Advisory Committee on Tax Exempt and Government Entities (ACT)

Report of Recommendations

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Public Meeting
1111 Constitution Ave., NW
Washington, DC 20224

June 9, 2010

Agenda

Welcome and Opening Remarks

- Douglas H. Shulman, Commissioner of Internal Revenue
- Sarah Hall Ingram, Commissioner, Tax Exempt and Government Entities
- Steven J. Pyrek, Designated Federal Official of the ACT
- Maryann Motza, Chair of the ACT

Reports of Recommendations

- Employee Plans: Analysis and Recommendations Regarding the IRS's Determination Letter Program
- Exempt Organizations: Getting It Right - An Online Guide to Setting Executive Compensation for Charities
- Federal, State and Local Governments: Federal-State-Local Government Compliance Verification Checklist for Public Employers (Phase II)
- Indian Tribal Governments: FICA Taxes in Indian Country and the Problem of Selective Incorporation in Administration of the Code
- Indian Tribal Governments: The Implementation of Tribal Economic Development Bonds Under the American Recovery and Reinvestment Act of 2009
- Tax Exempt Bonds: Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Member Biographies
2009-2010

EMPLOYEE PLANS

Barbara A. Clark, Oakland, CA

Ms. Clark is the benefits counsel for the retirement and health and welfare plans sponsored by the University of California, a state government agency and 501(c)(3) organization. The University provides a defined benefit pension plan and three defined contributions plans for its 124,000 employees and 41,000 retirees. Before joining the University in 2003, Ms. Clark had more than 20 years experience as an employee benefits attorney in the private sector. She received her Juris Doctorate from the Boalt Hall School of Law and is a member of the California State Bar.

Kathryn J. Kennedy, Chicago, IL

Ms. Kennedy is the Associate Dean for Advanced Studies and Research and Professor of Law at the John Marshall Law School. As the Director for the Center for Tax Law & Employee Benefits at the school, she established the first LLM program in the nation for Employee Benefits and has since developed the curriculum for more than 20 employee benefits courses. Ms. Kennedy served for three years on the Department of Labor's ERISA Advisory Council and co-authored an employee benefits law textbook. She received her Juris Doctorate from the Northwestern University School of Law, *summa cum laude,* and her Fellowship from the Society of Actuaries. She is also a Fellow of the American College of Employee Benefits Counsel and the 2009 ASPPA Educator of the Year.

G. Daniel Miller, Washington, DC

Mr. Miller is a partner in the Washington, DC, office of Conner & Winters LLP, and a member of that firm's Employee Benefits Practice Group. As a specialist in employee benefits for more than 30 years, he serves the needs of both large and small for-profit employers and the deferred compensation planning needs of a variety of non-profit employers. He is also a member of the Employee Benefits Committee of the Tax Section of the American Bar Association. Mr. Miller received his Juris Doctorate from the Vanderbilt University School of Law.

Susan P. Serota, New York, NY

Ms. Serota is a partner in the New York office of Pillsbury Winthrop Shaw Pittman LLP and chair of the firm's Executive Compensation and Employee Benefits practice. She has broad experience in complicated tax issues and analysis, including defined benefit plans, hybrid plans, section 409A non-qualified deferred compensation arrangements, and section 457 deferred compensation plans for tax-exempt and government entities. In 2006 – 2007, she served as the Chair of the American Bar Association Section of Taxation. Ms. Serota received her Juris Doctorate from the New York University School of Law.

Michael M. Spickard , Akron, OH

Mr. Spickard is the chief executive officer of The Tegrit Group and Summit Retirement Plans Services, a retirement solutions enterprise offering software solutions, actuarial consulting, plan design and administration services to public and private retirement plan sponsors. He has almost 20 years of experience designing and administering all types of retirement plans, with in-depth experience in the areas of salaried, hourly and union defined benefit plans. Mr. Spickard holds a Bachelor of Science in Applied Mathematics from the University of Akron.

Marcia S. Wagner, Boston, MA

Ms. Wagner is a principal and founder of The Wagner Law Group, an ERISA/employee benefits/executive compensation boutique law firm. Ms. Wagner specializes in the full range of employee benefits matters concerning retirement plans, welfare plans and executive compensation. With respect to such plans, she specializes in design, administration, compliance, dispute resolution, government audits, and corporate and employment transactions. Ms. Wagner is a frequent lecturer and author in the ERISA/employee benefits area. For the past three years*, 401k Wire* has listed Ms. Wagner as one of its 100 Most Influential Persons in the 401(k) industry, and she has been inducted as a Fellow of the American College of Employee Benefits Counsel. Ms. Wagner received her Juris Doctor from Harvard Law School and her B.A. from Cornell University *summa cum laude*.

EXEMPT ORGANIZATIONS

J. Daniel Gary, Nashville, TN

Mr. Gary is administrative counsel to the General Council on Finance and Administration (GCFA) of The United Methodist Church, the third largest religious denomination in the United States, with 35,000 churches and affiliated groups. GCFA is responsible for protecting the legal interests of the denomination, and Mr. Gary provides guidance on a wide variety of issues related to tax-exempt organizations, including the prohibition of political campaign activities, private inurement issues, and unrelated business income tax (UBIT). Mr. Gary received his Juris Doctorate from the Washington and Lee University School of Law and his Ph.D. in mathematics from the University of Illinois.

Fred T. Goldberg Jr., Washington, DC

Mr. Goldberg is a partner at Skadden, Arps, Slate, Meagher & Flom LLP, with a broad gauged tax practice that includes not only exempt organizations but also employee plans and tax exempt bonds. Mr. Goldberg served as Chief Counsel of the Internal Revenue Service (1984 – 1986), Commissioner of Internal Revenue (1989 – 1991) and Assistant Secretary (Tax Policy) (1992). He holds a Juris Doctor from Yale University.

Karin Kunstler Goldman, New York, NY

Ms. Goldman is Assistant Attorney General in the Charities Bureau of the New York State Department of Law, where she has a wide range of responsibilities in the oversight of tax-exempt entities. She is responsible for the Bureau's public education program and has also coordinated multi-state enforcement actions. She is a past president of the National Association of State Charities Officials (NASCO), and has been active in conducting educational seminars for officers, employees, and volunteers of exempt organizations throughout the State of New York. Ms. Goldman holds a Juris Doctorate from Rutgers Law School.

James P. Joseph, Washington, DC

Mr. Joseph is a partner and the head of the tax-exempt organizations practice at Arnold & Porter LLP. In the 15 years he has focused on representing tax-exempt organizations, he has advised public charities, colleges and universities, private foundations and advocacy groups on a variety of issues, including operating business ventures, conducting international activities and grant-making, lobbying and advocacy, nonprofit governance, and executive compensation. His practice has involved several high-profile matters that have had broad impact on the nonprofit sector. Mr. Joseph received his Juris Doctorate from the Georgetown University Law Center and is currently Co-Chair of the American Bar Associations Subcommittee on Intermediate Sanctions.

Mary Rauschenberg, Chicago, IL

Ms. Rauschenberg is Director of Deloitte Tax LLP's Chicago healthcare and not-for-profit tax practices. Her clients include academic medical centers, colleges and universities, teaching hospitals, cultural organizations, trade associations, public and private foundations, and other tax-exempt organizations. Ms. Rauschenberg holds a Masters of Accounting Science from the University of Illinois.

Jack B. Siegel, Chicago, IL

Mr. Siegel is an attorney (Illinois and Wisconsin) and CPA (Wisconsin), holding an LLM in Taxation from New York University and a Master's of Management from Northwestern University. Mr. Siegel provides consulting services through Charity Governance Consulting LLC. He focuses on training, governance, and financial management. Mr. Siegel is the author of *A Desktop Guide for Nonprofit Directors, Officers, and Advisors: Avoiding Trouble While Doing Good* (Wiley 2007), a 750-page guide addressing the legal, financial, tax, and governance issues facing nonprofits. Mr. Siegel writes the charitygovernance.com blog. He is producing a series of Webinars that will first become available later in 2010.

GOVERNMENT ENTITIES: FEDERAL, STATE AND LOCAL GOVERNMENTS

Paul Carlson, Los Angeles, CA

Mr. Carlson is the Vice President, Administrative Services at Los Angeles City College, where he oversees accounting, budgeting, facilities, security, auxiliary services, custodial and landscaping functions at the College. Previous to joining the College in 2010, he was the Nebraska State Accounting Administrator for ten years, responsible for the comptrollership functions for the State. He has been active in the National Association of State Comptrollers, recently serving as its president. Mr. Carlson has completed the coursework for a Ph.D. in Educational Administration at the University of Nebraska, and holds a Masters of Business Administration from the University of Montana.

Maryann Motza, Denver, CO

Ms. Motza is the State Social Security Administrator of Colorado, where she works closely with all state and local governments' employers and their financial and legal advisors to ensure compliance with federal Social Security, Medicare, and public pension system laws. She was a Past President of the National Conference of State Social Security Administrators (NCSSSA) in 2001-2002 and will become President again during 2010-2011. She was also a member of the IRS's Taxpayer Advocacy Panel (2004 – 2007). She currently serves as a member of the Board of Trustees for the Public Employees' Retirement Association of Colorado (since 2005). Ms. Motza has a Ph.D. in Public Affairs from the University of Colorado.

Patricia A. Phillips, Virginia Beach, VA

Ms. Phillips is Director of Finance for the City of Virginia Beach, where she oversees accounting, payroll, purchasing, risk management, and debt administration for the city. She has served on the Government Financial Officers Association (GFOA) Standing Committee on Debt Management, the GFOA Standing Committee on Economic Development and Capital Planning, as well as the GFOA Executive Board. Ms. Phillips is a Certified Public Accountant and a Certified Government Financial Manager, and she holds a Masters in Business Administration from Old Dominion University.

GOVERNMENT ENTITIES: INDIAN TRIBAL GOVERNMENTS

Bobette Joyce Kramer, Anchorage, AK

Ms. Kramer, an Aleut from Bristol Bay, Alaska, has more than 25 years' experience in tribal operations, business development and long-term enterprise planning with extensive hands-on knowledge of rural community development strategies. She is currently a business consultant specializing in rural enterprise development, personal finance training for tribal members, grant writing, as well as finance and bookkeeping solutions for tribes and non-profits. She was president and CEO of her Alaska Native Claims Settlement Act village corporation and is a member of the Native Village of Pilot Point. Ms. Kramer is pursuing a Bachelor's degree in rural development at the College of Rural Alaska, University of Alaska Fairbanks.

Joe Lennihan, Santa Fe, NM

Mr. Lennihan is a solo practitioner in Santa Fe, New Mexico. He has worked in the Tax Unit of the Navajo Nation Department of Justice and served as general counsel to the Colorado River Indian Tribes. He has also served as Chief Counsel to the New Mexico Taxation and Revenue Department. Mr. Lennihan received his LLM from Georgetown University Law School.

Wendy S. Pearson, Seattle, WA

Ms. Pearson has more than 20 years' experience as a former IRS attorney and a taxpayer representative and has handled numerous Indian tribal government matters, including constructive receipt, taxation of member benefit programs, and withholding and information reporting. She also regularly consults nonprofit entities, hospitals and health care organizations on matters like governance, excess benefit transactions, executive compensation and tax-exempt financing. Ms. Pearson received her LLM in Taxation from the University of Florida School of Law and her Juris Doctorate from the Gonzaga School of Law in Spokane, WA.

GOVERNMENT ENTITIES: TAX EXEMPT BONDS

Michael G. Bailey, Chicago, IL

Mr. Bailey is a partner with Foley & Lardner LLP in Chicago, specializing in public and tax-advantaged finance. He has represented a wide variety of state and local governments and exempt organizations. He is the immediate past Chair of the Committee on Tax Exempt Financing of the Section of Taxation of the American Bar Association. From 1990 through 1997, he was senior attorney in the Office of the Chief Counsel of the IRS. Mr. Bailey holds a Juris Doctorate from the University of Chicago Law School.

David Cholst, Chicago, IL

Mr. Cholst is a partner in the tax department of Chapman and Cutler LLP, where he provides tax advice relating to tax-exempt bonds. He represents governmental issuers, underwriters, investment brokers, and attorneys in all matters relating to tax-exempt bonds, including arbitrage rebate. His governmental clients include both large and small municipalities. Mr. Cholst has been a member of the faculty of the National Association of Bond Lawyers Tax Seminar and is a member of the ABA Tax Exempt Finance Committee. He received his Juris Doctorate from the University of Chicago Law School.

George T. Magnatta, Philadelphia, PA

Mr. Magnatta is the chair of Saul Ewing LLP's public financing department and an experienced practitioner in the tax aspects of public finance. His practice focuses on serving as bond counsel, underwriting counsel, borrower's counsel and tax counsel for states, cities, economic development authorities, housing authorities and nonprofit entities. Mr. Magnatta served as Assistant Branch Chief of the Office of Chief Counsel, Legislation and Regulations Division of the IRS (1981-85) and is a frequent panelist at meetings of the National Association of Bond Lawyers. He received his LLM in Taxation from the Georgetown University Law Center.

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GENERAL REPORT
OF THE
ADVISORY COMMITTEE ON TAX EXEMPT
AND GOVERNMENT ENTITIES

This General Report is presented in connection with the ninth annual public meeting of the Internal Revenue Service's Advisory Committee on Tax Exempt and Government Entities (the ACT). The Tax Exempt and Government Entities division of the IRS consists of divisions responsible for administration of federal tax laws related to exempt organizations, employee plans, tax exempt bonds, Indian tribal governments, and federal, state and local governments. The ACT provides the TE/GE officials with the stakeholders' perspectives as to how existing and proposed IRS policies and procedures will affect these various communities. The ACT Charter states, in pertinent part:

> The ACT is established to provide an organized public forum for discussion of relevant [issues related to TE/GE Division responsibilities] …and to enable the IRS to receive regular input with respect to the development and implementation of tax administration issues affecting those communities. ACT members will present in an organized and constructive fashion the interested public's observations about current or proposed Tax Exempt and Government Entities Division programs and procedures and will suggest improvements.

Traditionally, the ACT's principal activity is the preparation and production of year-long (and, in some cases, multi-year) projects that culminate in the final recommendations report presented during the June public meeting each year. All ACT members recognize the value of the teamwork between the members and IRS officials which is necessary for the ACT to provide meaningful recommendations to the IRS each year. This year is no exception. This year's projects are:

- Employee Plans: Analysis and Recommendations Regarding the IRS's Determination Letter Program
- Exempt Organizations: Getting It Right – An Online Guide to Setting Executive Compensation for Charities
- Federal, State and Local Governments: Federal-State-Local Government Compliance Verification Checklist for Public Employers (Phase II)

- Indian Tribal Governments:
  - The Implementation of Tribal Economic Development Bonds Under the American Recovery and Reinvestment Act of 2009
  - FICA Taxes in Indian Country and the Problem of Selective Incorporation in Administration of the Code
- Tax Exempt Bonds: Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds

In addition, this year the ACT members were also asked by Commissioner Shulman for their insights and ideas related to the IRS's Return Preparer Review, which was launched during the summer of 2009 and resulted in a final report being issued in January 2010. The ACT members provided that input via conference calls and e-mails during the fall of 2009.

The continuing members of the ACT want to thank the four members who are completing their terms this year:

- Fred T. Goldberg, Skadden, Arps, Slate, Meagher & Flom LLP, Washington, D.C. (EO)
- Mary E. Rauschenberg, Deloitte Tax LLP, Chicago (EO)
- Michael M. Spickard , Akron, OH, The Tegrit Group and Summit Retirement Plans Services, Akron, Ohio (EP)
- Marcia S. Wagner, The Wagner Law Group, Boston (EP)

Their dedication and invaluable assistance in helping improve the service provided by TE/GE, the IRS and its myriad diverse stakeholders is deeply appreciated.

On behalf of the entire ACT Committee, I want to thank Commissioner Doug Shulman for his interest in and support of the ACT's work. We particularly want to recognize TE/GE Commissioner Sarah Hall Ingram, TE/GE Deputy Commissioner Joseph Grant and the TE/GE division directors, Michael Juliannelle, Lois Lerner, and Moises Medina and their staff who worked throughout the year with each of the project teams to ensure we had the information and assistance necessary to perform our functions on behalf of the committee.

The ACT wants to also thank Steven J. Pyrek, the ACT's Designated Federal Official, who manages all of the administrative details associated with the ACT, all of which are expertly handled. He and his staff—Cynthia PhillipsGrady and Evelyn DeWald—ensure that both our face-to-face meetings and conference calls go smoothly and that the final report is a quality product.

Finally, the ACT would like to dedicate this year's report to the memory of IRS employee Vernon Hunter, who was killed during the February 18, 2010, airplane attack on the IRS building in Austin, Texas. Mr. Hunter was a Collection Field Group Manager in the IRS's Small Business/Self-Employed division. As Chris Wagner, SB/SE Commissioner, said in a message to IRS employees soon after the attack, "No matter what family he was a part of – the Army, the IRS, or as a husband, father and grandfather – it was evident to all who knew him that Vernon loved his family and his country."

Sadly, the IRS and its employees are too often the target of frustrated people who object to our federal tax system. We on the ACT, having worked closely with many IRS officials and employees during our tenure, recognize that the IRS is full of dedicated public servants who are honestly trying every day to do the job that Congress and the President have charged them with—administering the tax laws of the United States. We thank them—and the late Mr. Hunter—for their dedication to this great country.

Maryann Motza, PhD
ACT Chair, 2009-2010

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Employee Plans:
Analysis and Recommendations Regarding the IRS's Determination Letter Program

Marcia S. Wagner, Esq., Project Leader

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Michael M. Spickard, EA

June 9, 2010

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I. EXECUTIVE SUMMARY

The Employee Plans subcommittee of the Internal Revenue Service ("IRS" or "Service") Advisory Committee on Tax Exempt and Government Entities (the "ACT") has endeavored to conduct a comprehensive review of the staggered determination letter program that has been implemented by the Service. The ACT believes now, near the end of the first five-year Cycle period for individually-designed plans and the first two-year restatement period for preapproved defined contribution plans, is the opportune time to conduct such a review, as enough time has passed and experience been garnered that meaningful analysis and recommendations can be made, and changes in course can be made prior to the next full Cycle commencing in February 2011. In order to gather the necessary information for this review, the ACT has reached out to all types of stakeholders in the benefits community for input and suggestions, including but not limited to IRS Employee Plans specialists, plan sponsors, benefits attorneys, actuaries, accountants, third party administrators, consultants, plan document providers and organizations representing participants.

This Report provides an historical overview of the Service's determination letter program and includes insights and commentary on the current program received from practitioners. The Report also includes several recommendations that are based on the surveys conducted by the ACT with various stakeholders in the benefits community. These recommendations propose changes to the Service's current determination letter program which are intended to further the Service's goal of ensuring that the rights of plan participants and beneficiaries are adequately protected, and also foster a reasonable expectation among plan sponsors that they will be able to achieve, with reasonable time, expense and commitment, compliance under the applicable qualification rules.

A substantial portion of the ACT's findings relate to the current interim amendment requirement, which is placing a heavy burden on the entire private pension system. The fact that Congress explicitly superseded the existing interim amendment rules in each of the last three pieces of employee benefits legislation is also indicative of the need to reform these rules.[1] The ACT recommends that these interim amendment rules be modified and that future plan amendment adoption deadlines be clarified. With respect to governmental plans, the ACT recommends that better guidance and supporting

The Project Leader, Marcia S. Wagner, gratefully acknowledges her husband, Craig White, and their children, Jessica Hope, Olivia Faith, Cassandra Charity and Craig Isaac, for their love, support and understanding during the development of this Report.

[1] The three pieces of employee benefits legislation include the Pension Protection Act of 2006, Pub. L. No. 109-280 (2006), the Worker, Retiree, and Employer Recovery Act, Pub. L. No. 110-458 (2008) and the Heroes Earnings Assistance and Tax Relief Act, Pub. L. No. 110-245 (2008).

information that address the particular problems of governmental plans be provided to plan sponsors seeking favorable determinations. Similarly, the ACT recommends that the Service address several specific issues in connection with its development of an approval letter program for § 403(b) plans.

The Report also includes recommendations for changes to the determination letter program that the Service may wish to consider in order to: (i) improve customer service, (ii) streamline the determination letter process, (iii) improve its coordination with the Service's Employee Plans Compliance Resolution System, and (vi) prioritize certain off-cycle filings. The ACT recommends that the Service create a taxpayer advocate or designated EP determination letter specialist for resolution of unique issues that arise during the determination letter process and modify its prior plan documentation requirements for employers that do not have copies of their most recent determination letters. In addition, this Report includes other related recommendations with respect to the Service's determination letter program, including suggestions related to funding, training and staffing for the EP Determinations unit.

The ACT respectfully submits this Report with the hope that its findings and recommendations will be helpful in maintaining and strengthening the United States retirement system.

II. INTRODUCTION

In order to receive tax-preferred treatment under the Internal Revenue Code ("IRC" or the "Code"), a retirement plan and its related trust must satisfy the requirements of IRC §§ 401(a) and 501(a), respectively, for the tax year in which the employer is claiming the deduction and the tax year in which employees are deferring receipt of compensation. IRC § 401(b) sets forth the deadline by which the terms of the plan may be retroactively amended to satisfy these qualification requirements. These deadlines are extended by statute if the plan sponsor timely requests a favorable determination letter regarding the terms of the plan and related trust. Such deadlines may also be extended at the discretion of the Service. The division within the IRS that has the authority to issue favorable determination letters is the Tax Exempt/Government Entities ("TE/GE") Division. The effect of a favorable determination letter is similar to that of receiving a favorable private letter ruling from the Service.[2] While the plan sponsor is not required to request a favorable determination letter, the Code requires the IRS to opine if a favorable determination letter is requested.

From 1942 to 1974, the IRS experienced a relatively stable number of favorable determination letter requests regarding the qualified status of retirement plans. Due to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA") and other major pieces of subsequent legislation governing employee benefit plans,[3] the Service experienced major cyclical fluctuations in determination letter requests, requiring it to periodically divert resources away from plan examinations and towards plan document review and compliance.

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[2] Rev. Proc. 2009-1, 2009-1 I.R.B. 1, § 13.01.

[3] Employee Retirement Income Security Act (ERISA) of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26 and 29 U.S.C.). The other major changes included: Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.); Deficit Reduction Act (DEFRA) of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified as amended in scattered sections of 26, 29, and 42 U.S.C.); Retirement Equity Act (REA) of 1984, Pub. L. No. 98-397, 98 Stat. 1426 (codified as amended in scattered sections of 26 and 29 of U.S.C.); Tax Reform Act (TRA) of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified in scattered sections of 26 U.S.C.); GUST (the acronym used to refer to multiple acts to which the Service applied a single plan amendment deadlines as a matter of administrative feasibility) which includes: Uruguay Round Agreements Act of 1994, Pub. L. No. 103-465, 108 Stat. 4809 (codified as amended in scattered sections of 17, 19, and 26 U.S.C.), Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994, Pub. L. No. 1032-353, 108 Stat. 4172 (codified as amended in scattered sections of 28 U.S.C.), Small Business Job Protection Act (SBJPA) of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (codified as amended in scattered sections of 26 U.S.C.), Taxpayer Relief Act (TRA) of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 26 U.S.C.), Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 26 U.S.C.), and Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 26 U.S.C.), Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections of 26 and 29 U.S.C.); Pension Protection Act (PPA) of 2006, Pub. L. No. 109-280, 120 Stat. 780 (codified as amended in scattered sections of 26 and 29 U.S.C.).

Thus, in 2001, the IRS began a comprehensive review of its policies and procedures for issuing determination letter requests. Through the release of two White Papers, discussions with practitioners, and the release of a draft revenue procedure, the IRS revised its determination letter program in Revenue Procedure 2005-66,[4] which formally adopted a new system of cyclical remedial amendment periods ("RAPs") governing applications for a determination letter. At that time, the Service agreed that it would continue to evaluate how the program was working, identify potential problems and make recommendations during the initial years of the program's implementation. To that end, the Service has conducted a review, which is discussed in Part IV. D. of this Report.

