will take up to two years to review the submissions, request any necessary revisions from document providers and then issue opinion and advisory letters to sponsors. At that time, the IRS will announce the restatement period (expected to be a two-year period) for adopting employers to restate their defined benefit

plans. (See the discussion below on the ability to use Form 8905 to indicate an adopting employer's intent to convert its individually designed cash balance plan to a pre-approved cash balance plan.)

Addition of ESOP Features under the Pre-Approved Defined Contribution Program

Like cash balance plans, an ESOP currently must take the form of an individually designed plan. Over the past several years, the IRS informally has discussed the possibility of adding ESOPs to the pre-approved defined contribution plan program and Revenue Procedure 2015-36 does so. The new procedure, along with the new ESOP LRM, sets forth the parameters of the new program. Although document providers had asked the IRS to consider allowing document providers to submit documents with ESOP features during the current pre-approved defined contribution restatement cycle, the IRS will not consider ESOP plan features until the next defined contribution submission cycle that begins February 1, 2017.

In addition to satisfying the requirements for a pre-approved defined contribution plan, a pre-approved ESOP must include a provision that:

- States the plan is an employee stock ownership plan and is designed to invest primarily in employer stock;
- Defines employer stock in accordance with Code §409(l)(1) or (2);
- Meets the applicable diversification requirement;
- Meets the applicable valuation, independent appraiser, and allocation of earnings requirements;
- Meets the ESOP voting requirements;
- Meets applicable right to demand and put option requirements;
- Meets the distribution requirements of Code §409(o);
- Sets forth the requirements relating to exempt ESOP loans;
- Meets the ESOP Code §415 annual addition requirements;
- Meets the ESOP forfeiture requirements;
- Meets the special rules applicable to S corporation and C corporation stock; and
- Identifies (in the adoption agreement) the plan sponsor as being either a C corporation or an S corporation.

The IRS will not issue approval letters to ESOPs that are combination stock bonus plan and money purchase plan or to ESOPs that hold preferred stock. The IRS will allow ESOPs to include 401(k) provisions ("K-SOPs").

Using Form 8905 to Convert Individually Designed Plans to Pre-Approved Plans

Employers currently maintaining individually designed plans that intend to adopt pre-approved cash balance plans or ESOPs (when available) and do not wish to request an individually designed plan determination letter should complete Form 8905, Certification of Intent to Adopt a Pre-Approved Plan, before the end of their plan's current 5-year remedial amendment cycle.

The IRS has indicated that, if an employer does not know which

particular pre-approved plan it will ultimately adopt, the employer does not need to complete certain items on the Form 8905, including Part II (requiring identifying information on the pre-approved plan) and Part III, line 4 (certification by the M&P sponsor or VS practitioner). Instead, the employer should attach a statement to the Form 8905 indicating that it intends to adopt a pre-approved cash balance plan or ESOP when the plan has received an opinion/advisory letter. The employer should keep a copy of the form and statement and attach them to a later determination letter application (Form 5300, 5307 or 5310), if any.

ASCI Insight: Employers maintaining individually designed cash balance and ESOP plans now have the opportunity to avoid the cost of restating their plans by the end of their current five-year remedial amendment cycle. By timely executing Form 8905, the employer's five-year remedial amendment cycle is changed to the six-year remedial amendment cycle for pre-approved plans. ASCi clients should consult with their cash balance plan and ESOP clients to determine whether converting to a pre-approved plan makes sense for them.

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