To assist the IRS in its review, the Employee Plans subcommittee of the TE/GE's Advisory Committee has undertaken an analysis to determine what may be learned from the new process, whether it has been successful in its goals, and what may be recommended as improvements. In this endeavor, the ACT has reached out to all stakeholders (e.g., IRS Employee Plans specialists, plan sponsors, benefits attorneys, actuaries, accountants, third party administrators, consultants, master and prototype ("M&P") sponsors and volume submitter ("VS") providers[5]) for input and suggestions. The ACT also worked collaboratively with the IRS to provide and produce a report of practical importance and significance.[6] The goal is to create a determination letter program that functions efficiently so as to promote the viability and vitality of the employer-provided retirement system for all employers – small, medium and large. To that end, the ACT Report is divided into various components – Part III provides historical information regarding the Service's determination letter program; Part IV analyzes the Service's internal review and recommendations regarding the new determination letter program and the input of Employee Plans Specialists; Part V summarizes the results of the ACT's survey conducted with various stakeholders; Part VI provides the ACT's recommendations involving policy issues; and Part VII summarizes the ACT's recommendations involving administrative issues.

The importance of a robust yet reasonable determination letter program should be emphasized. The private pension system, while voluntary, imposes significant responsibilities and liabilities on plan sponsors and fiduciaries, particularly plan

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[4] Rev. Proc. 2005-66, 2005-2 C.B. 509, modified and superseded by Rev. Proc. 2007-44, 2007-28 I.R.B. 54.

[5] In Rev. Proc. 62-23, 1962-2 C.B. 487, § 3.02, the Service defines M&P and VS as follows: a "master plan" as a "standardized form of plan, with a related form of trust (or custodial) agreement, where indicated, administered by a bank or insurance company each acting as the funding medium for the purpose of providing plan benefits on a standardized basis," whereas the term "prototype plan" referred "to a standardized form of plan, with or without a related form of trust (or custodial) agreement, which is made available by the sponsoring organization, for use without change by employers who wish to adopt such a plan, and which will not be administered by the sponsoring organization which makes such form available."

[6] <u>See</u> Section IX. A. for the extensive list of persons and entities who have provide input to the ACT.

sponsors. As a result, it is important for plan sponsors to ensure that their plan documents satisfy the requirements of the law, and can assure themselves of this by the issuance of a favorable determination letter from the Internal Revenue Service. Moreover, the accounting profession typically requires a copy of a recent determination letter in order to issue a clean auditor's report.

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III. BACKGROUND

A. Reasons for a Determination Letter Program

Retirement plans that satisfy the requirements of IRC § 401(a) are qualified and therefore extended favorable tax treatment. Treasury regulations require that a qualified retirement plan must be a definite written program established and maintained by an employer and that it satisfy the requirements of IRC § 401(a) in form (i.e., the terms of the plan document must comply with the law), in operation (i.e., the plan must be operated in compliance with its terms and in compliance with the qualification requirements of IRC § 401(a)), and demographically (i.e., the plan must satisfy the Code's various nondiscrimination tests, even as the plan sponsor's employee workforce changes).[7]

The IRS's determination letter program permits a plan sponsor to have the IRS review the form of the plan for compliance. The Service refers to this as "up-front compliance."[8] Such compliance does not protect the plan sponsor from plan operational or demographic failures. Thus, failure to comply with either the plan form, or the operational or demographic qualification requirements (referred to as a "disqualifying provision") of the Code subjects the plan to potential disqualification. The IRS has the power to disqualify a plan should it contain a "disqualifying provision," and the courts have affirmed this authority, irrespective of the significance of the defect, the innocence of the wrongdoer, or the unreasonableness of disqualification compared to the violation committed.[9] The Service also contends that once a disqualifying provision occurs, the plan remains disqualified until the defect is rectified, regardless of the statute of limitations.[10]

While the determination letter program has been designed to assure plan document compliance, the IRS also has a correction program to assure plan operational and demographic compliance and to permit certain retroactive plan amendments to assure

[7] Treas. Reg. § 1.401-1(a)(2).

[8] *The Future of the Employee Plans Determination Letter Program: Some Possible Options, available at* www.irs.gov/irs-tege/paper1.pdf. The Service used the expression "up-front compliance" as the determination letter program, as it then existed, ensured that the form of the plan document or plan amendments is qualified from its inception. Such approach was traditionally viewed as the preferred method to ensure future compliance.

[9] See e.g., Buzetta Construction Corp., v. Comm'r., 92 T.C. 641 (1989); Martin Fireproofing Profit Sharing Plan and Trust v. Comm'r., 92 T.C. 1173 (1989); Basch Engineering Inc., v. Comm'r., 59 T.C.M. 482 (1990).

[10] Under the tainted asset theory, if a plan becomes disqualified for more than five years with money remaining in the plan, the IRS can disqualify the plan even for years barred by the statute of limitations. See Rev. Rul. 73-79, 1973-1 C.B. 194 and Martin Fireproofing Profit Sharing Plan and Trust v. Comm'r., *supra* note 9.

plan document compliance. This correction program is known as the Employee Plans Compliance Resolution System ("EPCRS").[11]

B. IRS's Determination Letter Program in Pre-ERISA Years

Early on, the Service established the authority and procedures by which the District Directors could determine the disposition of requests regarding the qualification of retirement plans.[12] By 1954, the Service referred to such disposition responses as "determination letters."[13] A determination letter was defined as "a written statement issued by a District Director of Internal Revenue in response to an inquiry by an individual or an organization, and solely by way of application to the facts involved in a particular inquiry or request of the principles and policies previously established by the National Office."[14] Such letters would be issued "only where a determination can be made on the basis of clearly established rules as set forth in the statute, Treasury Decisions or Regulations, or rulings, opinions or court decisions published in the Internal Revenue Bulletin."[15] The determination letter grew in importance as the plan sponsor could now rely on a favorable determination letter from the Service, absent a revocation of such determination. The authority of the District Offices to issue determination letters was, at this time, discretionary.[16]

Since then, the determination letter program has undergone several changes to accommodate changes in the law and clarifications in the procedure. The first notable change followed the Internal Revenue Act of 1954. Prior to the Act, employee plans qualified for favorable tax treatment under IRC §165, whereas after the Act, plans became qualified under IRC § 401. Thus, in 1956, the Service issued Revenue Procedure 56-8,[17] amending its determination letter procedures to reflect the legislative changes and listing the specific issues with respect to which the District Offices would issue determination letters:

- Initial qualification of stock bonus, pension, profit sharing and annuity plans under IRC § 401(a);

[11] See Rev. Proc. 2008-50, 2008-35 I.R.B. 464 for the rules governing the use of EPCRS. See also Wagner, Marcia and Cohen, Diane, EPCRS – Plan Correction and Disqualification, BNA Tax Management Portfolio (2010).

[12] Rev. Rul. 32, C.B. 1953-1, as referenced in Rev. Rul. 54-172, 1954-1 C.B. 394.

[13] Rev. Rul. 54-172, 1954 -1 C.B. 394 at § 4.01, *amplified by* Rev. Proc. 56-33, 1956-33, 1956-1 C.B. 1394, *modified by* Rev. Proc. 56-12, 1956-1 C.B. 1029, Rev. Proc. 60-6, 1960-1 C.B. 880 and *superseded b*y Rev. Proc. 62-28, 1962-2 C.B. 496.

[14] *Id*. at § 2.03.

[15] *Id.*

[16] *Id*. at § 5.01.

[17] Rev. Proc. 56-8, 1956-1 C.B. 1024.

- Initial exemption from federal income tax under IRC § 501(a) of trusts forming a part of such plans;

- Amendments, curtailments, or terminations of such plans and trusts; and

- Effect on the qualification of such plans and the exempt status of such trusts where plan assets were invested in the stocks or securities of the employer.

Later that year, the Service added to this list amendments that were made to existing qualified trusts participating in a common pension fund or group trust.[18]

The next significant change to the determination letter program came in 1963 as a result of the Self-Employed Individuals Tax Retirement Act of 1962. Revenue Procedure 62-23[19] authorized the issuance of determination letters to self-employed plans. It also authorized the Service's National Office to issue opinion letters as to the acceptability of M&P plans under IRC § 401(a) for use by self-employed individuals.[20] Such rulings did not constitute a determination, as an adoptee of a M&P plan still needed to request an individual determination letter.[21] Then in 1969, the Service approved procedures for issuing determination letters for M&P plans for use in the corporate arena, as well as the self-employed arena.[22]

C. IRS's Determination Letter Program: ERISA and Post-ERISA Years

The passage of ERISA in 1974 brought a wave of changes to the determination letter program. In September 1974, the Service temporarily suspended the issuance of determination letters for new individually designed plans[23] and of opinions on the acceptability of new M&P plans.[24] Determination letters issued to pre-existing plans before the passage of ERISA became ineffective for plan years beginning after December 31, 1975.

[18] Rev. Proc. 56-42, 1956-1 C.B. 54, § 3.

[19] Rev. Proc. 62-23, 1962-2 C.B. 487.

[20] *Id*. at § 3.02.

[21] *Id*. at § 3.03.

[22] Rev. Proc. 68-45, 1968-2 C.B. 957.

[23] Rev. Proc. 74-38, 1974-2 C.B. 492, § 4.07.

[24] Rev. Proc. 74-39, 1974-2 C.B. 494, § 3.03, *superseded by* Rev. Proc. 75-51, 1975-2 C.B. 590, *modified by* Rev. Proc. 75-38, 1975-2 C.B. 567 and Rev. Proc. 74-40, 1974-2 C.B. 494; *superseded by* Rev. Proc. 75-52, 1975-2 C.B. 592, *modified by* Rev. Proc. 75-42, 1975-2 C.B. 575.

In 1975, the Service resumed issuing opinion letters and determination letters.[25] As part of its preliminary guidance, the Service established standardized forms for applying for determination letters:

- Form 5300 for defined benefit plans;
- Form 5301 for defined contribution plans; and
- Form 5303 for collectively bargained plans.[26]

Prior to 2002, subsequent changes to the Service's procedures included:

- In 1977, the creation of the "pattern plan" whereby a law firm could obtain approval from a District Director as to the form of a pattern plan which the firm intended to use in submitting determination letter applications on behalf of its clients, limited to certain types of defined contribution plans;[27]
- Appeals of an adverse determination letter from a District Office could be made to the appropriate Regional Office and then to the National Office, and finally to the Tax Court once all administrative remedies were exhausted;[28]
- Establishment of the "short form" (Form 5307) for those seeking favorable determinations on an already approved M&P plan;[29]
- Creation of the "field prototype plan" under which a firm (other than a trade or professional association, bank, insurance company or regulated investment company) with at least ten (10) clients could obtain approval from Key District Directors of the form of a plan which the sponsors contemplate using as a field prototype plan, for both defined benefit and defined contribution plans, but not for plans with self-employed participants;[30]
- As of 1980, adopters of standardized "self-employed" M&P plans could rely on a favorable opinion obtained by the plan's sponsor whereas adopters of a "corporate" M&P plan needed to obtain an individual determination letter for reliance;

[25] Rev. Proc. 75-47, 1975-2 C.B. 581; Rev. Proc. 75-48, 1975-2 C.B. 583.

[26] *Id.* at § 4.02.

[27] Rev. Proc. 76-15, 1976-1C.B. 553, at § 2.02.

[28] Rev. Proc. 77-25, 1977-2 C.B. 534, § 5.

[29] Rev. Proc. 77-22, 1977-2 C.B. 529.

[30] Rev. Proc. 77-23, 1977-2 C.B. 530, § 2.02.

- In 1984, unification of the distinct "corporate" and "self-employed" M&P plans and reliance by the corporate standardized M&P adopters on the favorable opinion obtained by the plan sponsor;[31]

- Creation of an experimental "mass submitter" program, providing preference to a sponsoring organization provided at least ten (10) such organizations adopt the plan "word for word." This was created in response to the volume of opinion letter submissions generated by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA");[32]

- In 1988, the establishment of a fee schedule for rulings, opinions and determinations, pursuant to the Revenue Act of 1987;[33]

- In 1989, the establishment of the "volume submitter" ("VS") program which required a submitter to have at least thirty (30) determination letter applications for plans that are substantially identical to a previously approved lead plan;[34] and

- In 2001, a simplification of the determination letter application process, which included the optional submission of demographic data to show compliance with the Code's and ERISA's coverage and nondiscrimination requirements.[35]

D. Role of IRC § 7476

While nothing in the Code compels a plan sponsor to seek a determination letter, IRC § 7476 provides the Tax Court with the power to issue a declaratory judgment with respect to the qualification of a retirement plan if the IRS fails to make a determination regarding the plan's qualification, provided the petitioner has exhausted administrative remedies within the IRS.[36] Such statutory requirement thus mandates the Service to issue determination letters upon request.

[31] Rev. Proc. 84-23, 1983-2 C.B. 457.

[32] *Id*. The mass submitter program was made permanent in 1989. Rev. Proc. 89-9, 1989-1 C.B. 780, § 4.04.

[33] Rev. Proc. 88-8, 1988-1 C.B. 628. The fee schedule, set forth in Rev. Proc. 89-4, 1989-1 C.B. 767, § 6.03, was structured to create economic incentives to use the mass submitter or volume submitter programs.

[34] Rev. Proc. 89-4, 1989-1 C.B. 767, § 2.03. The volume submitter plan does not require the plan adopters to be a "sponsoring organization" (bank, insurance company, etc.) as with the mass submitter plan.

[35] Announcement 2001-77, 2001-2 C.B. 83, § I.

[36] Section 7476 of the Code was added by ERISA § 1041(a), 88 Stat. 949. See Treas. Reg. § 601.201(o)(10), specifying when administrative remedies with the IRS have been exhausted. See also

When ERISA was passed in 1974, IRC § 7476 provided that interested employees and the Pension Benefit Guaranty Corporation, as well as employers and trustees, could petition the Tax Court regarding an employer's request for a determination letter.[37] This judicial remedy was available if the IRS had issued an unfavorable determination letter or had failed to issue a determination after exhaustion of administrative remedies. The issue then arose as to whether this judicial remedy was available if the IRS rendered a plan disqualified upon a subsequent audit (due to operational failures) even though the employer had a favorable determination letter regarding the initial qualification of the plan. After an adverse ruling in Tax Court,[38] the statute was amended to empower the IRS to retroactively disqualify a plan which previously had a favorable determination letter.[39] However, in the absence of a change in law or guidance, or operational or demographic defects, it is rare for the Service to revoke a previously issued favorable determination letter.[40]

E. Role of IRC § 401(b)

Closely tied to the issue of disqualification, especially retroactive disqualification, is the role of IRC § 401(b). This section sets forth the rules that determine the deadline by which a plan must be retroactively amended as a result of changes in the law or published guidance that is necessary to keep the plan qualified. This period of time—between the date the change in the law or guidance is effective and the deadline under IRC § 401(b) for adopting the retroactive plan amendment—is referred as the "remedial amendment period" ("RAP"). This period affords plan sponsors additional time for adopting necessary plan amendments.

Under IRC § 401(b), a plan's qualification status is in jeopardy if there exists a "disqualifying provision," which refers to a provision in the plan or absence of a provision in the plan which would cause the plan document to fail to meet the Code's qualification requirements.[41] As long as the plan is retroactively amended by the end of the RAP, it

McManus v. Comm'r., 93 T.C. 79, 83-86 (1989), collecting cases regarding exhaustion of administrative remedies.

[37] Pub. L. No. 93-406, § 1041(a), effective as to pleadings filed after September 2, 1975.

[38] See Sheppard v. Meyers, Inc., 67 T.C. 26 (1976), where the court held that it lacked jurisdiction to issue a declaratory judgment regarding the plan's qualification status after the IRS issued a favorable determination letter but there was no subsequent plan amendment or plan termination.

[39] See IRC § 7476(a) which now provides for such remedy.

[40] Treas. Reg. § 601.201(l)(5), Statement of Procedural Rules. See also Rev. Proc. 2003-6, 21.04, 2003-1 I.R.B. 191.

[41] Treas. Reg. § 1.401(b)-1(b)(3) defines a disqualifying provision as one that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements that is effective after December 31, 2001, or (2) is integral to the qualification requirements of the Code that has been changed effective after December 31, 2001, but only if the provision is integral to the plan provision that is a disqualifying provision under the plan.

will be deemed to be in compliance with the qualification rules. There are certain exceptions to this general rule.[42]

Generally, the RAP ends on the due date of the employer's tax return for the tax year in which the disqualifying provision arose.[43] However, by applying for a determination letter for an individually designed plan on or before the end of the RAP, the deadline is extended until 91 days after the determination letter is issued.[44] For pre-approved plans, the deadline is extended to six (6) months after the opinion or advisory letter is issued.[45] The Service also has discretion under the remedial amendment rules to extend the time limit for retroactive amendment for plan sponsors who request a determination letter.[46] In recent years, the Service has repeatedly extended the amendment deadlines due to the sheer number of legislative changes and required regulatory guidance.[47]

In contrast, any other amendment made to a qualified plan not required for legal compliance is deemed to be discretionary. Such amendment, to the extent it does not result in a cutback of benefits, must be generally adopted by the end of the plan year in which the provision was first effective.[48] However, it is not always obvious whether part or all of a plan amendment is mandatory (in order to avoid a "disqualifying defect") or discretionary. For example, a regulation may be promulgated interpreting the qualification requirements of IRC § 401(k) and providing an optional safe harbor – use of the safe harbor is discretionary, whereas the other portions of the regulation are mandatory.

F. Overhaul of the IRS's Office of Employee Plans

Major IRS reform legislation occurred under the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA '98"), establishing an office of employee plans and exempt organizations. Thus, the division of Tax Exempt and Government Entities

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[42] Exceptions include: plan changes that reduce a protected benefit (as defined under IRC § 411(d)(6)) are required to be made before the change is effective; the law itself may grant an extension (e.g., the Pension Protection Act of 2006 delayed the plan amendment deadline until the 2009 plan year); IRC § 412(c)(8) provides a funding exception of 2½ months after the close of the plan year; and Treas. Reg. § 1.401(a)(4)-11(g) provides for corrective amendments relating to coverage and discrimination testing that may be made within 9½ months after the close of the plan year.

[43] IRC § 401(b) (2006).

[44] Treas. Reg. § 1.401(b)-1(e)(3) (as amended in 2009).

[45] Treas. Reg. §§ 1.401(b)-401-1(e)(1)-(2) (as amended in 2009).

[46] Treas. Reg. § 1.401(b)-1(f) (as amended in 2009).

[47] For example, Rev. Proc. 2005-66, 2005-2 C.B. 509, *modified and superseded by* Rev. Proc. 2007-44, 2007-28 I.R.B. 54, extended the EGTRRA remedial amendment period to the end of the initial five- and six-year remedial cycles for qualified plans.

[48] Rev. Proc. 2007-44, 20077-28 I.R.B. 54, § 5.05(2).

("TE/GE") was formed to serve employee benefit plans, tax exempt organizations, tax exempt bonds and government entities (federal, state and local, and tribal governments). The TE/GE Division replaced the unit of the former Assistant Commissioner (Employee Plans and Exempt Organizations), which was established by ERISA. Area Managers replaced Key District Directors. Employee Plans ("EP") Rulings and Agreements is a division of TE/GE and is responsible for the issuance of determination letters. Presently, Revenue Procedure 2010-6[49] sets forth the procedures for issuing determination letters on qualified retirement plans and related trusts. The issuance of determination letters is now centralized—all determination letter applications are submitted to the Cincinnati Campus in Covington, Kentucky, whereas pre-approved plan requests are submitted to the Pre-Approved Plan Coordinator EP Determinations in Cincinnati, Ohio.

G. Comprehensive Overhaul of the IRS's Determination Letter Program

Since most plan sponsors apply for a determination before the end of the RAP, affording them more time to make such amendments, the Service has experienced peaks and valleys in the submission of determination letter requests. Since ERISA's passage, the IRS has experienced the following number of determination letter submissions:

Year	Act	Approximate Number of Requests
1978	ERISA	In excess of 200,000
1986	TEFRA/DEFRA/REA	In excess of 450,000
1994	TRA '86	Almost 200,000
2002	GUST	Approximately 225,000

The net result was a financial and manpower toll on the IRS, forcing it to pull examination agents away from audit or other programs and re-train them so that they could review determination letter requests. The IRS announced changes to the determination letter program in Announcement 2001-77,[50] relieving plan sponsors from some of the prior program's burdens. The Service's introduction of a new processing system, known as the Tax Exempt Determination System ("TEDS"), was intended to speed up the internal process for issuing determination letters.[51] As of 2002, the decline in such requests reflected the fact that the majority of plan sponsors had moved to pre-

[49] 2010-I.R.B. 193. This revenue procedure is revised annually. See also Department of Treasury, Internal Revenue Service, No. 794, *Favorable Determination Letter* (2006), for additional information regarding the scope of the determination letter, including the requirement that all information submitted in the application be retained as a condition of reliance.

[50] Announcement 2001-77, 2001-2 C.B. 83.

[51] TEDS is currently being used by the IRS to electronically store all images and case data for initial determination applications, providing immediate access to such information without the movement of paper case files from one location to another. Currently, determination letter applications can be processed in TEDS up to the point of closure.

approved plans and away from individually designed plans. However, the continuance of peaks and valleys has taken its toll on the IRS.

In an attempt to consider alternatives to the then existing determination letter program, the IRS issued its first White Paper entitled The *Future of the Employee Plans Determination Letter Program: Some Possible Options*.[52] On August 8, 2001, it invited the public to participate in a dialogue on the future of the determination letter program, extending the comment period until July 1, 2002.[53] The first White Paper set forth the following alternatives:

- Eliminate the determination letter program
- Replace the current system with a third party certificate program
- Self certification or registration program by plan sponsors
- Stagger the application process and remedial amendment process over five (5) years; or
- Keep the status quo.

With some of these options, the IRS discussed the issue of whether immediate amendments should be required for law changes (e.g., under a staggered remedial amendment process, would immediate amendments nevertheless be required within the staggered period of time *or* would they be delayed to the end of the RAP)?

Based on the comments the IRS received, it issued a second White Paper entitled The Future of the Employee Plans Determination Letter Program: Evaluation of Public Comments and Additional Explanation of Staggered Remedial Amendment Period Option.[54] In the follow-up discussion, the IRS eliminated the first three original options and discussed the last two options. Later, the Service decided to implement the immediate amendment requirement, now commonly referred to as the "interim amendment" requirement.[55]

In Announcement 2004-32,[56] the Service announced that it would proceed with a five-year staggered determination letter program for individually designed plans and a six-year staggered program for pre-approved plans. It then asked for public comments

[52] Announcement 2001-83, 2001-2 C.B. 205.

[53] *Id.*; Announcement 2002-36, 2002-1 C.B. 703.

[54] Announcement 2003-32, 2003-1 C.B. 933.

[55] The interim amendment requirement was not in the draft of the proposed staggered RAP revenue procedure, but was added to the final version.

[56] Announcement 2004-32, 2004-1 C.B. 860.

regarding its draft revenue procedure.[57] The formal revenue procedure, Rev. Proc. 2005-66,[58] established the new determination letter program:

- A five-year staggered determination program for individual designed plans would be based on the employer identification number ("EIN") of the plan sponsor.[59] Each remedial amendment cycle would then end in a different year.[60] The end of a plan's remedial amendment cycle would be the last day by which the plan could be retroactively amended to correct a disqualifying provision, provided, however, that the plan sponsor adopts "good faith interim amendments."

  – Cycle A (for EINs ending in 1 or 6) initial RAP would end January 31, 2007;

  – Cycle B (for EINs ending in 2 or 7) initial RAP would end January 31, 2008;

  – Cycle C (for EINs ending in 3 or 8) initial RAP would end January 31, 2009;

  – Cycle D (for EINs ending in 4 or 9) initial RAP would end January 31, 2010;

  – Cycle E (for EINs ending in 5 or 0) initial RAP would end January 31, 2011.

  – Each cycle's subsequent RAP would end five (5) years later than its prior RAP.

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[57] Announcement 2004-71, 2004-2 C.B. 569.

[58] Rev. Proc. 2005-66, 2005-2 C.B. 509, *modified and superseded by* Rev. Proc. 2007-44, 2007-28 I.R.B. 54.

[59] *Id.* The cycles for three categories of plans would not be based on an EIN: multiple employer plans would be Cycle B, governmental plans would be Cycle C and multiemployer plans would be Cycle D. Note that governmental plans have the option to file in Cycle E instead of Cycle C. See IRS Employee Plans News (Nov. 5, 2008), *available at* http://www.irs.gov/pub/irs-tege/se1108.pdf.

[60] *Id.*

- A six-year staggered determination letter program would apply for pre-approved defined contribution and defined benefit plans.[61]
  - Defined contribution plan sponsors and practitioners would submit opinion or advisory letter requests in year one (which ended January 31, 2006, for defined contribution EGTRRA plans), to be reviewed by the IRS in years 2 and 3, and employers would adopt the updated plans in years 4 and 5 (April 30, 2010, for defined contribution EGTRRA plans).

  - Defined benefit plans would submit determination letter requests in year 3 (which ended January 31, 2008, for EGTRRA plans), to be reviewed by the IRS in years 4 and 5 and employers adopting the updated plans in years 5 and 6 for defined benefit EGTRRA plans.[62]

- The new staggered determination letter program would require timely adopted good faith interim amendments. A good faith interim amendment represents the sponsor's good faith effort to amend the plan to satisfy a particular qualification requirement and must be adopted by the end of the normal IRC § 401(b) RAP (i.e., the due date of the tax return for the year in which the disqualifying provision arose), unless otherwise extended by statute, not the end of the sponsor's staggered RAP. In contrast, a discretionary plan amendment (i.e., one adopted for reasons other than to correct a disqualifying provision) must be made by the end of the plan year for which the amendment is effective.

- The IRS's review of individually designed plans during each applicable Cycle would be based on the most recently issued Cumulative List of Changes in Plan Qualification Requirements, to be published before the commencement of the Cycle.[63] Since the earliest an on-Cycle employer could submit a determination letter request is February 1st, the Service wished to provide some lead time for the required amendments to be made. Hence, the Cumulative List setting forth the plan amendments required for qualification ends as of the October 1st of the prior year. This creates a gap between the

[61] *Id.* Pre-approved defined contribution plans would have a different six-year cycle than pre-approved defined benefit plans. The first advisory or opinion letter cycle for pre-approved defined contribution plans opened February 17, 2005, whereas the first advisory or opinion letter cycle for pre-approved defined benefit plans opened February 1, 2007. See Rev. Proc. 2005-16, , 2005-1 C.B. 674, *modified and superseded by* Rev. Proc. 2005-66, 2005-2 C.B. 509, and Rev. Proc. 2007-44, 2007-28 I.R.B.

[62] Announcement 2010-20, April 30, 2012.

[63] For Cycle A plans, Notice 2004-84, 2004-52 I.R.B. 1030, *modified by* Notice 2005-95, 2005-2 C.B. 1172, applied to defined contribution pre-approved plans and Notice 2005-101, 2005-52 I.R.B. 1219, applied to individually designed plans. For Cycle B plans, Notice 2007-3 , 2007-2 I.R.B. 255, applied to individually designed plans, pre-approved defined benefit plans and multiple employer plans. For Cycle C plans, Notice 2007-94, 2007-51 I.R.B. 1179, for individually designed plans. For Cycle D plans, Notice 2008-108, 2008-50 I.R.B. 1275, for individually designed plans. For Cycle E plans, Notice 2009-98, 2009-52 I.R.B. 974, for individually designed plans.

amendments that the Service will review for purposes of the determination letter and the amendments that may have actually been made to the plan to maintain its legal compliance but are not listed on the Cumulative List.

- Similarly, the IRS publishes a List of Required Modifications ("LRMs"), which are information packages to assist sponsors of M&P plans to conform to applicable law and guidance.[64]

H. Governmental Plans Initiative

As part of its efforts to overhaul the determination process, in 2007, the IRS launched its Governmental Plans Initiative to expand its knowledge of public sector plans.[65] The IRS is concerned that many state and local entities seem unaware of the importance of compliance with the tax qualification requirements and the value of a favorable determination letter. The IRS wants to bring them into the fold.

The Initiative's first public effort was a Governmental Plans Roundtable held April 22, 2008, to establish a dialogue with the governmental plans community. It was attended by representatives from various state and local retirement systems, consultants, benefits attorneys and actuaries. Over 40 government agencies were represented. The IRS was interested in communicating several messages:

- why tax compliance is critical,
- the need for timely amendments, and
- how the IRS voluntary compliance program can help.

The IRS also wanted to better understand the issues and barriers that governmental plans face in attempting to satisfy tax qualification requirements.[66] To that end, the attendees described actual and potential conflicts between federal law requirements and state constitutional and statutory law protections applicable to public plan benefits; the difficulties of meeting adoption deadlines when the legislative body meets infrequently; the problem of compiling the plan "document" when terms may be incorporated in statutes, ordinances, and regulations and the adoption process does not necessarily produce signed documents; the need for clear guidance in order to identify problems, assess the remedies and convince the decision makers of the need to make

[64] There is a LRM published for each major set of law changes, and for defined contribution and defined benefit plans separately.

[65] See *Pilot Questionnaire for Governmental Plans Initiative*, Form 14035, Feb. 2009, p. 2.

[66] *Id.*, pp. 1-2.

corrections; and the need for IRS personnel trained in and dedicated to the special needs of governmental plans.[67]

The sheer size of the public sector establishes state and local governmental plans as a force to be reckoned with, both in terms of the number of people affected and the amount of assets involved.[68] A 2007 study by the Government Accounting Office estimated that 12 percent of the nation's workforce are employees of state and local governments. Their numbers include public school teachers, police, firefighters, and correctional officers to name just a few categories.[69] A 2008 survey by the Bureau of Labor Statistics found that 84 percent of state and local governmental workers have access to a defined benefit pension plan. Total assets of state and local governmental plans are estimated at $2 trillion.[70]

Historically, federal regulation of public sector plans has been minimal in comparison to the regulation of private sector plans. In large part, the limited oversight is due to Congress's decision to exempt governmental plans from most provisions of ERISA.[71] Governmental plans have been spared from some of the more challenging provisions of the Code as well, including the minimum funding requirements,[72] minimum participation and nondiscrimination requirements,[73] and minimum vesting requirements.[74]

The legislative record indicates that Congress believed that public plans already incorporated generous vesting provisions and that the power of state and local entities to raise funds through taxation ensured they could fulfill their funding obligations for the promised benefits. Some members of Congress worried that imposing ERISA requirements would have unacceptable cost implications for state and local entities. Above all, the principles of federalism made Congress hesitant to allow federal

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[67] See *Employee Plans News*, Special Edition, May 9, 2008.

[68] During the Roundtable discussion Steven Miller, Commissioner, Tax Exempt and Government Entities pointed out that one out of five employees in the United States is a government employee and that governmental plans hold $3.5 trillion in assets.

[69] *Public Fund Survey, Summary of Findings for FY 2008*, prepared by Keith Brainard, National Association of State Retirement Administrators, October 2009.

[70] *The Structure of State and Local Government Retirement Benefits, 2008*, William J. Wiatrowski, Bureau of Labor Statistics, U.S. Department of Labor, *posted* February 25, 2009.

[71] 29 U.S.C. §§ 1004(b), 4021(b).

[72] IRC § 412(e)(C).

[73] IRC § 401(a)(5)(G).

[74] IRC § 411(e)(1)(A). However, in order to maintain qualification, governmental plans must satisfy the vesting requirements of pre-ERISA §§ 401(a)(4) and 401(a)(7).

regulation to interfere in the relationship between state and local governments and their employees.[75]

Because of the ERISA exemption, public plans are regulated to a large extent by a mixture of state and local constitutional and contractual law and certain Code requirements. Specific plan terms generally are set out in statutes, ordinances, promulgations and policies that are unique to each jurisdiction. The principal qualification requirements they share with private employer plans are limited to the written plan requirement of IRC § 401(a), the exclusive benefit rule of IRC § 401(a)(2), the compensation limit of IRC § 401(a)(17), the IRC § 415 limits on compensation and benefits, the minimum required distribution rules in IRC § 401(a)(9), the mandatory rollover rules in IRC § 401(a)(31) and the requirements applicable to retiree health benefit accounts within a pension plan in IRC § 401(h).

Since holding the Roundtable, the IRS has taken other significant steps to address barriers to compliance, particularly those related to the determination letter process. It established the Governmental Plans Web page[76] where members of the governmental plans community can submit questions, comments and suggestions and find the most recent information on relevant IRS guidance in one place. The IRS also has sent a pilot questionnaire to 25 randomly selected governmental plans to elicit demographic information and information on plan documentation, administration, communication, and the structure of public retirement systems. The IRS intends to use feedback from the pilot to refine the questions that will be sent to a larger group of state, county and local governmental plans.

The IRS also has given governmental plan sponsors, whose plans initially were scheduled for submission in Cycle C (deadline January 31, 2009), a one-time opportunity to delay submission to Cycle E (deadline January 31, 2011) based on feedback it received about obstacles to governmental plans' filing within the Cycle C timeframe.[77] Importantly, the IRS has used its dedicated governmental plans Web page to post responses to frequently asked questions ("FAQs") regarding the determination letter and voluntary processes specific to governmental plans.[78]

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[75] H.R. Rep. No. 533, 93d Cong., *reprinted in* 1974 U.S. Code Cong. & Ad. News 4667 (generous vesting provisions); S.Rep. No. 383, 93rd Cong., *reprinted in*, 1974 U.S. Code Cong. & Ad. News 4965 (tax power ensures adequate funding); H.R. Rep. No. 807, 93d Cong., *reprinted in* 1974 U.S. Code Cong. & Ad News 4829-4830 (cost implications); 1 *Legislative History of ERISA* 220 (1976) (federalism), *cited in* Feinstein v. Lewis, 477 F. Supp. 1256 (SDNY 1979).

[76] *Available at* http://www.irs.gov/retirement/article/0,,id=181779,00.html.

[77] Rev. Proc. 2009-36, 2009-35 IRB 304, § 4, Aug. 12, 2009; *Employee Plans News*, Special Edition, November 5, 2008.

[78] *Available at* http://www.irs.gov/retirement/article/0,,id=184690,00.html and http://www.irs.gov/retirement/article/0,,id=184417,00.html.

IV. THE IRS'S INITIAL EXPERIENCE WITH THE NEW DETERMINATION LETTER PROGRAM

The ACT directly solicited the opinions of many employees in Treasury and the Service (see Section IX. A. 1. for list of such persons). Furthermore, the ACT solicited the opinion of all EP Specialists working with determination letters – persons "in the trenches" – for their input and thoughts (see Section IX. B. for memorandum sent to such persons from Vickie A. Surguy, and Section IX. C. for a transcription of the EP Specialist survey results). What follows is a summary of our findings.

A. Expected versus Actual Determination Letter Submissions

The following table sets forth the Service's expected number of determination letter submissions for each Cycle versus the actual number of determination letter submissions for Cycles A, B, C and D and projected number of determination letter submissions for Cycle E:[79]

Form	Projected Cycle A	Actual Cycle A	Projected Cycle B	Actual Cycle B	Projected Cycle C	Actual Cycle C	Projected Cycle D	Actual Cycle D[80]	Projected Cycle E
5300	10,800	7,244	7,800	9,989	11,500	6,844	11,500	7,861	7,000
5307	16,000	6,774	16,000	4,907	11,000	3,281	121,000[81]	12,620	2,000
5310	8,000	3,663	8,000	3,275	4,000	3,307	4,000	2,902	4,000
Total	34,800	17,681	31,800	18,171	26,500	13,432	136,500	23,383	13,000
Closed %		97%		83%		43%		8%	

There were two unrealized assumptions under the original projections:

- It was anticipated that there would be an annual average rate of 16,000 Form 5307 applications, but the Service closed the Form 5307 program as it switched from GUST to EGTRRA. Hence, the actual number of Form 5307 submissions dropped significantly.

[79] Forms 5300 are based on 2/1 to 1/31 dates; Cycle A started 2/1/06; Forms 5310 and Form 5307 are based on FY of 10/1 to 9/30.

[80] The above numbers are as of April 7, 2010.

[81] This number is high because of the anticipated Form 5307 influx for pre-approved plans.

- It was anticipated that there would be an annual average rate of 8,000 Form 5310 applications, whereas the actual number dropped to approximately 4,000 per year.

For the Service, the new staggered determination letter procedure has leveled out the annual number of individually designed plan submissions for the first four Cycles; however, what the Service did experience was what it refers to as "mini-spikes," specifically, approximately 75 percent of the submissions came to the Service in the final weeks of the Cycle, which created instant backlogs in inventory. The Service would clearly prefer that submissions come in ratably during the Cycle year. In addition, case age (i.e., the time to process a submission) may be reduced if the applications were received ratably throughout the year. The average case age is 189 days, as compared to the case age of 467 days prior to the implementation of the staggered determination letter approach. Hence, the turnaround time on determination letter submissions has greatly improved, but further improvements can and should be made.

B. Successes of the New Determination Letter Program

The Service is generally pleased with the new determination letter program as it has eliminated major inventory spikes that have burdened it since the passage of ERISA. The Service has been able to process defined contribution pre-approved lead plans and individually designed cases with all EP determination specialists, no longer having to rely on the use of exam agents; it successfully completed the review of all the defined contribution pre-approved plans by the end of March 2008, within two (2) months of its target date.

C. Challenges for the Service (initial and ongoing)

Initially, the Service experienced a number of challenges: the five-month period between the issuance of Revenue Procedure 2005-66[82] and the beginning of Cycle A submissions made it difficult for EP to prepare for a major business change; the assignment of Cycle A plans to staff was delayed until September 2006; new internal controls and pre-screening procedures had to be implemented; and problems with the publication system delayed the issuance of Alert Guidelines until September and October of 2006.

Ongoing challenges for the Service include: issuance of annual Cumulative Lists, annual lists of Interim Amendments and annual Alert Guidelines; and internal quality control documents (e.g., recurring issue reports and worksheets, termination issue focus, and pre-screening criteria and tools).

[82] Rev. Proc. 2005-66, 2005-37 I.R.B.509.

D. Problem Areas for the Service

1. Interim Amendments

The IRS has experienced some unforeseen consequences of the interim amendment rule. There has been a dramatic increase in the number of plans requiring interim amendment corrections through the voluntary correction program ("VCP") under EPCRS or through closing agreements ("CA"). Either rectification method results in a monetary sanction for the plan sponsor, which was not the case under the prior determination letter rules. Since the commencement of Cycle A, the Service has entered into approximately 160 CAs, including an umbrella CA affecting over 600 plans, to resolve interim amendment nonamender issues in determination letter application cases. The revenue procedure governing EPCRS was altered in 2006 to address this problem by adding a special procedure (Appendix F) for such plans, effective September 1, 2006.[83] During the first six months of Appendix F's availability, 463 interim nonamender VCP cases were closed; during the fiscal year 2008, 703 interim nonamender VCP cases were closed. While the average hours per Appendix F case was about two hours, there was still a significant impact on the workload of the VCP staff due to the volume of cases.

The interim amendment requirement has increased the amount of the EP determination specialist's review time, generally between one to two hours per case. However, as time progresses, by the time the specialists reach Cycle E and each Cycle year thereafter, there could be up to five or more sets of separate interim amendments required to be submitted with every plan, and each will have different adoption deadlines. This will permanently add more hours to each case and likely will increase the case age of each submission for the EP determination specialist.

2. Off-Cycle Plans

The flexibility that existed under the prior determination letter program that permitted an application for a determination letter to be submitted at any time is no longer possible under the new procedure. A plan desiring a favorable determination letter is supposed to submit its application during its appropriate cycle; an application submitted in an alternate cycle is characterized as off-cycle and "will not be reviewed until all on-cycle plans have been reviewed and processed."[84] Revenue Procedure 2007-44 identified several categories of off-cycle applications that would be given priority treatment (e.g., new plans or sponsors that had urgent business needs). However, this change has had a minimal effect. As of August 25, 2007, the Service had received 925 off-cycle applications, a number that was not anticipated by the Service, and the Service has been unable to process the vast majority of these submissions.

[83] See Rev. Proc. 2008-50, 2008-35 I.R.B. 464, *superseding* Rev. Proc. 2006-27, 2006-1 C.B. 945, as *modified by* Rev. Proc. 2007-49, 2007-30 I.R.B. 141.

[84] Rev. Proc. 2007-44, 2007-28 I.R.B. 54.

3. Returned Applications

During Cycle A, the Service experienced a 10% return rate in determination letter submissions as compared to its previous 1% return rate. Applications were returned for a number of reasons, many relating to the new requirements of the determination letter program (e.g., failure to restate the plan; failure to include EGTRRA good faith amendments, non- or wrong submission of user fees, etc.).

4. Internal Training

The Service's internal training should continue to be strengthened, especially as to the annual Cumulative Lists and the specialty training for certain types of plans (e.g., governmental, multiemployer and multiple employer plans).

5. Staffing and Inventory

In its original estimates, the Service predicted that it would need approximately 152 EP determination letter specialists to process determination letter applications; currently, the Service has 125 such specialists. The Service's goal was to process each Cycle's cases within one year after the end of the submission period. Thus, a valid assessment of staffing needs is an ongoing initiative. Under the IRS's current system, determination letter submissions are first graded and then assigned to an EP determination specialist at that grade level. Many determination letter specialists are at grade 13 (a grade suitable to handle complex cases) and the bulk of the determination letter applications, approximately 31%, are at grade 13. However, the open inventory at grade 13 is approximately 40%, because of the complexity of such matters. Since it takes more time to process the open grade 13 inventory than other grade inventory, the Service has found that the available grade 13 staff hours are seriously short of the hours needed to process all grade 13 cases within the one-year goal. Thus, at the current grade 13 staffing levels, the Service does not expect to meet its objective of closing determination cases within one year of the end of the Cycle, thereby leading to an ever increasing backlog of older Cycle cases and increasing Cycle times. Coupled with the fact that the vast majority of the applications are filed at the end of the Cycle, this problem will become exacerbated over time.

Furthermore, union work rules agreements present difficulties due to limitations on the assignment of higher-graded work to lower-graded employees.

E. Insights from EP Determination Specialists

With the cooperation of the EP determinations leadership, the ACT conducted an online employee survey. Desiring the feedback from EP determination specialists who are primarily responsible for reviewing and approving determination letter applications (i.e., persons "in the trenches"), the anonymous survey requested input regarding three areas:

1. Remedial and interim amendment requirements;

2. Staggered timing of the current Cycle filing process; and

3. The determination letter process, including the time it takes to process an approval letter.

Between 15 and 19 responses, or approximately 15% of the persons surveyed, were received in each area for which feedback was solicited. Below is a summary of the responses. The verbatim responses from EP determination specialists are included as an Appendix to this Report, at Section IX. C.

1. Remedial and Interim Amendment Requirements

With respect to the remedial and interim amendment question, we received 17 responses. Although a few respondents felt strongly about preserving the current system, the most common theme was that the current system is confusing, complex, and difficult for plan sponsors, practitioners and the IRS itself.[85] In particular, there were comments indicating that the required interim amendments deadlines are not articulated clearly and that it would be helpful if there were an up-to-date listing of each amendment requirement for a given Cycle, consisting of amendment deadlines and effective dates. There was also a suggestion that model language be published for each interim amendment. This listing could be maintained on irs.gov.

2. Staggered Timing of the Current Cycle Filing Process

This topic received 15 responses. Again, the overarching theme of the responses received is that the staggered system is complex and confusing. In particular, it has been suggested that the five-year Cycle system contains too many exceptions, thereby adding to the confusion. Additionally, by having a mixed inventory, one EP determination specialist noted that they have to constantly "switch gears" as they work different cases from different Cycles. As a result, specialists continuously have to refer to their training manuals and the related revenue procedures in order to ensure that they are applying the correct requirements for a given Cycle. Finally, a few responses noted the difficulties created by the lack of staffing necessary to properly handle the workload.

[85] The BNA has reported that not only do practitioners find it difficult to comply with Internal Revenue Service rules for interim amendments, but the IRS finds it challenging to enforce the interim amendment rules, a senior tax law specialist told practitioners at a February 5 joint meeting of Baltimore area TE/GE councils and pension liaison groups. "As difficult as it is for the practitioner community to work with interim amendments, it's also difficult for us to enforce them," said Donald Kieffer, IRS senior tax law specialist. BNA Pension & Benefits Daily, February 10, 2010.

3. The Determination Letter Process, Including The Time it Takes to Process an Approval Letter

The third area received 19 responses. Several of the responses focused on the technology (including TEDS) being used to process cases. These responses indicate that certain specialists feel the current processing systems increase the amount of time it takes to process cases, in certain instances. Additionally, the responses noted that the practitioner community has a stake in the timeliness. In particular, the completeness of an application when submitted has an impact on the amount of time an application takes to process. Also, the tendency to file applications within a few weeks of the end of a given Cycle creates mini-spikes that are difficult for the Service to process.

V. PRACTITIONER EXPERIENCES AND GOALS

A. Responses to Practitioner Survey and Outreach

The ACT published through various online venues a list of five questions, reproduced in Section IX. D., which asked practitioners to provide their experiences with certain aspects of the current determination letter program as well as their suggestions as to how the current program can be improved. Summaries of the responses to each question are provided below. A transcription of those responses is contained at Section IX. E. Also contained in Section IX. E. is the formal response of ASPPA. Furthermore, the ACT reached out to industry and practitioner groups listed in Section IX. A. 3 and held a public conference call.

1. Remedial and Interim Amendment Requirements

The overwhelming majority of survey respondents spoke extremely negatively about interim amendment requirements. Many thought that the new process is more difficult to manage, results in unnecessary additional costs to plan sponsors, and increases the likelihood of missing an amendment or filing deadline. One respondent's comment was representative of the whole: "The logic and reasoning behind the structured cycle filing method was easy to understand and seemed like a very good idea. In practice, however, it has thus far proven to be as cumbersome as the old process in many ways. The current process of requiring interim amendments to be made, even when there are no discretionary elections for the Plan Sponsor, needs to be reviewed."

At the TE/GE Annual Joint Conference that was held Friday, February 5 at the University of Baltimore School of Law, the members of the three TE/GE Advisory Councils presented the IRS with a paper entitled "Practitioner Viewpoint Turning The Tables: What's In Our Inbox? A 'Top 10' List of Practitioner Issues for IRS Consideration." Item #4 was the Good Faith Interim Amendment topic, which stated: "Practitioners and plan sponsors are groaning under the increased burdens imposed by this requirement. The Service also is bogged down by the EPCRS load generated by this requirement and the determination issues it raises. The verdict seems unanimous – this requirement should be eliminated or modified."

2. Staggered Timing of the Current Cycle Filing Process

Concerning the staggered timing of the current cycle filing process (for new plans and for restated plans), the survey revealed quite a mix of responses—roughly half liked the staggered cycle as opposed to the prior regime. Some thought that five years was too short of a time frame to have to restate individually designed plans. Numerous concerns were raised about the length of time it takes to process determination letter filings for off-cycle plans, particularly for new plans or plans that redesigned their benefit formulae mid-cycle.

A great deal of confusion still remains in the practitioner community with respect to the cycles of controlled groups, merger and acquisition situations, changes in plan sponsors, adoption of new plans and for employers who maintain both individually designed plans and prototypes or volume submitter plans. These situations multiply the complexity of an already complex process, creating uncertainty in the practitioner community because of the many exceptions to the typical filing cycle period that these situations create.

Other practical issues raised with respect to the staggered cycle filing process and interim amendment requirements relate to the perplexing effect that it has on certain types of plans. For instance, EGTRRA restatements for defined benefit plans will occur almost more than 10 years after the legislation was enacted, yet many plan sponsors will have already executed amendments for the Pension Protection Act of 2006, which was enacted five years later.

3. The Determination Letter Application Process

Concerning the determination letter application process, including the time it takes to process an approval letter, most respondents believe that the process takes far too long. Many practitioners offered various examples of long delays in the application process, several of which were due to interim amendment issues, as well as the restarting of the process due to a change in assigned personnel. Expectations appear to have been created in the practitioner community that the transition to a staggered restatement cycle system would expedite the review and processing of applications for determination letters, but virtually all survey respondents indicate that the assignment, response and processing times from the Service remains too long.

Suggestions for improvement of the filing process include the creation and use of an automated/online filing system, more routine and consistent training for IRS personnel processing and reviewing the applications, and streamlined forms and procedures.

4. Experience with IRS Personnel Who Review the Plan Filings

Survey respondents offered a wide variety of opinions and experiences, but a majority expressed satisfaction with determination letter specialists reviewing and processing the filings. Practitioners feel that determination letter specialists are professional, knowledgeable, and helpful, but are constrained from working efficiently by the complexity of the process and their perceived lack of experience with the determination letter review process. Some practitioners expressed frustration with the apparent strict adherence by reviewers to "checklists and processes" without respect to the actual details of a plan filing. Furthermore, there is a general perception that IRS has no common method of how and when to respond to determination letter applications.

Suggestions for improvements included improved communications protocols by determination letter specialists, resulting in more specificity and uniformity. Due to concerns about the variability in the knowledge level of determination letter specialists, survey respondents suggested that the Service provide more comprehensive and standardized training for personnel reviewing the filings.

5. Other Input Related to the Filing and Restatement Process

Other issues raised by practitioners include the erosion in confidence in the value of a determination letter as several reported that prior determination letters received were not granted deference because of plan defects that were missed by the prior determination letter specialist, or changes in the IRS's positions with respect to certain regulations (e.g., IRC § 401(a)(4)).

Additionally, the new determination letter program has created the need to spend much more time tracking deadlines (e.g., interim amendments which have no or little impact on the plan's operation) that add no or little value to the plan sponsor's benefit program, thus increasing the expense to and frustration of the plan sponsor.

B. EPCRS Issues

The Employee Plans Compliance Resolution System ("EPCRS") is highly regarded by the plan sponsor and practitioner community because it permits a plan sponsor who meets certain conditions to make "common sense" corrections to errors made in the form or operation of its plan. If such corrections meet the criteria of the Service, a plan sponsor is assured that the error and its correction will not jeopardize the qualified status of the plan. Operational errors that are not permitted to be remedied through self-correction may be corrected through the Voluntary Correction Program ("VCP"). VCP requires plan sponsors to make an application to the Service in which they identify the plan errors, and illustrate the correction method in detail. The Service then reviews the VCP application and the correction method and, if both are approved, issues a "compliance statement" to the plan sponsor.

Due to varying required deadlines for both nondiscretionary and discretionary amendments, and the need to continuously amend the plan document to meet interim amendment requirements, an increasing number of plan sponsors are failing to amend their plans properly or on a timely basis. However, plan document failures are not permitted to be corrected through the self-correction method under EPCRS, no matter how inconsequential the effect of the amendment may be. Thus, to preserve the qualified status of the plan, the employer's only recourse is to correct the failure by amending the plan and filing a VCP application with the Service.

Based upon conversations between the ACT and Joyce Kahn, Manager of Voluntary Compliance (the "VC Unit") for the Service, it is our understanding that the VC Unit has seen a significant increase in its workload due to VCP submissions relating to plan document failures, which by far are the most common type of failure processed by the VC Unit.[86] During fiscal year 2008, the VC Unit received a total of 2,950 VCP submissions. Over half of them related to nonamender failures. From fiscal year 2007

[86] See also discussion in Section IV. D. 1.

to fiscal year 2009, there has been a 35% increase in the number of VCP filings related to interim/good faith nonamender failures.

The VC Unit handles a wide diversity of applications related to compliance failures. However, due to the complexity of the interim amendment requirements, the VC Unit has difficulty discerning if a plan document failure relates to an interim or discretionary amendment. In many instances, a VCP applicant will submit a determination letter filing in tandem with the VCP filing, in accordance with the EPCRS guidance for correcting plan document failures under VCP. Thus, the VC Unit is encumbered with the process of reviewing determination letter applications, even though it is not as proficient at reviewing plan language requirements as the Service's Determinations unit.

With respect to the relevant EPCRS guidance, many practitioners have had significant interpretive difficulty with the VCP rules concerning whether and when a determination letter filing must be submitted in connection with a VCP application to correct a plan document failure. The confusion in this area appears to arise from the broad manner in which the terms "interim amendment" and "nonamender failure" are defined under such guidance.[87] Although a literal interpretation would suggest that a Nonamender Failure would include the failure to timely adopt an interim amendment (an "Interim Failure"), our best reading of the relevant EPCRS guidance is that an Interim Failure is intended to mean a separate type of plan document failure, which is distinct from a Nonamender Failure. This distinction is significant, because the EPCRS guidance expressly provides for different procedural requirements with respect to determination letter submissions, depending on whether a plan document failure is a Nonamender Failure or an Interim Failure.

1. Nonamender Failure Issues

A "Nonamender Failure" is a failure to timely amend a disqualifying provision before the end of the applicable remedial amendment period. For example, if an employer fails to timely restate and submit its plan document within the applicable remedial amendment cycle, any disqualifying provision in the document will result in a Nonamender Failure. When a plan is submitted under VCP in order to correct a Nonamender Failure, an application for a determination letter with respect to the corrective plan amendment must be submitted in tandem with the VCP application.[88] The determination letter application is required regardless of whether the plan sponsor submits the plan for its

[87] See Rev. Proc. 2008-50, 2008-35 I.R.B. 464, *superseding* Rev. Proc. 2006-27, 2006-1 C.B. 945, as *modified by* Rev. Proc. 2007-49, 2007-30 I.R.B. 141, defining an "interim amendment" as an amendment with respect to a disqualifying provision and a "nonamender failure" as a failure to amend the plan to correct a disqualifying provision within the applicable remedial amendment period.

[88] Rev. Proc. 2008-50, 2008-35 I.R.B. 464, *superseding* Rev. Proc. 2006-27, 2006-1 C.B. 945, *as modified by* Rev. Proc. 2007-49, 2007-30 I.R.B. 141.

Nonamender Failure under VCP during an on-Cycle or an off-Cycle year.[89] Except as otherwise specified in Revenue Procedure 2008-50, the general procedural guidance provided under Revenue Procedure 2007-44 governs the determination letter application. Thus, unless an off-Cycle submission relates to an urgent business need or falls under another specific exception, the off-Cycle submission will not be given the same priority as an on-Cycle filing.

It does not appear that a Nonamender Failure includes filing past the Cycle due date; this leaves the plan sponsor in the difficult position of not having § 401(b) reliance, and no way of obtaining such reliance. Specifically, practitioners have had difficulty determining the extent to which VCP may be used to address situations where the plan sponsor has timely amended and restated the plan document in good faith but has failed to file a determination letter application during its on-Cycle year. In the absence of a VCP filing, such plan sponsor would have little choice but to file a determination letter application after the end of the plan's applicable remedial amendment period in an off-Cycle year. It is our understanding that any favorable determination letter issued as a result of the off-Cycle filing would result in a gap in the reliance period (from the end of the expired remedial amendment Cycle through the date of the late filing). Furthermore, as a result of the delayed filing after the end of the plan's remedial amendment cycle, any plan document failure identified by the Service in connection with its review of the off-Cycle filing would presumably be viewed as a disqualifying provision that must be corrected under the Service's closing agreement program, potentially resulting in substantial penalties for the plan sponsor.

Alternatively, the plan sponsor could file a VCP submission for any potential Nonamender Failures contemporaneously with its off-Cycle determination letter filing, with the expectation that any plan document failures identified by the Service in the course of processing the determination letter submission would be addressed under the VCP filing. However, the VCP rules contemplate the correction of specific plan document failures identified by the plan sponsor as of the time of the VCP application, and these rules do not clarify the extent to which a plan sponsor may use VCP (i) to correct unspecified Nonamender Failures that may be identified by the Service in the course of processing the related determination letter filing, and (ii) to secure a favorable determination letter without any gap in its period of reliance.

[89] Rev. Proc. 2008-50, 2008-35 I.R.B. 464 , § 6.05(2), *superseding* Rev. Proc. 2006-27, 2006-1 C.B. 945, as *modified by* Rev. Proc. 2007-49, 2007-30 I.R.B. 141. It provides that an application is required for a determination of whether the plan document, including the corrective amendment, complies with the qualification requirements of § 401(a) if the plan sponsor submits the failure under VCP during an on-cycle year. An "on-cycle year" means the last 12 months of the plan's remedial amendment cycle set forth in Rev. Proc. 2007-44. It further provides that a determination letter application is required to correct a nonamender failure under VCP, whether or not the plan is submitted under VCP during an on-cycle year.

2. Interim Failure Issues

In contrast to the procedural rules for Nonamender Failures, in the case of an Interim Failure, a determination letter application is only required if the plan is submitted under VCP during an on-Cycle year.[90] In other words, a determination letter application should not be submitted with a VCP submission during an off-Cycle year to the extent it only involves an Interim Failure in the plan document. Our best reading of the EPCRS guidance is that an Interim Failure includes the failure to satisfy the ongoing requirement to adopt "good faith" amendments, but does not include the failure to amend a plan within the applicable remedial amendment cycle. For example, the failure to adopt a good faith EGTRRA amendment would result in an immediate Interim Failure, but the failure to submit a restated plan document which included deficient EGTRRA provisions within the applicable remedial amendment cycle would be viewed as a Nonamender Failure (and not an Interim Failure).

3. Compliance Fee Matters

The compliance fee under VCP to correct a Nonamender Failure is determined in accordance with the fee schedule in Revenue Procedure 2008-50 based on the number of participants in the plan. It ranges from a minimum fee of $750 for a plan with 20 or fewer participants, to a maximum fee of $25,000 for a plan with over 10,000 participants. However, this fee is reduced by 50% if the submission is made within a one-year period following the expiration of the plan's remedial amendment period. The compliance fee to correct an Interim Failure is significantly less than the VCP fee for a Nonamender Failure. A VCP submission to correct Interim Failures only is a flat $375. In all cases, the VCP compliance fee is in addition to the user fee for any related application on Form 5300 for a determination letter with respect to the corrective plan amendment.

[90] Rev. Proc. 2008-50, 2008-35 I.R.B. 464, §§ 60.5(2)(a)(i) and 6.05(3), *superseding* Rev. Proc. 2006-27, 2006-1 C.B. 945, *as modified by* Rev. Proc. 2007-49, 2007-30 I.R.B. 141.

VI. RECOMMENDATIONS – POLICY

Our private pension system is based on voluntary participation, and it will ultimately fail unless the rules governing such participation give plan sponsors a reasonable expectation of achieving compliance, within a reasonable timeframe, and with expertise and commitment. While many aspects of the new staggered determination letter program have improved the voluntary process for gaining assurance that a plan is qualified as to its form, other aspects of the program have created new challenges for both plan sponsors and practitioners. The interim amendment requirements, in particular, are adding stress to the private pension system. The content, timing and frequency of the amendments are taking their toll. These requirements and certain other elements of the determination letter program should be examined and reformed.

The ACT's recommendations to improve the determination letter process are as follows:

A. Modification of Interim Amendment Requirements

1. Service's Authority

The Service has the authority and the flexibility to modify the Interim Amendment requirements, through its power to designate a plan provision (or absence of such provision) as a "disqualifying provision" under Code § 401(b). The regulations under Code § 401(b) provide that a plan that does not satisfy a qualification requirement solely as a result of a disqualifying provision will be deemed to have satisfied such requirement if the provision is amended on or before the last day of the remedial amendment period ("RAP") and it is made retroactively effective to the beginning of the RAP. In other words, the relief under § 401(b), which enables plan sponsors to fix potential plan document failures, is available with respect to the "disqualifying provisions" in their plan documents.

The regulations grant the Commissioner the discretion to designate certain plan provisions as disqualifying provisions and to extend their applicable RAPs. They also give the Commissioner the power to impose limits and additional rules regarding the amendments that may be made with respect to disqualifying provisions during the RAP.

The Service used this discretion to impose a "good faith" amendment requirement with respect to disqualifying provisions subject to the EGTRRA RAP. The related relief was expressly contingent on the timely adoption of good faith EGTRRA amendments. Notice 2001-42[91] specifically provides that an EGTRRA-related plan provision will be treated as a disqualifying provision, and therefore subject to rectification during the RAP, only if it was timely adopted on an interim basis.

[91] 2001-2 C.B. 70.

The good faith amendment concept was expanded further by Revenue Procedure 2005-66[92]. In addition to establishing the new staggered determination letter program, it established deadlines for the timely adoption of both interim and discretionary amendments. If an interim or discretionary amendment has not been timely adopted, or if the interim amendment is not reasonable or in good faith, the remedial amendment cycle is no longer available to the plan.

A historical summary of the guidance from the Service regarding plan amendments and remedial amendment periods, which proves by its very length and breadth the Service's broad discretion in this area, is included as an Appendix under Section IX. F.

Based on the authority granted pursuant to the Code § 401(b) regulations, the Service can and has frequently in the past exercised the same discretion it used to establish the interim amendment rules and to revise and refine them. Given its broad authority, the Service should consider exercising such discretion and using its authority to make the changes recommended in the sections below.

2. Comments Received

The comments received from the various stakeholders in the benefits community were highly critical of the interim amendment requirement in its current form, and none of the comments received expressed satisfaction with the current rules. Based on their experience with the interim amendment requirement, the stakeholders noted the surprising complexity of the rules and the administrative burden and increased expenses that they imposed on plan sponsors and benefits practitioners. A number of comments expressed the view that the rules and uncoordinated deadlines were confusing and traps for the unwary and wary alike, and that they posed a compliance challenge for even the most sophisticated plan sponsors and experienced practitioners. Employers, third-party administrators, consultants and attorneys found it difficult and challenging to track the separate sets of interim amendments required for different types of tax-qualified plans, each with different adoption deadlines. In many instances, there is a lack of guidance or clarity regarding when amendments are needed and what the amendments must contain. The comments received reflected an overall view that the interim amendment requirement raised policy concerns, and that compliance with these rules necessitated a disproportionate amount of attention, adversely affecting and overloading the stake-holders' limited time and resources within the current pension system.

Likewise, the interim amendment rules have also imposed a significant additional burden on the Service. The dramatic increase in the number of plans that have been corrected through the VCP under EPCRS and through closing agreements to resolve interim amendment and non-amender issues confirms and substantiates this view. From the Service's perspective, the cumbersome nature of the interim amendment

[92] 2005-2 C.B. 509.

requirement has diverted, and will continue to divert, significant resources from other priorities. The complexity of the requirements has made it difficult for the Service's auditors in the field to know when a plan has been timely amended. In the absence of any reform to these rules, this drain on resources will increase substantially in the future if sponsors of individually designed plans were to file off-Cycle applications for determination letters, as a defensive strategy to gain assurance their plan documents were being maintained in compliance with the interim amendment rules.

It should also be noted that each of the last three pieces of employee benefits legislation passed by Congress included its own specific deadlines for plan amendments.[93] Presumably, Congress incorporated these adoption deadlines into its statutes in order to provide relief to plan sponsors from the existing interim amendment requirements, which would have otherwise imposed earlier adoption deadlines. The fact that Congress explicitly superseded the existing interim amendment rules on three separate occasions suggests that the applicable rules are in need of reform and introduces inconsistency into the process as plans sponsors must amend for some changes as they become effective while they can wait for as long as three years to amend for others.

3. Alternatives

Based on the comments received from stakeholders, the ACT believes there are six basic alternatives for dealing with the interim amendment rules, with the understanding that there must be a reasonable balance between the need to hold down unnecessary costs and complexity and the need to keep plan documents current:

i. Keep the interim amendment requirement in its current form.

ii. Require the timely adoption of all applicable interim amendments by a clear deadline set each year.

iii. Require the biennial adoption of all applicable interim amendments by the end of established two-year periods, or require the adoption of all interim amendments by the midpoint of the plan's Cycle.

iv. Permit delayed adoption of plan amendments by the end of the remedial amendment period, subject to adoption of a cumulative summary of plan changes on an interim basis.

v. Require the annual or otherwise timely adoption of certain core amendments ("Core Amendments"), and permit the delayed adoption of non-core amendments ("Non-Core Amendments") to

[93] The three pieces of employee benefits legislation include the Pension Protection Act of 2006, Pub. L. No. 109-280 (2006), the Worker, Retiree, and Employer Recovery Act, Pub. L. No. 110-458 (2008) and the Heroes Earnings Assistance and Relief Tax Act, Pub. L. No. 110-245 (2008).

the end of the applicable Cycle. The distinction between Core and Non-Core Amendments is set forth below.

vi. Require the adoption of all interim amendments by the end of the remedial amendment period, provided any amendments impacting "section 411(d)(6) protected benefits" within the meaning of Treasury Regulation § 1.411(d)-4 are adopted in accordance with the current rules.[94]

The ACT evaluated each of these six basic alternatives in light of two competing policy considerations. On the one hand, in light of the general principle that plans must be operated in compliance with their terms in order to remain qualified, plan documents should include provisions that timely reflect the terms of such plans, and participants should be made aware of new and changing provisions. The Service's review procedures for plan documentation are based on the premise that the rights of participants should be adequately protected, and that such rights are derived entirely from the terms of a legally-binding plan document that has been formally adopted by the employer.[95] On the other hand, the need for a timely amended plan document should not unreasonably burden plan sponsors and benefits practitioners, nor should participants be deluged with plan notices. Additionally, the determination review process for plans to confirm that their documentation timely and properly reflects changes in the applicable law should not disproportionately consume the limited resources of the Service.

The first alternative, keeping the interim amendment requirement in its current form, is not a viable option. As discussed previously, in the absence of any reform, the requirement will continue to impose an undue burden on the Service, plan sponsors and other stakeholders. The second and third alternatives have also been rejected on similar grounds, since neither option, when coupled with the requirement to timely amend for changes affecting § 411(d)(6) benefits, would significantly reduce the administrative burden that is currently imposed on the Service, employers and practitioners.

The fourth alternative would eliminate the burden and cost of adopting fully realized, detailed plan amendments on an interim basis. Under this proposed approach, plan sponsors would need to adopt an amended and restated plan document prior to the end of the applicable remedial amendment cycle reflecting all necessary changes in plan operation and applicable law. In addition, to ensure the rights of participants are adequately protected under this alternative, plan sponsors would be required to

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[94] "Section 411(d)(6) protected benefits" as defined under Treas. Reg. Section 1.411(d)-4, Q/A1, generally include a participant's accrued benefit, early retirement benefits and retirement-type subsidies, and optional forms of benefits.

[95] EP Determinations Quality Assurance Bulletin, *Verification of Prior Plan Documents in the Absence of a Determination Letter,* dated September 8, 2006.

maintain a cumulative summary of the changes being made to the plan, which must be adopted by the employer pursuant to a corporate action (which could be delegated to an appropriate party such as the Plan Administration Committee, the Director of Human Resources, etc.) where the change does not involve § 411(d)(6) protected benefits. With respect to any plan change that prospectively decreases or eliminates any § 411(d)(6) protected benefits, such change would need to be included in the employer's written cumulative summary and adopted by the employer under formal corporate procedures. Although this and similar approaches have been proposed by various members of the benefits community, the ACT does not endorse them, as the ACT believes the formal written maintenance of the cumulative changes would likely be as burdensome as the current interim amendment requirements.

The fifth alternative would mandate the interim adoption of any "Core Amendments." Like the sixth alternative, this approach would generally require the adoption of amendments impacting § 411(d)(6) protected benefits on an interim basis, while adoption of Non-Core Amendments could be delayed to the end of the remedial amendment period. However, the fifth alternative would additionally require the interim adoption of any amendment materially or significantly affecting benefits and rights of importance to participants, as well as any other amendment deemed to be a Core Amendment by the Service in its discretion. The advantage of this approach would be that: (i) plan sponsors would be required to adopt significantly fewer plan amendments on an interim basis, reducing the annual burden and cost of maintaining their plan documentation, and (ii) the rights of participants would be adequately protected by virtue of the fact that all Core Amendments would have to be timely adopted. Although Non-Core Amendments would not be required on an interim basis, we note that the Service (in conjunction with the DOL) could impose a participant notification requirement. To implement this alternative, guidance would need to be provided to plan sponsors and practitioners clarifying which types of changes in the law constitute Core Amendments.

Under the sixth alternative, a plan sponsor would be able to delay the adoption of a plan amendment to the end of the remedial amendment period, if it does not involve a prospective decrease or elimination of a § 411(d)(6) protected benefit. Although amendments that do not involve a cut-back in § 411(d)(6) protected benefits would not be required on an interim basis, we note that the Service (in conjunction with the DOL) could impose a participant notification requirement.

4. Recommendations – In the Alternative

The ACT is making two recommendations, the fifth and sixth, in the alternative to reform the interim amendment rules. We note that either of the recommendations, if adopted, would constitute a substantial improvement over the current scheme and would benefit plan sponsors significantly. The ACT urges the Service and Treasury to consider adopting one of the following recommendations.

a. Core amendments as interim amendments.

(i) The Recommendation. The ACT recommends the Service and Treasury give serious consideration to the fifth alternative listed above. Under the ACT's proposed approach, the interim amendment rules would be modified to require the adoption of any Core Amendment by the later of: (i) the last day of the plan year during which a Core Amendment becomes effective, (ii) the due date for filing the employer's tax return (plus extension) for the taxable year during which the provision becomes effective, and (iii) any applicable amendment deadline established under the relevant statute; except, and the ACT specifically acknowledges, that any amendment prospectively decreasing or eliminating an IRC § 411(d)(6) protected benefit might have to be made at an earlier point, given that no amendment can retroactively reduce a benefit once accrued and certain amendments must be in place prior to the benefit structure's operation (e.g., cash or deferred provisions). The proposed rule would permit the retroactive adoption of any Non-Core Amendments by the end of the IRC § 401(b) remedial amendment period.

(ii) Core Amendment – Defined. Core Amendments would include mandatory and discretionary plan amendments that: (i) materially or significantly affect any benefit, right or feature ("BRF") of importance to the general population of plan participants, (ii) permit or require an action to be taken by participants with respect to benefits under the plan, (iii) prospectively decrease or eliminate any § 411(d)(6) protected benefits, except to the extent such plan amendment merely reduces or eliminates a § 411(d)(6) protected benefit that has already accrued in a manner that is permitted to be reduced under the applicable regulations and guidance from the Service,[96] or (iv) are deemed to be Core Amendments as determined by the Service in its discretion and announced in published guidance. As a general matter, any modification that affects eligibility, or vesting, or materially changes benefits, should be considered a Core Amendment.

Since Core Amendments would include amendments involving any BRF of importance or broad applicability, this approach would provide protection for more than § 411(d)(6) protected benefits. Although § 411(d)(6) protected benefits generally include important benefits and rights under a plan (e.g., early retirement subsidy, installment payment option), many important benefits and rights are not necessarily § 411(d)(6) protected benefits. Examples of benefits and rights that are of significant importance to participants, but that are not § 411(d)(6) protected benefits, include the right to make elective deferrals under the plan and the right to direct investments. A Core Amendment would include a plan amendment that: (i) provides participants with the

[96] Treas. Reg. Sections 1.411(d)-3, 4 provide for the permissible elimination of certain types of § 411(d)(6)(B) protected benefits, including but not limited to: (i) optional forms of benefit that are redundant, (ii) noncore optional forms of benefit where core options are offered, (iii) protected benefits that create significant burdens and complexities, and (iv) protected benefits to the extent their elimination or reduction does not result in the loss of either a valuable right or a subsidized optional form of benefit but only as permitted by the Commissioner.

freedom to diversify their investments in publicly traded employer securities in accordance with Code § 401(a)(35), or (ii) accelerates the vesting of employer nonelective contributions in accordance with Section 904 of the Pension Protection Act of 2006.

(iii) Non-Core Amendments – Defined. Non-Core Amendments would include all amendments that are not Core Amendments. It is intended that Non-Core Amendments be limited to plan amendments that: (i) reflect plan changes that are purely operational, ministerial or technical in nature[97], (ii) are immaterial for, or would have a *de minimis* impact on, the general population of plan participants and with respect to which the provision of a notice summarizing the impact of the applicable amendment would be a sufficient safeguard for the small number of affected participants[98], or (iii) involve an area in which incorporation by reference is permitted. Examples of Non-Core Amendments might include a plan amendment that: (i) eliminates the need to calculate gap-period earnings when distributing excess deferrals as provided under the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), (ii) implements changes in accordance with the final regulations under § 415[99], or (iii) adds required provisions relating to employees who are in the military in accordance with the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART").

Non-Core Amendments would also include an amendment that merely reduces or eliminates a § 411(d)(6) protected benefit that has already accrued in a manner that is permitted to be reduced under the applicable regulations and guidance from the Service. For example, a technical amendment that is required due to a change in the law or published guidance impacting § 411(d)(6) protected benefits, but which is allowed to be eliminated because of its *de minimis* impact in accordance with applicable regulations or guidance from the Service, should be viewed as a Non-Core Amendment. Such view is consistent with the statutory language in IRC § 411(d)(6)(B), which expressly provides anti-cutback relief to a plan amendment that creates significant burdens or complexities for plans and participants, unless such amendment adversely affects the rights of any participant in more than a *de minimis* manner.

(iv) Service – Issue Guidance as to what is Core v. Non-Core. In connection with its proposal, the ACT recommends that the Service issue guidance under which it will determine which types of plan amendments constitute Core Amendments, and, whenever possible, when the law changes, issue timely guidance

[97] For example, inclusion of § 132(f) fringe benefit in definition of compensation.

[98] For example, 2009 waiver of minimum required distributions.

[99] The ACT notes that one of the strengths of the Core v. Non-Core proposed approach is its flexibility; some practitioners, for certain of their plan sponsor clients, will determine that § 415 changes are, indeed, Core Amendments. For example, those plan sponsors providing robust stock options might consider the gain on such options as material to the § 415 definition of compensation, whereas for the vast majority of plan sponsors this would not be material.

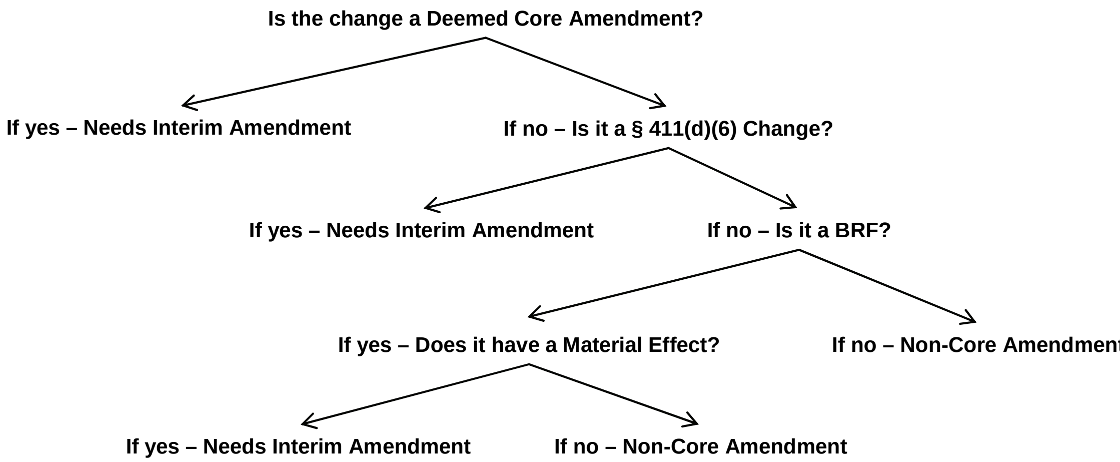
regarding whether resulting amendments are Core or Non-Core. To the extent there is ambiguity as to whether a type of plan amendment should be viewed as a Core Amendment, under the ACT's proposal, the Service would retain the power to designate it as a Core or Non-Core Amendment in its discretion.

To determine the ease by which a Core v. Non-Core determination could be made and what portion of recent amendments would be Core v. Non-Core, the ACT reviewed the required and optional amendments under PPA, HEART and WRERA for Cycle D filers and designated each applicable plan amendment as either a Core Amendment or a Non-Core Amendment in accordance with the principles outlined above. The ACT's findings are included as an Appendix to this Report, at Section IX. G, which should be read in conjunction with and is an important part of this section of this Report. This deliberative process was effectively and quickly accomplished, and the designation of each provision as either a Core or Non-Core Amendment was a clear-cut and unambiguous finding, although in certain instances it was somewhat challenging to articulate the precise rationale for designating an amendment as either Core or Non-Core. In this regard, the proposed test is remarkably similar to the famous "I know it when I see it" test articulated by the late United States Supreme Court Justice Potter Stewart.[100] It is our belief that the Service would be able to conduct its own reviews of plan amendments in a similarly straightforward and definitive fashion. We note that if the Service determines all or a majority of law changes constitute Core Amendments, this recommendation is meaningless. However, we favorably note that Service personnel reviewed the ACT's Core v. Non-Core determinations listed in Section IX. G hereof and considered the methodology and factors utilized in making such determinations reasonable; of course, this was an informal review and does not mean that the position of the IRS officially expressed following a formal review would necessarily be the same. Furthermore, we favorably note that this Section IX. G demonstrates that, absent plan design changes, the majority of interim amendments are Non-Core.

Based on the guidance to be published by the Service under this proposal, plan sponsors and practitioners would determine which individual plan amendments are Core Amendments subject to interim adoption requirements and which plan document changes are Non-Core Amendments. Below is a prototype "decision tree" for determining if an amendment is Core or Non-Core.

[100] Jacobellis v. Ohio, 378 U.S. 184 (1964).

Decision Tree[101]



(v) Best Efforts Compliance. The ACT recommends that plan sponsors be held to, and be able to rely on, a "best efforts" compliance standard for operational compliance with Non-Core Amendments which must, under the ACT's recommendation, be adopted no later than the end of the applicable remedial amendment period. Even though plan sponsors would be permitted to delay adopting Non-Core Amendments to their plan documents until the end of such period under this proposal, plans would need to operate on a best efforts basis as though such Non-Core Amendments had been adopted during the relevant interim period.

Additionally, the Service could require "best efforts" compliance to include the distribution to employees of a notice summarizing any changes in plan operation in a manner calculated to be understood by the average plan participant.[102] Although such notice would not include detailed provisions, it would constitute a written record that operational changes were being made under the applicable plan. The intention would be to incorporate the same standard for disclosure that applies under Title I of ERISA and is typically met by distributing a Summary of Material Modification ("SMM"), but would in no way have Title II (i.e., Code Section 401(a), et. seq.) implications.

[101] Assumptions and definitions:
"Deemed Core Amendment" means an amendment characterized as a "Core amendment" by the Service in regulations or other guidance.
"§ 411(d)(6) Change" means a change that prospectively decreases or eliminates a § 411(d)(6) protected benefit, except as permitted by applicable regulations or IRS guidance.
"BRF" means a benefit, right or feature within the meaning of § 401(a)(4) regulations.
"Material Effect" means a change that is likely to cause significant loss in the value of a BRF for most participants in a plan (for example, at least 60%) or offers a choice that requires participant action.

[102] A summary of any material modification in the terms of the plan must be written in a manner calculated to be understood by the average plan participant in accordance with ERISA § 102(a) and furnished to plan participants in accordance with ERISA § 104(b)(1).

Furthermore, in order to avoid many of the same issues plan sponsors are facing with respect to interim amendments, guidance would be needed to clarify the timing and content of the notices. The deadline to distribute the notices should be uniform and long enough to ensure that adequate time is available to prepare and distribute such notices. So that plan sponsors do not have to incur the additional cost of delivery for such notices, plan sponsors should be permitted to deliver them simultaneously with, or efficiently incorporated into, other participant communication materials. For example, the notice could be combined, or distributed, with a defined contribution plan's Summary Annual Report ("SAR") or a defined benefit plan's Annual Funding Notice.[103]

This best efforts standard for Non-Core Amendments would be a higher standard than the "reasonable, good faith" standard applicable under the current rules for interim amendments, since it would entail the concrete step of providing a SMM-like notice.[104]

It should be noted that like any other situation where the deadline for adopting amendments is delayed, the proposed rule may have implications under Title I of ERISA. ERISA § 404(a)(1)(D) requires plan fiduciaries to discharge their duties in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of ERISA. Accordingly, if the adoption of a Non-Core Amendment were delayed until the end of the RAP, it could be asserted that the plan's fiduciaries should follow the plan document's provisions without regard to the Non-Core Amendment during such interim period. By their nature, the adoption of Non-Core Amendments would not materially affect the benefits and rights of participants, but, in theory, a participant may nevertheless assert a claim under ERISA that turns on whether the plan document is deemed to include a Non-Core Amendment during the interim period. Requiring employers to provide SMM-like notices for Non-Core Amendments may mitigate any related concerns arising under Title I of ERISA. The ACT recommends the Service and the Department of Labor create a working group to review and resolve any potential issues arising ERISA § 404(a)(1)(D) with respect to this proposal, and to develop guidance with respect to the manner in which SMM-like notices for Non-Core Amendments should be delivered to participants. The ACT recommends such working group pay particular attention to how

[103] ERISA §101(f) generally requires the administrator of a defined benefit plan to provide a plan funding notice for each plan year to each plan participant. Large plans must provide this notice within 120 days after the end of the plan year, and small plans must provide it on or before the filing of the Form 5500. ERISA § 104(b)(3) generally requires the administrator of any plan that is not subject to ERISA §101(f) to furnish a copy of the plan's Summary Annual Report ("SAR") to each plan participant. Such notice must be provided within 9 months after the close of the plan year (or 2 months after the extended deadline for Form 5500 in the case of an approved extension).

[104] The ACT met with a staff attorney of the Pension Rights Center, which provides assistance to and is a powerful advocate for plan participants. The staff attorney stated that plan participant rights, including being able to rely on up-to-date, accurate plan documentation, would not be adversely impacted by the ACT's recommendations regarding modifying the interim amendment requirements, especially if there were a "best efforts" standard along with an annual SMM-like notice regarding amendments.

an SMM-like notice would be carried out in the context of prototypes, where one provider is providing services to thousands of clients.

b. Interim amendments for § 411(d)(6) benefits only

The ACT recommends consideration of the sixth alternative listed above. Under this proposed approach, only those plan amendments required to avoid a cutback in a participant's plan benefits under Code § 411(d)(6) must be made prior to the end of a plan's RAP, unless such § 411(d)(6) amendment is required or permitted to be made in a particular year due to a specific statutory or regulatory directive or transition rule. All other plan amendments may be delayed until the end of the plan's applicable remedial amendment cycle. This alternative has the distinct advantages of simplicity and ease of administration, and is more in line with what the practitioner community originally envisioned for the Cycle RAP system. Moreover, this approach may be administratively more efficient and simpler for sponsors of prototype and volume submitter plans.

The IRS unquestionably has the authority to adopt this proposal as demonstrated by the numerous occasions on which it extended the remedial amendment period. We note that this approach is similar to the plan amendment rules that were in place before the Service began to require good faith amendments with respect to EGTRRA plan documentation and the interim amendments that are currently required under the new staggered determination letter program. For example, with respect to TRA '86 plan documentation, the Service generally did not require a plan sponsor seeking a determination with respect to its plan to have adopted mandatory and optional plan amendments timely.[105]

In order to assist plan sponsors with making the necessary plan amendments, the ACT recommends that the IRS indicate in each year's Cumulative List, or, preferably, in a new comprehensive notice discussed in Section B immediately below, which amendments it believes involve a potential impermissible § 411(a)(6) cut-back if not made currently.

Similar to the "Core" and "Non-Core" proposal above, the ACT would recommend that plan sponsors be held to, and be able to rely on, a "best efforts" compliance standard with respect to all non-§ 411(d)(6) amendments, which, under the ACT's recommendation, must be adopted no later than the end of the applicable remedial amendment period. As discussed above, plans would need to operate on a "best efforts" basis as if such non-§ 411(d)(6) amendment had been adopted during the relevant interim period, including, as also discussed above, a written notification to plan participants. See discussion in Section VI. A. 4. a. (v) above.

[105] With respect to determination submissions prior to Revenue Procedure 93-39, the Service may have reviewed plan documents to verify the timely adoption of certain provisions relating to Code §§ 401(a)(17) and 401(a)(31). EP Determinations Quality Assurance Bulletin, *Verification of Prior Plan Documents in the Absence of a Determination Letter,* dated September 8, 2006.

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The bottom line is that the ACT firmly believes that adopting recommendations five or six will go a long way to unraveling the Gordian Knot that is the current interim amendment requirement.

B. Clarify Deadlines

The comments received from stakeholders concerning their experience ascertaining and identifying the adoption deadlines for interim amendments were highly critical of the existing guidance. A number of comments expressed the view that the information for such due dates is not readily accessible and that certain guidance is confusing. One explanation provided for such confusion is that the Service had made multiple changes to due dates in certain instances. Another explanation is that the due date information for interim amendments is scattered across Treasury decisions, Revenue Procedures and Notices, and that other related information concerning the timing of interim amendments is contained in Revenue Rulings, Announcements and the applicable statutes.

1. New Comprehensive Notice

Regardless of how the IRS decides to deal with the interim amendment requirements, the ACT recommends the Service clarify when interim amendments are due by publishing a single Notice with an interim amendment chart stating the effective dates and deadlines for adoption. Proposed plan amendment language would be extremely useful to plan sponsors and benefits practitioners, and model provisions could also be included in this Notice. The Service's *2007 Interim and Discretionary Amendments*, an informational release that appears to be available only through its Web site, is a helpful resource, but it is not a complete and comprehensive guide to the separate deadlines for all applicable sets of interim amendments.[106] As discussed below, such proposed Notice would be most helpful if issued in early September of each year. This Notice should also be updated and re-published each time a change in the law or published guidance requires a plan amendment.

With respect to the proposed Notice, the ACT further recommends this guidance be presented in a chart format, with: (i) a reference to the applicable Code section and/or new law that pertains to each change, (ii) a brief description of the required change, (iii) effective dates, (iv) the due date for adoption of the interim amendment, (v) a description of whether the change is discretionary or mandatory, and (vi) commentary concerning the nature of the amendment. The chart should be printed twice in the proposed Notice, once organized by Code section and a second time organized by due date. An updated Notice (which would include an updated chart) should be published for any new change in the law or published guidance requiring a plan amendment, and

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[106] *Available at* http://www.irs.gov/retirement/article/0,,id=173372,00.html

annually. A sample of what the Notice might look like is included as an Appendix under Section IX. H. The format and content for the Cumulative List should also be conformed to the format and content of the proposed Notice. Thus, intra-year updates to the Cumulative List and the proposed Notice would involve substantially similar changes for both documents.

2. Cumulative List Changes

The Notice containing the Cumulative List of Changes in Plan Qualification Requirements (the "Cumulative List") is published annually. Under the Service's current procedure, the target date for publishing the Cumulative List is mid-November of each year. The ACT notes that the Cumulative List comes out too late, particularly for prototype providers. The ACT recommends that consideration be given to an earlier release of the Cumulative List, for example, early September of each year.

The ACT recommends that the IRS post on its Web site a notice published as frequently as necessary after the publication of the Cumulative List that provides new changes which will be on the next Cumulative List. This Web-based notice should also be updated and re-published each time a change in the law or published guidance requires a plan amendment.

3. Gap Period/Interim Amendment Issues

Under the Service's current procedure, the target date for publishing the Cumulative List is mid-November of each year. The Cumulative List identifies changes in the qualification requirements that will be considered by the Service in its review of plans for determination letters, whose submission period begins on the February 1st following the issuance of the Cumulative List. Accordingly, as currently provided under Revenue Procedure 2007-44[107], any changes in the law or published guidance during the period (the "Gap Period") which begins with the issuance of the Cumulative List (mid-November) and ends with the start of the applicable submission period (February 1st) will not be considered by the Service in its review. The Service should modify its submission procedures so that any changes in applicable law or published guidance arising during the Gap Period and adopted by the plan sponsor as interim amendments are considered in its review of plans for determination letters; the adoption of the ACT's recommendation in Section VII. A. 2 regarding the plan sponsor's submission of a "self-identification sheet" of all interim amendments and the order of their acceptance could be helpful and practical to the Service in this regard.

[107] 2007-28 I.R.B. 54.

C. Approval Letter Program for Individually-Designed IRC § 403(b) Plans[108]

On April 15, 2009, the IRS issued Announcement 2009-34[109] in which it published a draft Revenue Procedure that (when finalized) will permit an employer sponsoring certain eligible § 403(b) retirement arrangements to apply for an opinion letter or advisory letter issued by the IRS with respect to the qualified status of such sponsored arrangements under § 403(b). Announcement 2009-34 indicates that the IRS also intends to establish a document approval program for individually designed IRC § 403(b) plans at a later date. IRS representatives have informally indicated that the IRC § 403(b) pre-approved plan program will be finalized by mid-2010. The IRC § 403(b) individually designed document approval program will in all likelihood not be available until 2011.[110]

Practitioners anticipate that most small IRC § 501(c)(3) organizations that maintain such § 403(b) arrangements will utilize pre-approved prototype or volume submitter plan documents prepared by the IRC § 403(b) vendors handling the investment and/or compliance and administration of such plans. However, it is anticipated that a significant number of large § 501(c)(3) organizations (e.g., health care systems, colleges and universities) will choose to maintain individually-designed IRC § 403(b) plans.

The IRS has already received numerous comments from IRC § 403(b) practitioners and vendors on the proposed prototype plan program and draft revenue procedure, so this Report will not address issues related to such program, other than to note that the interim amendment issues discussed elsewhere in this Report will present the same significant challenges and problems in the IRC § 403(b) world as they already have in the IRC § 401(a) tax-qualified plan world. However, we would like to offer the following recommendations regarding the IRC § 403(b) Approval Program:

1. Release 403(b) Approval Program Rev. Proc. in Draft Form

The ACT recommends that the Revenue Procedure that will be utilized to implement the IRC § 403(b) Approval Program be released in draft form for comment prior to its finalization, as was done for the IRC § 403(b) prototype plan program.

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[108] The ACT notes that many 403(b) plans are sponsored by governmental entities. Our recommendations relevant to governmental § 403(b) plans contained in Section VI. D. hereof should be considered incorporated by this reference.

[109] 2009-18 I.R.B. 916.

[110] The IRC § 403(b) individually designed document approval program is hereinafter referred to as the "403(b) Approval Program."

2. Determine Estimated Number of 403(b) Document Approval Submissions

The current IRC § 401(a) qualified plan determination letter program utilizes five cycles for employer submissions. The same five cycles and related employer identification numbers can, of course, be used for the IRC § 403(b) Approval Program. However, it is not clear at this time what the actual number of submissions will be under such program. If they are few enough in number, perhaps a five-year cycle system will not be needed. We recommend that the IRS work with the IRC § 403(b) practitioner and vendor community prior to releasing a draft revenue procedure for the IRC § 403(b) Approval Program to attempt to determine the level of submissions that will be made under it. Such an estimate will also be important for staffing the program.

3. Include Special Remedial Amendment Determination Rules in 403(b) Approval Program Rev. Proc.

Sections 10.02, 10.03 and 10.04 of Revenue Procedure 2007-44 provide special remedial amendment rules for determining the appropriate filing cycles for multi-employer plans, multiple employer plans and governmental plans. The ACT recommends that these special rules be included under the IRC § 403(b) Approval Program, if there is a staggered or cycle feature to the program. Section 10.07 of Revenue Procedure 2007-44 provides a special rule for a group of tax-exempt employers that do not constitute a controlled or affiliated service group under Code §§ 414(b), (c) or (m) but that are participating in the same (or virtually the same) § 401(a) tax-qualified plan maintained by a "centralized organization" (such as a national headquarters or a common administrative committee). The controlled group rules for tax-exempt organizations permit certain tax-exempt employer groups that coordinate their day-to-day activities to elect to be treated as a controlled group under Treas. Reg. § 1.414(c)-(5), and such groups will, presumably, be able to utilize the Cycle filing rules that will be applicable to controlled groups. However, there will no doubt be instances in which the special rule contained in Section 10.07 of Revenue Procedure 2007-44 will be useful, so the ACT also recommends its inclusion in the 403(b) Approval Program.

4. Identify 403(b) Changes As Such in Cumulative List

In preparing the annual Cumulative List of Changes in Plan Qualification Requirements called for under § 4.01 of Revenue Procedure 2007-44, the ACT recommends that provisions applicable only to IRC § 403(b) plans should be identified as such in the list. Consideration should also be given to whether a separate Cumulative List should be issued for IRC § 403(b) plans.

5. Include Underlying Annuity Contracts and Custodial Agreements in Scope of DL

Section 5.04 of Revenue Procedure 2007-44 reflects the requirement that a § 401(a) tax-qualified plan be maintained pursuant to the terms of a written plan document. The final Section 403(b) regulations contain a similar written plan document requirement, but

IRS personnel have indicated informally at public conferences that the IRC § 403(b) written plan document requirement can be satisfied by "paper clipping" more than one document together to constitute the required written plan. For example, an employer may draft a IRC § 403(b) plan document that serves as an "umbrella" plan document covering different underlying annuity contracts issued by insurance companies or custodial agreements entered into with mutual fund providers. The "umbrella" plan document will typically incorporate the terms and provisions of the underlying annuity contracts and custodial agreements. Under this scenario, when an employer applies for an individually designed IRC § 403(b) plan approval letter, the issuance of the letter only with respect to the "umbrella" plan document would not seem to provide the employer with the desired IRC § 7805(b) protection. The ACT therefore recommends that the IRC § 403(b) Approval Program be structured so that a favorable approval letter will also cover any underlying annuity contracts and custodial agreements utilized in connection with a IRC § 403(b) plan.

If annuity contract certificates and custodial accounts will be covered under the IRS 403(b) prototype program, the ACT also recommends that the IRS develop a procedure so that IRC § 403(b) vendors can have their respective annuity contract certificates and custodial agreements pre-approved so that IRS reviewers will not need to review such certificates and agreements in connection with each individually-designed plan utilizing them. Changes to annuity contracts must be approved by state insurance regulators, and the same standard annuity contracts and custodial accounts are often used for many different plans, meaning that it would be virtually impossible to make changes in the context of one single plan. A procedure whereby annuity contract certificates and custodial agreements can be pre-approved would be preferred by all 403(b) providers. This will avoid providers' annuity contract certificates and custodial agreements being subject to review (and proposed changes) as part of each determination letter request. This could perhaps be accomplished under the IRC § 403(b) prototype program because vendor annuity contract certificates and custodial account agreements will presumably be submitted for approval under that program. Alternatively, the IRS could create a "snap-on" amendment or rider that will satisfy the IRS's review requirements, similar to the prototype IRA documentation that is currently available and updated from time to time by the IRS.

We also recommend that the IRS provide a schedule on which the employer can list all the IRS-approved vendor 403(b) contracts and agreements by providing the name of the vendor and an IRS reference number assigned to the pre-approved document. This approach will avoid the necessity of attaching the approved vendor documents to an individually-designed 403(b) plan approval filing.

6. Make 403(b) Approval Letter Available in the Event of a Plan Termination

Section 8 of Revenue Procedure 2007-44 sets forth the determination letter rules related to § 401(a) tax-qualified plan terminations. The ACT recommends that the IRC § 403(b) Approval Program contain a similar provision, and that the current IRS Form

5310 be revised to accommodate § 403(b) plan terminations, or another form be created to do so.

There continues to be some doubt within the IRC § 403(b) practitioner community over the issue of exactly when a IRC § 403(b) plan is, in fact, terminated. This is particularly true because, in the multiple vendor world of IRC § 403(b) plans, it may be disadvantageous to plan participants to terminate and distribute such plan assets due to surrender charges and early withdrawal penalties that may be imposed by vendors in connection with the termination. We recommend that this issue be addressed through the issuance of additional guidance.[111]

7. Permit Employers to Request Coverage and Nondiscrimination Rule Determinations as Part of the 403(b) Approval Process

Some IRC § 403(b) plans are subject to coverage and nondiscrimination testing under IRC §§ 410(b) and 401(a)(4) with respect to employer contributions when a safe harbor contribution or QACA is not utilized. Employee elective deferrals to IRC § 403(b) plans are subject to a universal availability requirement, under which the opportunity to make voluntary, elective deferrals must be made available to all nonexcludable employees. The current determination letter program for § 401(a) tax-qualified plans permits employers to elect (on the Schedule Q associated with IRS Form 5300) to have the IRS determine, among other things, that an employer's plan coverage rules satisfy the requirements of IRC § 410(b), that specified benefits, rights and features of the plan meet the § 401(a)(4) rules, that the plan satisfies the § 401(a)(4) nondiscrimination general test and that a plan's definition of compensation is nondiscriminatory. The ACT recommends that similar elections be made available under the IRC § 403(b) Approval Program. With respect to testing available benefits, rights and features, the ACT recommends that the IRS's determination also cover any underlying annuity contracts and custodial account agreements used as funding vehicles under the plan.

D. Special Issues of Governmental Plans

The IRS has publicly stated its intention to increase compliance among governmental plans. Encouraging participation in the determination letter program could be a key element in making this happen or it could simply create more frustration for both the applicants and the IRS if certain realities are not addressed beforehand. Reviewers are likely to encounter noncompliance on a scale and of a type not often seen with ERISA-covered plans. If reviews are conducted based on standard checklists, the IRS will lose an excellent opportunity to work toward its ultimate goal, which is tax-compliant plans. This section briefly explains some historical reasons for the current state of public

[111] The 403(b) regulations indicate that the delivery of a fully-paid individual insurance annuity contract is treated as a distribution for purposes of the plan termination rules. However, it is not clear that this provision covers all types of funding vehicles used in connection with 403(b) plans.

employer plans and makes several recommendations to create a workable determination letter program that will help the IRS achieve its goal.

While it is tempting to take the position that the same rules should apply to private employer plans and governmental plans (to the extent applicable), the reality is they are different creatures in several significant respects. The importance of governmental plans' exemption from ERISA cannot be overstated. It means that governmental plans do not file Form 5500 or generally submit any other type of annual report or return so federal regulators do not have an easy way to identify them or confirm their numbers. It also complicates the IRS's efforts to communicate and educate to promote compliance.

The motivation of private versus public plan sponsors is different, which bears on the kinds of protections that participants' interests need. The significant tax advantages afforded private for-profit employers for contributions to qualified plans is an important incentive for them to establish retirement plans and maintain their qualified status. In contrast, tax-exempt governmental plan sponsors establish pension plans primarily to attract and retain the best qualified employees. In many cases, public entities use a generous benefit package to offset lower salaries.[112] Governmental plan sponsors are motivated to avoid wrongdoing in order to preserve employees' tax advantages so they can continue to attract and retain the employees they want.

Making changes to governmental plans is often a complicated process fraught with potential legal challenges because of a patchwork of state and local constitutional and statutory protections applicable to plan benefits that has evolved over the years. In addition, governmental plan amendments typically are subject to some aspect of the varying state legislative processes. Obtaining approval for any type of change, including conforming legislation, is often subject to political considerations that create uncertainties in the outcome as well as the timing. Furthermore, the legislative bodies of the state and local entities with authority to amend state or local statutes that govern retirement plans may meet infrequently, which complicates meeting adoption deadlines.[113]

Historically, participants in public sector plans have relied on their pension plan benefits to serve as the foundation of their retirement income because a significant portion of the participants will never be eligible for full, or even partial, Social Security benefits. Thus, some of the ancillary benefits routinely offered under governmental plans are not entirely consistent with IRS requirements. According to Social Security Administration

[112] See *Public Fund Survey, Summary of Findings for FY 2008*, prepared by Keith Brainard, National Association of State Retirement Administrators, October 2009.

[113] In recent guidance, the IRS provided much-appreciated relief by extending the RAP for governmental plans to the 91-day period beginning after the last day of the first regular legislative session beginning more than 120 days after the determination letter has been issued or the declaratory judgment petition has been disposed of. Rev. Proc. 2009-36, 2009-35 I.R.B. 3004.

estimates, about 30 percent of state and local government employees are currently not covered by Social Security[114] so this is a significant issue.

Given the patterns and practices that have developed without much interference or input from the IRS over time, the more relevant question at this juncture should not be whether a plan was always technically compliant, but whether the plan's actions were consistent with the intent of the tax legislation. Several factors work together to limit the possibilities for doing harm to participants' interests: the employees' self-interest in protecting their primary source of retirement income; the relatively high percentage of represented employees in the public sector workforce;[115] and the scrutiny that the state and local legislatures as well as the voting public regularly apply to public pensions.[116] Thus, the ACT makes the following recommendations for the determination letter program that would apply specifically to governmental plans. The key components are limited amnesty determined under uniform principles for noncompliant past practices where participants' interests were not harmed and a user-friendly process for fostering compliance going forward.

[114] *Reported in* State and Local Government Retiree Benefits, Report 07-1156, U.S. Government Accountability Office, September 2007. Previously, many state and local governments chose not to participate in Social Security in order to avoid the employer contribution (currently 6.2 percent of covered pay). The tradeoff has been to offer employees a more generous pension plan that provides benefits roughly equivalent to the amount an employee in the private workforce would receive from a combination of Social Security and the employer-provided retirement plan.

[115] Over 40 percent of employees in federal, state and local government are covered by union agreements compared with about 10 percent of private sector workers. *State and Local Government Retiree Benefits, Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs*, U.S. Government Accountability Office, Report no. GAO-07-1156, September 2007.

[116] The current economic downturn has heightened the scrutiny as legislatures and the tax paying public seek ways to decrease the enormous accrued liabilities associated with public plans. See, e.g., *The Washington Post,* Jan. 2, 2010.

1. Combine the Determination Letter Program with a Voluntary Compliance Process for Governmental Plans During This First Cycle

Because of problems associated with the vested rights doctrine[117] and other historical developments, many if not most of the governmental plans submitted are likely to present the reviewer with some compliance issues. Unless changes are made to the current determination letter program, these instances of noncompliance will potentially require the involvement of the Voluntary Compliance Unit, which is already becoming overwhelmed with problem plans as described in Section V.B. It will also mean that governmental plans will no longer be handled by the reviewers specially trained in their idiosyncrasies, which will cause further delays and frustration. About 1,500 governmental plans submitted in Cycle C are already in the review queue. Thousands more are expected to be submitted in Cycle E, which ends on January 31, 2011. These numbers could overload the system; it is for this reason the ACT recommends that the IRS rely heavily on its trained governmental plans cadre to resolve issues consistent with clearly articulated principles by effectively combining the determination letter program with a voluntary compliance process, manned by those IRS specialists with preexisting governmental plan knowledge.

2. Leverage the Experience Acquired in Cycles C and E to Develop Fix-It Guides Geared to State and Local Governmental Plans

The IRS has developed Fix-It Guides for 401(k) plans, SEPs and IRAs that support up-front compliance by providing a wealth of practical information to plan sponsors and practitioners.[118] Charts identify common problems that can arise with all facets of plan administration (e.g., eligibility, contributions, distributions, vesting) and direct the reader to a summary of the appropriate corrective action and, if applicable, the correction program. This type of information could go a long ways toward allaying one of the big fears that governmental plan sponsors have identified as a hurdle to applying for a determination letter, namely, what happens if the IRS finds something wrong with our

[117] Although there are variations on the definition of vested rights, the protections generally posit that an employee has a vested right to the terms of the plan in place on the employee's date of hire. See *State Constitutional Protection for Public Sector Retirement Plans*, prepared by the National Conference of Public Employee Retirement Systems, March 15, 207, *available at* http://www.ncpers.org/Files/News/03152007Retirement Benefit Protections.pdf. Any material changes can be made to apply only to new employees. The vested rights protections are not the same as those afforded a private sector participant's accrued benefit under § 411(d)(6). The latter allows changes to plan terms provided they do not reduce benefits accrued to date. The former prohibits changes to the terms that define an existing employee's benefit subject to a few narrowly drawn exceptions. See, e.g., Betts v. Board of Administration, 21 Cal. 3d 859 (1978). For example, if a public plan states that a plan member's benefits will be calculated with an age factor of two percent at age 60, with few exceptions, that factor cannot be changed for that employee during the employee's working life.

[118] *Available at* http://www.irs.gov/retirement/sponsor/article/0,,id=181908,00.html.

plan?[119] The type of clear explanations offered in the current Fix-it Guides can also help the plan administrative staff explain what needs to be corrected and the process to the boards that oversee them or the legislative body that must decide whether to make a legislative change.

The ACT recommends publication of a State and Local Government Fix-It Guide, once sufficient experience, gained in reviewing governmental plans in Cycles C and E, can be leveraged. Too early publication could be counterproductive to achieving the ultimate goal of widespread compliance among governmental plans if the remedies are unrealistic or too rigid. In the interim, much of the material already developed for 401(k) plans will also be useful for governmental entities that sponsor 403(b) and 457(b) plans.

3. Promote Coordinated Reviews for Large State Governmental Plans

Many states, including California,[120] have plans that cover state employees that also can be adopted by any state contracting agency for its employees. Typically, some optional provisions are permitted, but the core provisions embodied in state statutes are standard for all plans. Many county and regional entities offer a similar arrangement. The IRS could achieve significant efficiencies in the determination letter program if these plans were treated similar to volume submitters so that once the core provisions were reviewed, and compliance problems addressed, only optional provisions would need to be reviewed for a large number of plans. One promising example of the coordinated approach is presented by a group of county retirement systems in California. All are subject to the same statutory provisions although they are operated independently, and different practices have developed over the years. They are working with the Service to develop a process for having the common statutory provisions reviewed and uniform solutions worked out to address any compliance issues that are identified. Each system would also need to have its non-core provisions reviewed to obtain a determination letter, but the limited individual review could save the IRS, and the plan administrators, considerable time and frustration. The coordinated approach may also facilitate getting any legislative changes that may be needed through a fractious legislature. The IRS has encouraged this type of innovative response by demonstrating its flexibility in guidance, especially the FAQs.[121]

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[119] <u>See</u> *Employee Plans News*, Special Edition, May 9, 2008.

[120] The California legislature has established the California Public Employees' Retirement System. Cal. Gov't Code § 20000 *et seq*.

[121] For instance, the IRS responded as follows to the following question that almost all governmental plans face: if a plan has a failure that may be corrected under EPCRS and the provisions of the state law relating to the failure provide a higher benefit than the applicable provision of the Internal Revenue Code, will a state protected benefit be affected by the EPCRS principle of full correction?

> "State constitutions, statutes, and state court cases often provide participants with some protection or guarantee of their state provided retirement benefits. These governmental plans must satisfy a

4. Generally, Continue the Current Efforts at Education and Outreach

The governmental plans community has been out of the primary determination letter loop for many years. Rumors about Draconian consequences are widespread, fanning fears about letting the federal government in and fostering a defeatist attitude among plan sponsors. The experience of government plan filers in the current five-year Cycle could provide reassurance for those who held off because of all the unknowns. Already, there are indications that the IRS's helpful attitude is encouraging plans to come in.

To build on that momentum, the IRS should keep track of filers whose problems were dealt with quickly and fairly, and encourage them to appear at conferences attended by people who work in the public plan sector to discuss the determination letter process. If the IRS can reach consensus on the big issues, most notably how to address the state constitutional, statutory and common law protections, more governmental plans will seek the comfort regarding plan compliance that favorable determination letters offer.

E. EPCRS Improvements and Coordination

The EPCRS guidance for correcting plan document failures under VCP draws an important distinction between a "Nonamender Failure" to timely amend a disqualifying provision before the end of the applicable remedial amendment period, and an "Interim Failure" to timely adopt an interim amendment.[122] In the case of a Nonamender Failure,

number of tax-qualification requirements under the Internal Revenue Code, including the benefit and contribution limits of section 415 and the compensation limits under section 401(a)(17). These plans must also follow their plan terms to retain their tax-qualified status so that the participants receive favorable tax treatment on their benefits and contributions. Under some circumstances the state provided benefits under the plan can conflict with the Internal Revenue Code requirements. Rev. Proc. 2006-27, containing the provisions of the Employee Plans Compliance Resolution System (EPCRS), provides that generally, 'a failure is not corrected unless full correction is made with respect to all participants and beneficiaries, and for all taxable years (whether or not the taxable year is closed).'

Under the EPCRS process, the correction should be reasonable and appropriate for the failure. What is reasonable and appropriate is based on the facts and circumstances of each case. Whether or not full correction is made is one of the facts and circumstances to be considered. While the IRS's expectation is that full correction will be made, the existence of a state law protecting pension benefits is one factor, among many, that may be taken into account in determining an appropriate correction method. A correction involving a state protected benefit should be submitted under the Voluntary Correction Program of EPCRS".

Retirement Plans FAQs regarding Governmental Plans and EPCRS, Q&A 3, *available at* *http://www.irs.gov/retirement/article/0,,id=181908.00.html.*

[122] Our best reading of the relevant provisions under Rev. Proc. 2008-50 is that separate procedural rules apply to (i) an Interim Failure, the failure to timely adopt an amendment during the interim period, and

the VCP rules require a determination letter submission, regardless of whether the VCP filing is submitted during an on-Cycle or an off-Cycle year.[123] On the other hand, in the case of an Interim Failure, a determination letter application should only be filed if the plan is submitted under VCP during an on-Cycle year.[124] Because of the confusion over the distinction between Nonamender Failures and Interim Failures, the ACT recommends that the Service clarify the difference between these two types of plan document failures and provide examples illustrating the separate procedural rules that apply to each.

The ACT also recommends that the Service provide clear guidance with respect to the manner in which VCP may be used to address situations in which the plan sponsor has timely amended and restated the plan document in good faith, but has failed to file a determination letter application before the end of its remedial amendment cycle. Specifically, the Service should clarify how such plan sponsors may make an off-Cycle filing and a simultaneous VCP submission (i) to correct any Nonamender Failures identified by the Service in the course of processing such off-Cycle filing, and (ii) to secure a favorable determination letter without any gap in its period of reliance. If this type of relief is deemed to be inappropriate or otherwise unavailable under VCP, a method of voluntary correction providing the relief described above should be developed for late filers and incorporated into the Service's determination letter program.

Due to the sizable difference between the VCP fee for Interim Failures and the significantly larger compliance fee for Nonamender Failures, the ACT also recommends that the Service review the fee structure under VCP for this type of plan document failure. The fees for each type of plan document failure should be rationalized so that they are proportionate to one another and to the nature of the document deficiencies corrected. The Service could undertake a study to determine the suitability and sufficiency of the compliance fees for correcting Nonamender Failures and Interim Failures in plan documents submitted under VCP. Based on the study's findings, the respective compliance fees should be modified to ensure that any difference in VCP fees for correcting plan document failures is appropriate and warranted.

When submitting off-Cycle determination letter applications in accordance with VCP requirements to correct Nonamender Failures, practitioners have found that such applications are not timely processed. To address this problem, the ACT recommends that the Service give off-Cycle submissions that are submitted in tandem with VCP applications, the same priority as on-Cycle submissions.

(ii) a Nonamender Failure, the failure to amend the plan to correct a disqualifying provision within the applicable remedial amendment period. See discussion in Section V.B. of this Report.

[123] Rev. Proc. 2008-50, 2008-35 I.R.B. 464.

[124] *Id.*

Given the significant increase in the workload of the Service's VC Unit due to submissions relating to plan document failures, the ACT also recommends that the Service further streamline the application and review process of the on-Cycle and off-Cycle submissions relating to Nonamender Failures and the on-Cycle submissions relating to Interim Failures. The Service could develop a new Appendix under its EPCRS guidance, providing model language designed to assist practitioners in drafting corrective amendments for specific types of Nonamender Failures and Interim Failures and to simplify the Service's review of such corrective amendments.

If the Service retains the interim amendment requirement in any form, the ACT further recommends that the Service permit Interim Failures to be remedied through the self-correction method under EPCRS. The Service could permit the adoption of an interim amendment by the end of the plan year following the plan year in which the good-faith amendment deadline occurred, provided that the plan amendment does not result in a violation of the anti-cutback rules under IRC § 411(d)(6).

In light of the complexity of the interim amendment rules and the confusion among practitioners with respect to the application of such rules, the ACT also recommends that the Service clearly identify for plan sponsors, the practitioner community and the VC Unit what interim amendments need to be made and when they need to be made (for an example of such a chart, see Section IX. H., and discussion regarding same in Section VI. B.).

F. Use of the Determination Letter Program for Policy Decisions

We note that there have been situations where the determination letter program has been used to effectuate policy changes. One example is the cash balance plan freeze on issuing determination letters.

1. Case in Point: The Cash Balance Plan Freeze 1999-2007

During the 1990s, a number of plan sponsors determined that a traditional defined benefit pension plan was no longer the appropriate retirement vehicle for their employees and instead decided to provide retirement benefits through cash balance plans. Some plan sponsors made this decision for economic reasons, others to better reflect that their workforces did not remain long enough to accrue a significant retirement benefit from a final average pay plan. Typically, the new program was implemented by a conversion of a traditional defined benefit plan to a cash balance plan.

Because a number of qualification issues arose due to conversions to cash balance plans, beginning September 15, 1999, a Field Directive was issued by the Service's Director, Employee Plans, requiring applications for a determination letter or a plan under examination that involved an amendment to change a traditional defined benefit plan into a cash balance plan ("cash balance conversions") to be submitted to the Washington, D.C. office of the Internal Revenue Service (the "National Office") for technical advice on the plan's qualified status.[125] In 2002, proposed regulations under Code § 411(b)(1(H) were issued that specifically addressed cash balance plans as part of a package of regulations that also addressed Code § 401(a)(4) nondiscrimination cross-testing rules applicable to cash balance plans.[126] In Announcement 2003-1[127], the Service announced that the cases subject to the 1999 Field Directive would not be processed pending issuance of regulations addressing age discrimination.

Congress also became interested in the cash balance plan and cash balance plan conversion issues after thousands of comment letters were submitted on the 2002 proposed regulations and the courts[128] began to address some of the age-discrimination issues in cash balance plan conversions. As a response to employer concerns over the 2002 proposed regulations, Consolidated Appropriations Act §5, (the "CAA")[129] provided that none of the funds made available under the Act could be used to issue any rule or regulation reaching similar results. Further, CAA required the Secretary of the Treasury to propose legislation providing transition relief for older and longer-service participants affected by cash balance conversions. As a result, in 2004, Treasury and the IRS withdrew the 2002 proposed regulations. In Announcement 2004-57, the Treasury and the IRS stated that they did not intend to process cash balance plan determination letter submissions which had been sent for technical advice to the National Office pursuant to the 1999 Field Directive while these issues are under consideration by Congress.[130]

As part of the Pension Protection Act of 2006, the Code, ERISA and ADEA were amended to remove the statutory and regulatory uncertainties involving cash balance and other hybrid plans by providing special rules relating to age discrimination in "applicable defined benefit plans." A special grandfathering rule applies to plans that were converted prior to June 30, 2005.[131] As a result, the IRS announced in Notice 2007-6 that it was beginning to process determination letter and examination cases that involved a conversion from a traditional defined benefit plan to a cash balance plan.

Although we understand that most of the cases which had been left in limbo have now been processed, such process was severely flawed. During the process, the IRS not only tried to implement and enforce new rules, it tried to do so retroactively.

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[125] September 15, 1999 Field Directive (the "1999 Field Directive").

[126] 67 F.R. 76123. These proposed regulations replaced a 1988 proposal under §411(b)(1)(H).

[127] 2003-1 C.B. 281.

[128] See Cooper v. IBM, 274 F. Supp 2d 1010, (S.D. Ill 2003).

[129] Pub. L. 108-199.

[130] Announcement 2003-1, 2003-1 C.B. 281.

[131] Sec. 701(e)(5) of the Pension Protection Act of 2006 (the "PPA").

Prior to the 1999 Field Directive imposing the cash balance freeze, the IRS issued Notice 96-8.[132] This Notice provided certain guidance with respect to cash balance plans. This Notice provides: "The anticipated regulations will be effective prospectively. In addition, for plan years beginning before the regulations are effective, a frontloaded interest credit plan would not be disqualified for failing to satisfy section 411(a) or 417(e) if the amount of the distribution satisfied those sections based on a reasonable, good-faith interpretation of the applicable provisions of the Code, taking into account pre-existing guidance. For this purpose, plans that comply with the guidance in this notice are deemed to be applying a reasonable, good faith interpretation."

Notwithstanding the Notice's good faith interpretation standard, when processing cash balance plan determination letter submissions, the IRS, for the first time, disclosed its own interpretation of this Notice and notified plan sponsors this was the only valid good faith interpretation of the Notice. It then routinely told sponsors of plans that had otherwise complied with the Notice on a reasonable, good faith basis that their plans had to be retroactively amended to comply with the IRS's now disclosed interpretation of the Notice. Not only was the IRS's demand for retroactive correction contrary to the Notice's good faith interpretation standard, the IRS's interpretation of the Notice was contrary to the provisions of the Notice.

Cash balance plans were administered for 11-12 years (1996-2008) in compliance with Notice 96-8 based on its stated good faith interpretation standard. If the IRS wanted to change the guidance set forth in the Notice, it should have done so publicly and earlier through appropriate means. To attempt to retroactively change the rules via the determination letter process is unreasonable. The determination letter program should be a process solely to determine whether a plan complies with existing published rules. It should not be used as a mechanism to surprise plan sponsors by informing them of new, previously unpublished rules, especially where these rules are retroactive. To expect plans to alter prior plan administration (in this case 11-12 years' worth) to comply with new, unpublished rules wreaks havoc on the private pension system and provides employers even more reason to terminate existing plans or not adopt new ones.

2. Recommendation

The determination letter cycle program should be an efficient and straightforward process for plan sponsors to obtain a determination letter and should be based on current law and regulations. The use of the program by Treasury and the IRS to implement policy changes complicates and corrupts the process.

The ACT understands that Treasury and the IRS need to address policy issues as part of their responsibilities in administrating the tax laws. However, we do not think that those policy decisions should be made and implemented through the determination letter process. In this light, the ACT recommends that, in order to maintain the integrity

[132] 1996-1 C.B. 359.

of the determination letter process and at the same time avoid issuing favorable letters for unresolved issues, the Service could issue determination letters caveating that the letter does not address the particular issue (which the Service has done in other circumstances).

G. Clarify Which IRC § 415 Limitations Can Be Incorporated by Reference

Practitioners would find it useful to have more clarity regarding which qualification requirements may or may not be incorporated by reference in the plan document. For example, the regulations permit a plan to incorporate by reference the limitations of IRC § 415.[133] If the IRC § 415 limits can be applied in more than one manner, but there is a statutory or regulatory default rule, the default rule applies if the plan incorporates the limitation of IRC § 415 by reference.[134] If the IRC § 415 limits can be applied in more than one manner, but there is no statutory or regulatory default, then the plan must specify the manner in which the limitation is to be applied in addition to incorporating the IRC § 415 limits by reference.[135]

In the context of the "definition of compensation" for purposes of the IRC § 415 limits, the regulations state that if the plan uses one of the safe harbor definitions of compensation set forth in Treas. Reg. §§ 1.415(c)-2(d)(2)-(4), the plan automatically is considered to satisfy IRC § 415(c)(3). Thus, a plan that incorporates the limits of IRC § 415 by reference does not need to explicitly define what constitutes IRC § 415 compensation. However, the Service has taken a contrary position. In the Internal Revenue Manual, it states "[a] plan that otherwise incorporates IRC § 415 by reference must specify which definition of compensation is incorporated."[136] In addition, the IRS's Alert Guidelines for Limitations on Contributions and Benefits state "[a] plan that incorporates § 415 by reference must specify which definition of compensation is incorporated," referring to the various safe harbor definitions of compensation set forth in the regulations.[137] We note that the EP Determinations has addressed this issue in a Quality Assurance Bulletin dated December 7, 2009.

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[133] Treas. Reg. § 1.415(a)-1(d)(3)(i).

[134] Treas. Reg. § 1.415(a)-1(d)(3)(ii).

[135] Treas. Reg. § 1.415(a)-1(d)(3)(iii). For example, where an employer maintains two or more qualified profit sharing plan and a participant participates in two such plans, then both documents must specify which of the plan's annual addition must be reduced if the aggregate annual additions would otherwise exceed IRC § 415 limits.

[136] Internal Revenue Manual, Part 4 Examining Process, Chapter 72 Employee Plans Technical Guidelines, Section 6 Section 415(b). See also EP Determinations Quality Assurance Bulletin, FY-2004 No. 5 (July 6, 2004), stating that the plan must specify exactly which definition of compensation is being used under the terms of the plan, even if it is citing one of the definitions in Treas. Reg. § 1.415-2(d).

[137] See Employee Benefit Plans, Pub. 7001 (Rev. 3-2008).

Such positions and varying guidance leave practitioners and the IRS EP DL specialists confused, making plan drafting and the determination letter process more time consuming and tedious; while the Quality Assurance Bulletin is helpful, such guidance is not formally binding, and there is a need for formally binding guidance. It would be helpful to have one clear rule; to that end, the ACT recommends, for the sake of clarity and ease of plan administration, that the IRS issue a revenue procedure or a notice clarifying that the definition of compensation for IRC § 415 purposes be required to be contained in the plan document.

VII. RECOMMENDATIONS - ADMINISTRATIVE

A. Expedite and Streamline Determination Letter Process

The ACT has sought out the opinions of stakeholders regarding what practical measures should be considered to expedite and streamline the manner in which the Service handles the determination letter process; moreover, the ACT visited Covington, Kentucky and Cincinnati, Ohio to get a view of the process "from the trenches." The following recommendations result from this effort:

1. Practitioners Making Multiple Filings

The ACT understands that IRS personnel working in EP Determinations currently have an informal practice of "batching" individually-designed plan determination letter requests of practitioners that file 30 or more of such requests at the same time. The ACT also understands that EP Determinations personnel also "batch" individually designed plan determination letter applications filed by the same practitioners within a 45-day period. Revenue Procedure 2005-16 contains special determination letter procedures for volume submitter practitioners and master and prototype plan mass submitters. Generally, such special procedures are tied to the volume submitters or "M&P" prototype submitters submitting opinion letter applications on behalf of at least 30 unaffiliated sponsors adopting the same basic plan document or specimen plan. Expedited and less complicated determination letter processing is available if a determination letter application involves a prototype or volume submitter plan. The ACT recommends that the current informal practice described above be continued, and perhaps be made into a more formal process and expanded. For example, the practice could also be used for practitioners filing a smaller number of plans (e.g., 10), or plans filed by the same practitioner could be routed to the same reviewer or group of reviewers, whenever filed. This reviewer or group of reviewers could be changed intermittently to avoid any potential impropriety or appearance of favoritism that might ensue over time. The ACT believes that any practice that encourages more efficient and timely processing of determination letter applications should be encouraged.

2. List Interim Amendments

Under current determination letter procedures, practitioners requesting a determination letter during the appropriate cycle are required to submit all interim amendments made to the plan being submitted since the issuance of the last determination letter received by the plan. However, under current procedures, when the IRS issues a favorable determination letter on the plan, the letter does not expressly cover the interim amendments submitted for review. The ACT recommends that favorable determination letters issued in the future expressly cover submitted interim amendments. In order to most efficiently adopt this recommendation, the IRS could require practitioners to submit a list of all interim amendments and the date of their adoption,[138] which could be referred to as a "self-identification sheet." The self-identification sheet could then be attached as an appendix to and referenced in the favorable determination letter.

3. Plan Qualification Checklist

Under current IRS determination letter procedures, practitioners are required to provide information on certain key qualification requirements through a "check the box" approach. The information provided on Form 5300 through this method addresses, for example, general eligibility provisions of the plan and the type of vesting schedule used. However, the specific plan sections that contain the particular required provisions are not required to be identified, and only a few qualification issues are addressed in the current form. The ACT recommends that a checklist be created, to be attached to Form 5300, that identifies the plan sections in which the various Code qualification requirements are satisfied, with the goal of expediting a reviewer's handling of a plan submission.

4. Eliminate Mini-Spikes

One of the main purposes of adopting the five-year staggered determination letter program for individually designed plans and the six-year staggered program for pre-approved plans was to alleviate the major cyclical fluctuations in determination letter requests following changes in law and regulations which caused the Service to divert resources away from plan examinations and towards compliance. The ACT understands that although the adoption of these programs has spread the workload for plan review over the relevant periods, the vast majority of the filings in each Cycle are submitted in the last month of the Cycle period. Thus, each filing Cycle is experiencing "mini-spikes" during the final month ending with the last day for filing for the plan sponsor's assigned Cycle.

The ACT recommends that the Service provide certain incentives to plan sponsors to file early in their assigned Cycle. One incentive that could be used to expedite the process would be to provide reduced user fees for filings made before July 1st. The ACT understands that user fees are determined by the type of case and average time spent on the case. While these characteristics would not change if a filing were made early, it appears to the ACT that the result of spreading out a Cycle's filings so that IRS

[138] This does not necessarily work for prototypes unless the IRS issues guidance specifically applicable to prototype providers. Current IRS guidance does not require the prototype provider to evidence a date of adoption on the face of an amendment. Thus, there may be many amendments to prototypes where all the Service could practically receive would be the prototype provider's assurance that the amendments were timely adopted, but no specific "date of adoption." If the process discussed herein is established, where all interim amendments are referenced in the favorable determination letter, the fact that there was no process for prototypes beforehand needs to be taken into account in a way that does not limit the scope of reliance on a determination letter.

staff workload would not see a "spike" during the last month of the Cycle may be worth the change in process that this proposal would require.[139]

In lieu of incentives, the Service could consider assigning different filing due dates within an assigned cycle year of the plan sponsor. Generally, Cycles A-E are assigned by the last digit of the plan sponsor's EIN. For example, if the last digit is 1 or 6, then the assigned cycle is Cycle A; if the last digit is 2 or 7, then the assigned cycle is Cycle B, etc. The IRS could require those plan sponsors whose EIN ends in 1, 2, 3, 4 or 5 to file during the first six months of the assigned cycle year, i.e., February 1 through July 31 and if the EIN ends in 6, 7, 8, 9, or 0, the plan sponsor would be required to file in the second six months of the cycle year, i.e., August 1 through January 31. Assuming that EINs are assigned randomly, the determination letter work load should be split between the first half of the cycle year and the second half of the cycle year, smoothing out the submissions and reducing the strain on the Service's resources.

The ACT acknowledges that different user fees and/or different filing due dates may lead to increased complexity and mistakes, but believes that, after a transition period, the benefits could well outweigh the costs.

5. Auto Closure Procedures for Certain Applications

The ACT recommends that the Service's EP Division develop "auto closure" procedures similar to what has been developed within the EO Division for Form 1024, *Application for Recognition of Exemption Under Section 501(a)*. Such "auto closure" procedures could be administered so that they only apply to determination submissions for plans which, by reason of their simplified design or lack of "risk factors", do not warrant a special review.

a. Auto closure for certain Form 5307 Filings

Based on information provided to the ACT by several managers and directors from the Service involved in the determination letter review process, it is our understanding that the Service receives a large volume of Form 5307 applications involving pre-approved plan documents with especially "straightforward" plan designs. An example of such a plan might include a pre-approved, volume submitter document for a money purchase pension plan with simplified design features (e.g., eligibility after one year of service for all employees meeting statutory eligibility requirements, 6-year graded vesting, salary ratio allocation).

We understand that the Service has developed auto closure procedures for reviewing certain Form 5307 submissions on behalf of pre-approved defined contribution plans with straightforward plan designs. We applaud these efforts and urge that "auto

[139] The ACT understands that this type of incentive – reduced user fees – was used to incentivize the use of electronic submissions by exempt organizations.

closures" be expanded as much as possible to include submissions that are relatively straightforward, such as, by way of example, those submissions that do not include elective determination requests with respect to testing demonstrations, and that do not have more than a minimal amount of amendments since the prior restatement.[140]

The expansion of an "auto close" Form 5307 review process would represent a common-sense modification to the Service's review procedures. The ACT believes that the adoption of this proposal to further streamline the review process for Form 5307 would be appreciated and embraced by the practitioner community, and would lessen the burden on the Service.

b. Auto closure for certain Form 5300 and 5310 filings

Based on information provided by representatives of EP Determinations, it is our understanding that the Service receives a significant volume of Form 5300 and 5310 submissions for individually designed defined contribution plans with a single participant or a small group of participants consisting of highly compensated employees only. Such participants, who have a substantial amount of control and influence over both the plan and the plan sponsor, do not need the same level of protection from a policy perspective that other participants generally require. Thus, the Service does not necessarily need to give the documentation for plans that benefit sole proprietors, partners or highly compensated employees exclusively the same level of scrutiny that is applied to other types of plans. Moreover, the plan designs and plan document requirements for defined contribution plans are generally less complex than those for defined benefit plans.

Accordingly, the ACT recommends that the Service implement auto closure procedures with respect to individually designed defined contribution plans that benefit a single participant or a group of participants comprised exclusively of highly compensated employees with straightforward plan designs. Just as an auto closure procedure for straight forward Form 5307 applications would lessen the burden on the Service as described in the preceding section, an auto closure procedure for Forms 5300 and 5310 would be similarly beneficial.

6. Electronic Filing Process

The IRS and other government agencies such as the PBGC (online premium filings and payments) and the DOL (EFAST Form 5500 filings) have made significant progress in the utilization of the Internet to publish forms and guidance, and to give taxpayers and plan sponsors the ability to submit filings and information electronically. Additionally, the IRS has reformed its internal processes for cataloguing and tracking determination

[140] In developing such procedures for expansion of Form 5307 auto closures, the Service should ensure that "auto closure" occurs after the expiration of the 60-day comment period prescribed under the notice to interested parties in connection with any Form 5307 submission.

letter applications through the use of the TE/GE Determination System ("TEDS") software platform.

Based upon survey responses from both practitioners and EP specialists, the ACT believes that there is significant opportunity for the IRS to further improve the determination letter application process by increasing the use of the electronic "channel." Greater utilization of electronic means for filing plan documents will facilitate and expedite Form 5300 processing by providing greater uniformity of document submissions and related demonstrations.

The IRS should establish a goal of creating an online filing system that would allow applications for determination letters by plan sponsors to be submitted through the Internet. The ACT understands that various security concerns exist, as well as budgetary constraints. Since the submission process does not necessarily include any confidential information, security concerns should be able to be addressed. Any budgetary constraints that exist should be tempered by the increased efficiency of an online process that will automatically reject incomplete filings and greatly reduce the amount of paper expended.

In advance of the development of an online filing and processing system, the EP Determinations division could create Web-based "demo" forms similar to what has been done for VCP filings and the related schedules. Due to the fact that such forms require an OMB number, their usage would be voluntary (as it was done for IRS Form 8821, Tax Information Authorization) and could be provided in the popular Adobe format on the IRS's Web site.

B. Customer Service Issues

1. TEDS Improvements

a. Background information gathered

Based on observations made during an on-site demonstration of TEDS, the ACT believes that TEDS is a powerful technology-driven tool for EP specialists, allowing them to manage cases more effectively and to store and retrieve plan document information more efficiently. Although the ACT received negative feedback with respect to the usefulness of TEDS from certain EP specialists, such criticism of TEDS may have been based on a negative view of digital technology generally. EP specialists with high levels of computer literacy lauded the usefulness of TEDS. This dichotomy in the feedback provided to the ACT suggests that there may be a "generational" divide between EP specialists who are comfortable using computer-driven platforms and those who have had little exposure to such technology during their careers.

TEDS was created to implement the "paperless" system for determination letter filings and to provide for efficient storage and ease of transferring cases. However, customers have received inquiries on various occasions from DL specialists indicating that they were missing pieces of a filing that were included in the submission previously sent to the IRS, especially filings involving large, complex plan documentation. From the ACT's due diligence, it appears that in many situations, whole files were sent back erroneously and prior plan documents may have been lost.

It is our understanding that the submissions are currently being optically scanned into TEDS. Unfortunately, in certain instances, the persons scanning such documents into TEDS seem to lack training and are, at times, inputting one side only of two-sided documents and placing materials into "[o]ther documents, amendments and other categories" without noting where such items belong and whether the items are related to one another.

The ACT also learned that if plan amendments are not relabeled and broken out for TEDS, the closing letter takes longer to create, as each date must be identified properly. Previously, with paper files, an EP specialist would staple such amendments individually and pencil the date on the first page so it could be easily identified and checked by anyone reviewing the file.

Further, on TEDS, it takes numerous steps to record a simple action. For example, the ACT has learned that once an EP determination specialist receives a phone call from the holder of a power of attorney, instead of simply opening a physical folder and jotting down a comment to record the conversation, it takes six steps or more using TEDS to reflect the call.[141]

For a Form 5307 review with an adoption agreement and only a few amendments, it appears from the comments received, that the TEDS system is adequate for review, especially if the individuals inputting the documents for scanning have received proper training.

For transfer and storage, the TEDS system is extremely useful. One of the advantages of TEDS, by reason of its elimination of the Service's reliance on hard copies, is that Service personnel do not have to package and ship/mail heavy boxes or requisition large numbers of file cabinets to hold them. In addition, flexi-place employees only have to tote their computers home.

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[141] The EP determination specialist needs to log on to TEDS and then go through 3 or 4 screens in addition to creating the actual substantive entry and the time entry. By way of example, the steps are as follows:

1. Log on
2. Go to "In-box"
3. Go "My Cases" and select case
4. At the Basic Case screen, select "Case Chronology"
5. Go to "File" and click on "Create Case Chronology Entry"
6. Select a "Current role" (usually "Specialist") and "Activity" (usually "Review Case" or "Request Information").

Based on the information provided from on-site interviews, the ACT learned that TEDS cannot be used to issue favorable determination letters, although the system can be used for virtually all other stages of the determination letter process. Our understanding is that the funding for TEDS was exhausted before this functionality could be created on this new system. Thus, EP specialists are forced to create the final determination letter on the predecessor system and then import such letter into TEDS, adding an inordinately time-consuming step to the determination letter process.

In summary, although much of the feedback received by the ACT included praise for the enhanced data storage and retrieval features of TEDS, some end-users would like and have suggested certain improvements.

b. Recommendations

(i) We recommend that the IRS develop guidelines as to when EP specialists may be given the discretion to use hard copies of the plan, rather than TEDS, for example, in large complex case filings, including, but not necessarily limited to, submissions for governmental plans and multiple employer plans.[142]

(ii) From comments we have received, it is clear that in various instances the process by which documents are scanned is not working properly. Priority needs to be given to properly training "intake specialists" in the TEDS system so that errors, such as scanning only the first side of double-sided documents, do not occur. Such training should also ensure that the appropriate personnel learn how to organize, file and correctly identify different types of documents so that they can be filed and retrieved properly.

(iii) We recommend additional funding for TEDS, so that EP specialists can use this paperless system throughout all stages of the determination letter process, including the issuance of a determination letter. The current arrangement under which specialists must access the predecessor system is inefficient, and this change should be made as soon as practicable.

(iv) The Service needs to improve its scanning capabilities and, before sending a file back to the holder of the power of attorney or plan sponsor, request any missing (or lost or misplaced) documents. In addition, the Service could require a complete list of documents submitted with an application for a determination letter, and if the agent does not have a document on that list, it would be far more cost- and time-effective to have the agent provide a clear list of missing items and give the holder of the power of attorney or plan sponsor an opportunity to complete

[142] For example, a Form 5300 or 5310 submission with multiple sets of plan documents, each with more than 100 pages and with as many as a dozen or more amendments, should be reviewed in hard copy. Quickly flipping the pages of paper documents, which can be spread out and compared against one another, would be far more efficient with respect to both the quality and speed of the review, in comparison to the more trying task of skimming through digital images on multiple computer screens.

the application before returning it. If those items are not provided by a certain date, then the application should be returned as incomplete with the opportunity to refile.

(v) From the comments we have received, it is clear that certain EP personnel have an aversion to certain technological aspects of TEDS. TEDS software engineers should routinely reach out to EP determination letter specialists, i.e., those who actively utilize the system, for their suggestions, comments and suggested improvements. The system should be enhanced and modified to accommodate the functional needs of the end-users.

(vi) A system that allows plan sponsors to file Form 5300 or 5310 submissions electronically would eliminate the above-mentioned scanning issues altogether and would make it less likely that submission documents will be lost or misplaced. As discussed in Section VII. A. 6, above, we recommend that the Service consider establishing a system that will accommodate electronic submissions for Forms 5300 and 5310.

2. Determination Letter Database

The IRS should create an online searchable database that will allow practitioners to: (i) find information regarding the status of a determination letter application, and (ii) retrieve old and prior determination letters issued. TEDS seems to have this capability already, and all that would be required is the necessary modification for public access. Code Section 6103(e) provides that taxpayers and other persons having a material interest in a return have a right, upon written request, to inspect or have disclosure of the applicable return. Such persons would include a practitioner holding a power of attorney with respect to the determination letter submission. There are, of course, legitimate privacy concerns in the dissemination of this information (see Federal Information Security Management Act of 2002 (requiring federal agencies to implement and document security programs for their Internet-based systems and databases)). However, the Service could develop codes and passwords (e.g., IRS's acknowledgement letter could include a special code assigned to each plan for accessing the database and require the plan sponsor or authorized practitioner to obtain a special PIN number in order to access the filing) to alleviate such concerns if the Service is willing to devote the resources to this matter, which we advise it should consider given the goal of efficient administration and customer service.

3. Better Training for Reviewers

Agents reviewing submissions should be better educated on the relevant laws and, at a minimum, be able to tell the difference between mandatory and discretionary changes. This will curb agents insisting on amendments that have no possible effect on a plan. Updated and periodic training would lead agents to ask better questions and limit the agent's need to request more information from the plan sponsor.

The Service could also implement a policy under which agents may request more information or ask questions of filers twice or thrice, and then all further questions must be approved by a manager.

The goal should be that the reviewers act and behave in a consistent manner. Quality assurance across the determination letter process should be an ongoing area whereby improvement is constantly sought. Ultimately, this will create a review process that is relevant and much more efficient, resulting in a decrease in the number of submissions being open for review at any one time.

4. Cross-Functional Staffing

The survey of plan sponsors and practitioners revealed a concern with the ability of EP determination specialists to review the applications and filings of more complex and unusual plans. Clearly, within the EP Determinations unit there are highly qualified specialists who are more than capable of reviewing these types of plans, but there is not an unlimited supply.

The determination letter specialists capable of reviewing ESOPs, cash balance plans and other complex plan designs are generally at grade 13 (a grade suitable to handle complex cases). Under current union work rules agreements, pay-related limitations apply where EP Determinations personnel at grade 11 (a level that is lower than grade 13) are assigned to cases that should otherwise be assigned to grade 13 determination letter specialists.

Often, however, grade 13 specialists are required to spend at least some of their time working less complex cases, or their time is taken up in performing the more perfunctory and clerical aspects of a determination letter filing. Furthermore, grade 11 specialists are capable of working on the easier elements of the complex cases assigned to grade 13 specialists.

Thus, the ACT recommends that grade 11 specialists be assigned to work on the less difficult aspects of complex cases, leaving the more challenging aspects of the submission to grade 13 specialists. Such cross-functional staffing would provide valuable training for the less-experienced grade 11 specialists, giving them experience with plan designs to which they would otherwise have no exposure. Additionally, this type of vertical integration in case management could significantly improve the efficiency and organizational speed at which determination letter submissions are processed by EP Determinations, which should help to alleviate the backlog that is so commonly associated with more complex plan designs (e.g., ESOPs). We note that a precedent exists for this type of vertical integration in EP Determinations, as demonstrated in the handling of cash balance conversions following the relevant field directive in 1999.[143]

To test the efficacy of this proposed organizational change, EP Determinations could staff a representative sample of ESOP cases under the auspices of a "pilot" program. Under the terms of such pilot program, a pair of grade 13 and 11 specialists would be assigned to each of the covered ESOP cases. Since an ESOP is essentially a profit-sharing plan with benefits that are distributable in stock of the employer, subject to an overlay of special requirements under Code Sections 409 and 4975, the grade 11 specialist could be asked to review the profit-sharing plan elements of the plan document as well as the simpler ESOP elements, leaving the remaining components of the submission to the grade 13 specialist's review.

C. Problem Resolution – Taxpayer Advocate/Designated EP Determination Letter Specialist

The Code's qualification requirements set forth a complex and confusing set of rules for compliance. Such complexity has the potential to affect the relationship between the EP determination specialist and the practitioner representing the plan sponsor from that of a cooperative relationship to that of an adversarial relationship. Certainly, such result is not in the best interests of the plan participants, plan sponsors, practitioners or the Service. The Service has had a history of assisting taxpayers. For example, the Office of the Taxpayer Ombudsman was created in 1979 to serve as a primary advocate within the IRS for taxpayers.[144] The Ombudsman had the statutory authority to issue a Taxpayer Assistance Order ("TAO") "if, in the determination of the Ombudsman, the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary."[145] By 1996, the Ombudsman was replaced with a Taxpayer Advocate.[146]

In an effort to resolve issues efficiently and expeditiously, the ACT recommends that the EP determination letter program make more and better use of the Taxpayer Advocate,

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[143] On September 15, 1999, the Service's Director, Employee Plans, issued a field directive requiring that open determination letter applications that involved the conversion of traditional pension plans to cash balance plans be submitted for technical advice with respect to the conversion's effect on the qualified status of the plan. Thus, certain aspects of these determination letter submissions were reviewed and handled by the National Office. See also Notice 2007-6.

[144] For the history of the Ombudsman program, see http://www.taspresskit.irs.gov/TAS-History. This position was codified in the Taxpayer Bill of Rights (TBOR 1), which was included in the Technical and Miscellaneous Revenue Act of 1988.

[145] See TAMRA, Pub. L. No. 100-647, Title IV, Sec. 6230, 102 Stat. 3342, 3733 (Nov. 10, 1988).

[146] See Pub. L. No. 104-168, Sec. 101, 110 Stat. 1452, 1453 (July 30, 1996), creating the Office of the Taxpayer Advocate with rights to (1) assist taxpayers in resolving problems with the IRS; (2) identify areas in which taxpayers have had problems in dealing with the IRS; (3) to the extent possible, propose changes in the IRS' administrative practices to mitigate identifiable problems; and (4) identify potential legislation changes that would be appropriate to mitigate such problems.

when disputes arise between the assigned EP determination specialist and the practitioner representing the plan sponsor. In order to do so, the Taxpayer Advocate would need to be specifically trained in EP matters, particularly the determination letter process.

In addition, or in the alternative, the ACT recommends that a specific EP determination letter specialist or specialists in Cincinnati serve as a "facilitator" when disputes arise between the assigned EP determination specialist and the practitioner representing the plan sponsor. The position could be filled by a dedicated determination letter specialist who oversees the other specialists or one of numerous specialists who rotate in and out of such position. Hence, an informal program should be established that would involve a single dedicated EP determination specialist as the designated point person or the rotation of various EP determination specialists in such a role.

D. Off-Cycle Exceptions for Individually-Designed Plans

Generally, off-Cycle applications for determination letters on behalf of individually designed plans will not be reviewed until all on-Cycle plans have been reviewed and processed. However, in accordance with Revenue Procedure 2007-44, the following types of applications are given the same priority as on-Cycle applications: (i) terminating plans, (ii) any new plan whose next regular on-cycle submission period ends at least two years after the open submission period, and (iii) applications submitted in accordance with any published guidance requiring an off-Cycle submission in connection with a particular event. Under the current procedure, the Service will also consider priority requests for off-Cycle applications due to urgent business needs, but such applications will only be prioritized in limited cases where exceptional circumstances exist.

In light of the good faith need for determination letters before an applicable plan sponsor's next on-Cycle submission period, the Service should consider expanding the types of off-Cycle applications that should be given priority treatment. Specifically, off-Cycle filings for plans with substantial benefit changes should be given the same priority as on-Cycle applications. Furthermore, off-Cycle filings for plans directly impacted, or that will be directly impacted, by transactions in which the sponsoring or participating employer is involved, such as a merger, acquisition or other corporate reorganization, should also be prioritized. If requested, the ACT would be available to consult with the Service in determining effective standards as to which off-Cycle submissions would be granted priority.

The Service could also consider permitting off-Cycle filings during the first half of a Cycle period (to avoid mini-spikes). See discussion in Section VII. A. 4.

Various benefits practitioners have noted that off-Cycle submissions are not being processed on a timely basis. The ACT recommends the Service allocate dedicated personnel for off-Cycle applications, including but not limited to off-Cycle submissions made for terminating plans on IRS Form 5310. This proposed staffing change would be intended to reduce any backlogs in inventory and decrease the processing time for off-Cycle submissions, by increasing efficiency.

To ensure that plan sponsors do not abuse the privilege of making off-Cycle requests, the ACT recommends the Service increase the user fee for such filings. The ACT believes that a higher user fee would dissuade non-substantive filings.

E. Cycle-Changing Events for Individually-Designed Plans

Revenue Procedure 2007-44 states that an individually-designed plan's remedial amendment cycle may be changed as follows:

- If plans with different Cycles are merged, the merged plan's Cycle will be based on the EIN of the employer maintaining the merged plan.

- If an employer acquires an existing employer and its plan, the acquired plan's Cycle will be based on the EIN of the acquiring employer maintaining the plan.

- If there is a change in the EIN, controlled group status, or affiliated service group of the employer maintaining the plan, the plan's Cycle will be based on the changed EIN, controlled group status or affiliated service group.

- If a portion of a plan is spun off, the spun-off plan's Cycle will be based on the EIN of the employer maintaining the spun-off plan.

- If a plan changes its status by becoming or ceasing to be a multiemployer plan or a multiple employer plan, the plan's Cycle will be based on the plan's new status.

Depending on the EIN of the new plan sponsor or the plan's changed status, as applicable, these Cycle-changing events may force an employer sponsoring an individually- designed plan to file an application for a determination letter more than once in a five-year period, or extend the plan's open remedial amendment Cycle beyond five years.

Since the purpose of the Service's established system of cyclical remedial amendment periods for individually designed plans was to put such plans into five (5) pre-determined tranches, the ACT recommends employers, at their election, be permitted to retain the plan's existing Cycle or move to a new Cycle based on the EIN of the new plan sponsor or the plan's changed status, as applicable.

F. Plan Documentation

Good faith EGTRRA amendments and interim amendments are routinely submitted to the Service in connection with determination letter submissions, so that EP specialists can confirm their timely adoption. However, in accordance with the Instructions for

Forms 5300 and 5307, additional prior plan documentation is required whenever plan sponsors do not have a copy of the latest determination letter, or if no determination letter has previously been requested by the employer.[147] Thus, many plan sponsors who file determination letter applications have also been required to provide copies of prior plan restatements and other historical amendments, since the original establishment of the plan in certain instances.

As an internal resource for its EP specialists, the Service maintains guidelines with respect to any plan sponsor seeking a determination without the benefit of a GUST determination letter, as provided under the EP Determinations Quality Assurance Bulletin, *Verification of Prior Plan Documents in the Absence of a Determination Letter*, dated September 8, 2006.[148] Under these guidelines, if a GUST determination letter (or a GUST advisory or opinion letter in the case of a pre-approved plan) has not been issued for the plan, the specialist must request and verify all of the employer's GUST documents. If the plan was not timely amended for GUST, verification of full compliance with the Tax Reform Act of 1986, the Unemployment Compensation Amendments Act of 1992, and the Omnibus Budget Reconciliation Act of 1993 (collectively, "TRA '86") is required. If a TRA '86 determination letter has not been issued, all TRA '86 plan documents adopted by the employer must be requested and reviewed in their entirety. If no GUST or TRA '86 amendments have been made, verification of plan documentation for the Tax Equity and Fiscal Responsibility Act of 1982, the Deficit Reduction Act of 1984, and the Retirement Equity Act of 1984 (collectively, "TDR") is required only if operational violations of significant TDR-related provisions are revealed during the determination case review.

The application of this prior plan document rule is problematic, especially in situations in which the plan sponsor received a prior determination letter but is merely unable to locate a copy of it. It is not uncommon for an employer to change its plan document vendor from time to time, and it may make such change on an ongoing basis every five to ten years, or on an even more frequent basis. Due to the employer's reliance on its document provider, turnover in its human resources personnel or any number of

[147] The instructions for Line 3b of Form 5300 state, "If you do not have a copy of the latest determination letter, or if no determination letter has ever been received by the employer, submit copies of the initial plan, or the latest plan for which you do have a determination letter, and any subsequent amendments and/or restatements including all adoption agreements." The instructions for Line 3f of Form 5307 similarly state, "If you do not have a copy of the latest determination letter, or if no determination letter has ever been received by the employer, submit copies of the initial plan (or adoption agreement along with the appropriate opinion or advisory letter), or the latest plan (or adoption agreement along with the appropriate opinion or advisory letter), and any subsequent amendments and/or restatements." Additionally, the instructions for both Forms 5300 and 5307 state, "The IRS may, at its discretion, require a plan restatement or additional information any time it is deemed necessary."

[148] The EP Quality Assurance Bulletins are an internal resource tool for the Service's agents, and which may not be relied upon by taxpayers. The Bulletins are issued by the Employee Plans Quality Assurance Staff, and they cover topics of interest to ensure the consistent processing of case files by EP specialists.

additional reasons, the sponsor may not have been able to maintain a comprehensive record of its plan documents for the relevant period. Requiring copies of all applicable prior plan documents and amendments often necessitates contact with a prior document provider, which may have warehoused such documents or even disposed of them.

It is also not uncommon for one or more "predecessor plans" to be merged into a "surviving plan." Thus, when the surviving plan files for a determination, it may be required to provide copies of historical plan documents with respect to the plans that have been merged into it. Since the sponsor of the surviving plan may have little or no ongoing contact with the sponsors of the predecessor plans, this requirement may be virtually impossible to satisfy.

The prior plan document requirement is often extremely burdensome to employers, document providers and other practitioners. Additionally, this requirement can add long delays and unnecessary expense for the plan sponsor, who often has to solicit the information from a former vendor. It also delays the Service's processing time and ties up valuable resources each time a filing is delayed indefinitely as the plan sponsor attempts to track down all of the prior documents and amendments requested.

In cases where the sponsor of an individually designed plan is unable to locate a copy of its most recent determination letter, the ACT recommends that the Service limit its request for prior plan documents to the specific restatement covered by such prior determination letter and any subsequent amendments. Thus, the Service should make the presumption that any historical amendments preceding the restatement covered by the most recent determination letter are qualified as to their form and in compliance with applicable prior law. Accordingly, even though an employer in this situation would need to submit a prior restatement of the plan, it would not need to locate any historical documents and amendments that preceded such prior restatement.

With respect to an employer filing a Form 5307 for a pre-approved plan document that is unable to locate a copy of its most recent determination letter for the prior pre-approved plan document, the ACT recommends that the Service make the presumption that the prior plan document covered by such determination letter is qualified as to its form, but only if (1) the sponsor of such prior plan document received a valid opinion or advisory letter with respect to such pre-approved plan, and (2) the employer furnishes evidence that it timely adopted the interim amendments required with respect to the most recent determination letter. With respect to the latter proposed requirement, in many cases, employers that are on a prototype do not adopt interim amendments, as such amendments are adopted by the prototype sponsor. To provide proof of such timely adoption, the Service could permit the employer to submit an affidavit signed by both the employer and the employer's plan document provider, third party administrator or recordkeeper, confirming that the interim amendments were actually adopted on a timely basis. Such affidavit could be based on a model form developed by the Service, with the requirement that it be signed by both the employer and the applicable provider under penalties of perjury.

As previously recommended in Section VII. B. 2., the ACT also recommends that the Service create a database that allows practitioners and employers to retrieve copies of prior determination letters in the event that the employer is unable to locate a copy.

The IRS might consider implementing an official registration mechanism for each plan sponsor adopting a prototype plan, which would be administered by the prototype sponsor. This would make the tracking of prototype plans and their compliance in form with new laws easier for the plan sponsors, the Service and the prototype sponsors.

G. Strong Interaction with Education and Outreach Determinations

1. Education for IRS Personnel

As noted above in our discussion relating to customer service issues, it appears that the IRS staff members responsible for scanning determination letter submissions into TEDS need additional training to assure that the complete document is scanned successfully and also filed under its proper category on TEDS.

Issues have also arisen with respect to the consistency of review by various IRS staff, many of whom are outside of the Cincinnati office. For example, certain agents were unaware of Announcement 2008-23, *Issuance of Opinion and Advisory Letters and Opening of the EGTRRA Determination Letter Program for Pre-Approved Defined Contribution Plans*, and its impact on submissions. In another situation, an agent requested that an EGTRRA pre-approved document be amended to incorporate the final 415 regulations, presumably unaware that such amendment was not required under the Service's most recent guidance for pre-approved plan documents. In both cases, the practitioner needed to send copies of these IRS pronouncements to the agent.

A lack of consistency also exists with respect to the scope and nature of informational requests made by IRS personnel in connection with the review of submissions, and the manner in which such requests are communicated. Certain agents consistently ask for proof of compliance with the GUST RAP, while others request only copies of interim amendments. In situations where a submission fails to include the user fee, certain IRS staff will simply fax a request for the fee, while others will return the entire filing and require a full resubmission with the proper user fee. Furthermore, certain IRS staff make requests for information or plan document changes over the telephone, rather than making such requests in writing. Such verbal communication can be imprecise, and may be challenging in situations where it is difficult to understand the reviewer due to language barriers. The ACT also notes that faxing or emailing a request for additional information provides the applicant with additional time to respond, since the postal mailing of such request effectively takes up to seven to ten days of the allotted response time.

The ACT recommends that additional training be given to input takers in the TEDS system. Additional training is also recommended for the DL specialists submissions, to assure that they are aware of all current pronouncements from the Service regarding submission requirements. Guidelines should also be provided to DL specialists, to assure consistency with respect to the type of follow-up information or action required of applicants, and to assure consistency with respect to the manner in which such requests are communicated to applicants. Specifically, DL specialists should be instructed to make requests for additional information or plan changes in writing, and to use fax or email in lieu of telephone requests whenever possible.

2. Education and Outreach for Plan Sponsors and Practitioners

a. Current interim amendment rules

There is confusion on the part of plan sponsors and practitioners with respect to the rules for determining applicable remedial amendment periods and the related interim amendments. For example, at least one prominent government official has stated that a sponsor of an individually designed plan who timely files a Form 8905, *Certification of Intent to Adopt Pre-Approved Plan*, and then timely adopts a pre-approved plan document, may still have a qualification issue to the extent it did not timely adopt the interim amendments required for the pre-approved specimen document. This statement was made without support from any published guidance for this position, causing confusion over the application of the RAP rules with respect to plan sponsors converting from individually designed plans to pre-approved plans.

The classification of amendments as either a "discretionary amendment" or a non-discretionary "interim amendment" is another area of confusion for plan sponsors and practitioners. For example, there is no clear guidance on whether the optional provisions in a compliance amendment relating to the final IRC § 415 regulations were, in fact, subject to the same adoption deadline for non-discretionary provisions (which were required to have been adopted by the due date of the employer's 2008 tax return in the case of plans with calendar plan and limitation years). Informal guidance from the Service suggests that such optional provisions did not have to be amended by this deadline, but practitioners remain uncertain in the absence of any formal pronouncement from the Service on this matter.

It is our understanding that the Service encounters numerous issues and makes administrative decisions relating to interim amendments, remedial amendment periods and other similar issues. The ACT believes such information would be especially useful to plan sponsors and practitioners. Thus, the ACT recommends that the Service publish more specific guidance on the substantive and procedural issues addressed in this Report. This guidance should be in writing so that all applicants have access to the same information. This recommendation should not be construed in a manner that discourages the ongoing communication between the Treasury and the Service and the rest of the benefits community, such as the informational exchanges that occur through bar association, accounting and actuarial meetings. However, if administrative decisions have been made on specific issues, it would be helpful to publish them in the Service's newsletter or other publications, with the appropriate caveats. As discussed elsewhere in this Report (Section VI. B.), so long as the interim amendments continue to be required, the Service should develop for each Cycle the necessary amendments, an example of which is contained in Section IX. H. hereof for Cycle D.

b. Communicating best practices for DL filings

The ACT further recommends that the Service issue a list of the "top 10" or "top 20" mistakes made when applicants file for determination letters, and describe the "best practices" for how such mistakes can be avoided, or if need be, corrected.

Based on conversations with representatives of EP Determinations, it is our understanding that, whenever the Service makes a written request for additional information to the applicable employer or its representative, an Applicant Identification Sheet ("AIS") is generated with a unique bar code. The AIS accompanies each written request made by the Service, and the information requested by the Service is supposed to be returned together with the AIS. Employers and practitioners are asked to return the AIS along with the requested information, so that this new documentation can be scanned electronically on TEDS and filed under the correct case file. However, employers and practitioners are unaware of the significance of the AIS, and the ACT recommends that the Service increase awareness of it within the benefits community by publicizing the importance of returning the AIS (along with any requested information).

In the course of discussing the capabilities of TEDS with EP Specialists, it was communicated to the ACT that supplemental information provided in the form of a "footnote" on the pages of a Form 5300 or Form 5307 is not easily scanned and filed onto TEDS. It would be much more helpful, from a processing standpoint, if applicants included any supplemental information for their determination letter submissions as separate attachments, rather than including such information as footnotes on the actual pages of the Form. The ACT recommends that the Service make this clarification in the instructions to the relevant Forms.

H. Increased Staffing for EP Determinations

As noted above, EP Determinations has a backlog of cases and it does not expect to meet its objective of closing determination cases within one year of the end of the each applicable Cycle based on its current staffing levels. In addition, although the new staggered determination letter procedure has leveled out the number of individually-designed plan submissions across multiple Cycles, EP Determinations continues to experience "mini-spikes" in the volume of submissions at the end of any individual Cycle.

The ACT does not believe that EP Determinations will be able to eliminate the backlog of cases without additional funding and staffing. We recommend that the funding for EP Determinations be increased, enabling it to hire and train additional determination letter specialists with the requisite expertise to review additional cases.

To address the problem of mini-spikes in the volume of submissions at the end of each applicable Cycle, the ACT recommends that the Service consider creating a "variable workforce" within EP Determinations which could increase in size to accommodate any such mini-spikes in the future. Variable staffing for determination cases could be achieved by having EP Examinations personnel rotate through EP Determinations on a pre-determined basis at the end of each Cycle whenever mini-spikes are expected to occur. Such experience and cross-functional training could be valuable for EP Examinations personnel, and the additional staffing would help EP Determinations eliminate its growing backlog of cases.

VIII. CONCLUSION

This Report, which was developed collaboratively with the IRS, was prepared with the goal of improving the Service's new staggered determination letter program and ensuring that it will function as efficiently as possible and that it will promote the viability and vitality of the employer-provided private retirement system. The recommendations made by the ACT in this Report were formulated after careful consideration of the comments and supporting information submitted from various stakeholders in the benefits community. Such commentary was submitted in response to the ACT's surveys and interviews, enabling the ACT to collect invaluable insights from all types of plan sponsors, benefit practitioners and plan service providers, as well as from members of the Service and Treasury.

As discussed at length in this Report, the overwhelming majority of survey respondents spoke extremely negatively about the interim amendment requirement. Many thought that the applicable rules are difficult to manage, resulting in unnecessary additional costs to plan sponsors and increasing the likelihood of missing an amendment or filing deadline. It is our view that these requirements and certain other aspects of the existing determination letter program are placing the current pension system at risk, and the program can and should be reformed as soon as practicable.

The recommendations in this Report include proposals for changing the interim amendment requirement as well as specific proposals for improving and further streamlining the determination letter program. Given the considerable deliberation, effort and care with which the Report was prepared and the overwhelming amount of commentary provided by survey respondents requesting that changes be made to the current program, we respectfully request that the Service consider modifying the program in accordance with the ACT's findings and the recommendations presented in this Report.

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Appendix A. List of Persons Who Provided Input and/or Were Consulted

1. Government

- Margaret Bisberg, EP, Employee Plans Compliance Unit
- George H. Bostick, Treasury, Office of Tax Policy, Benefits Tax Counsel
- William Bortz, Treasury, Office of Tax Policy, Associate Benefits Tax Counsel
- William Evans, Treasury
- James Flannery, TE/GE/EP
- Ingrid Grinde, EP, Rulings & Agreement
- Joseph Grant, Deputy Commissioner, TE/GE
- Sarah Hall Ingram, Commissioner, TE/GE
- Mark Iwry, Deputy Assistant Secretary for Retirement and Health Policy, Department of Treasury
- Dan Jones, EP, Manager of Determinations Quality Assurance
- Michael Julianelle, Director, EP
- Joyce I. Kahn, EP, Acting Manager, Technical Guidance and Quality Assurance; Manager of Voluntary Compliance
- Donald J. Kieffer, Area 1 Manager (acting), EP Determinations
- Louis Leslie, TE/GE, EP, Senior Manager
- Nancy Marks, Office of Chief Counsel, Deputy Chief Counsel, TE/GE
- Helen Morrison, Treasury, Office of Tax Policy, Deputy Benefits Tax Counsel
- Robert Noonan, Jr., EP, Program Evaluation and Risk Analyst
- Mark O'Donnell, Acting Manager of Voluntary Compliance
- Sylvan J. Oppenheimer, EP, TE/GE
- Cathy Pastor, IRS, Office of General Counsel
- Michelle Pendzick, EP, Lead Program Evaluation and Risk Analyst
- Martin Pippins, EP, Manager of Technical Guidance and Quality Assurance
- Michael D. Sebastiani, EP, Acting Director of Planning
- Paul T. Shultz III, (retired) former EP, Director Rulings & Agreement
- Margo Stevens, Esq., IRS Office of Chief Counsel
- Vickie A. Surguy, EP, Manager of Determinations
- Monika A. Templeman, EP, Director of Examinations
- Joanna (Crickette) H. Weber, Area 2 Manager, EP Determinations
- Harlan Weller, Treasury, Office of Tax Policy, Actuary
- Ruth Williams, EP, Actuary
- John Wright, EP, Employee Plans Compliance Unit

- Andrew E. Zuckerman, EP, Director of Rulings & Agreements

2. Private Practice

- Barbara J. Avard, Charlotte Firefighters' Retirement System
- Michael L. Bain, CMC Retirement & Employee Benefits
- Holly Bander, Employee Benefit Resources, LLP
- Susan Barrett, Hawker Beechcraft
- Carol Buckmann, Osler, Hoskin & Harcourt LLP
- Melanie Buschmeyer, Kravitz, Inc.
- Penny Butler, Independent Actuaries, Inc.
- Nita Cahn, Amstar Group, LLC
- Paula Calimafde, Esq., Paley Rothman
- Alison J. Cohen-Jang, Transamerica
- Rhonda L. Corbitt, QPA, QKA, Financial Decisions Group, LLC
- Theresa Corona, Leonard, Street & Deinard PA
- Christine Daly, Holme Roberts & Owen LLP
- Rebecca Davis, Esq., Pension Rights Center
- Mark S. Dray, Esq., Hunton & Williams LLP
- Thomas Farnham, Esq., The Farnham Law Firm
- John A. Feldt, Kidder Benefits Consultants, Inc.
- Robert A. Ferencz, Sidley Austin LLP
- Stephen Ferszt, Wolff & Samson PC
- Michael Finch, Ascensus
- Ellen A. Fredel, Ellen A. Fredel, P.C.
- Lisa Germano, Actuarial Benefits & Design Company
- David Gordon, Esq., Frederic W. Cook & Co.
- Mark Greer, Esq., Greer Benefit Consultants, Inc.
- Dodi Walker Gross, Esq., ReedSmith LLP
- Brian H. Graff, Esq.
- Peter Gulia, Fiduciary Guidance Counsel
- Evelyn A. Haralampu, Esq., Burns & Levinson LLP
- Edward Heintzberger, HPnorthwest
- Richard Herdich, Creative Pension Design, Inc.
- Lanning R. Hochhauser, Esq., DATAIR Employee Benefit Systems, Inc.
- Guy Hocker, Benefit Planning, Inc.
- Craig P. Hoffman, Esq., ASPPA
- Peter Huntting, Peter L. Huntting & Co., Inc.
- Jan Jacobson, American Benefits Council
- Amanda Jaffe, ADP Retirement Services
- Thomas A. Jorgensen, Esq., Calfee, Halter & Griswold, LLP
- Alan H. Kandel, Husch Blackwell Sanders LLP
- Sharon Kennedy, Matthews, Gold, Kennedy & Snow, Inc.

- Laura Kenney, OneBeacon Insurance Company
- Deborah Kusmierz, Capital Research and Management Company
- Charles M. Lax, Esq., Maddin, Hauser, Wartell, Roth & Heller, P.C.
- David Levine, Groom Law Group, Chartered
- David M. Lipkin
- Phyllis Maley, Pension Works, Inc.
- Kenneth Marblestone, Esq., The Mand Marblestone Group LLC
- Alson R. Martin, Esq., Lathrop & Gage LLP
- Pamela Marlin, The McKeogh Company
- Steve McInally, Aon Consulting
- Suzanne Meeker, Verrill Dana, LLP
- Joy M. Mercer, Esq., Joy M. Mercer, P.C.
- Kari Middleton, Merrill Lynch
- Judy Miller, ASPPA
- Cynthia Moore, Dickinson Wright PLLC
- Cam Moultrie, LL.M. candidate, The John Marshall Law School
- David Mustone, Esq., Hunton & Williams LLP
- Carol L. Myers, Myers & Shaw, P.A.
- Curt A. Oppel, Stanley, Lande & Hunter
- Renee W. O'Rourke, Greenberg Traurig LLP
- Marika Ostendorf, Baldwin Law Group LLP
- Samuel J. Palisano, Harter Secrest & Emery LLP
- James Paul, Esq.
- Susan Perry, E.A. Edberg Associates, Inc.
- Beverly Platt, Karel-Gordon & Associates
- Marc Purintun, Esq., Hunton & Williams LLP
- Kathryn Ricard, ERIC
- Robert M. Richter, Esq., SunGuard Relius
- Jay Ritter, Esq., Hunton & Williams LLP
- Richard A. Rogers, Jr., Esq., Wyrick Robbins Yates & Ponton LLP
- Irwin N. Rubin, Esq., Danziger & Markhoff LLP
- John Sample, The Vargo Company
- Pat Scahill, Nyhart, Inc.
- Eric Scarmardo
- Donald Segal, JP Morgan Chase
- Harvey Shifrin, Chuhak & Tecson, P.C.
- Patty Shlonsky, Ulmer & Berne LLP
- James Silverman, Rhoades & Wodarczyk, LLC
- Dale F. Smith, OPA, Pension Plan Professionals, Inc.
- Alan Stonewall, Independent Actuaries, Inc.
- Ruth A. Streit, Thompson Coburn LLP

- Henry Talavera, Esq., Hunton & Williams LLP
- James Turpin, FCA, The Turpin Consulting Group, Inc.
- Barrie K. Watson, Esq., Pullman & Comley, LLC
- Robert C. Wender, Wender & Company
- Gary L. Yerke, Vice President and Associate General Counsel, Fidelity Investments

3. Private Organizations

- American Benefits Council
- American College of Employee Benefits Counsel
- American Institute of Certified Public Accountants (AICPA)
- The American Society of Pension Professionals & Actuaries (ASPPA)
- The ERISA Industry Committee (ERIC)
- The Group, Inc.
- IRS Determination Letter Liaison Group
- Pension Rights Organization

Appendix B. Memorandum from Vickie A. Surguy to EP Specialists

From: Surguy Vickie A [mailto:Vickie.A.Surguy@irs.gov]
Sent: Tuesday, December 01, 2009 2:58 PM
To: &TEGE:EP:RA Determ Ees
Cc: Julianelle Michael D; Zuckerman Andrew E; Riddle John G; Scott Debra C; Adam Debbie A; Payne Nancy E; Pyrek Steve J; Belscher Michael C; O'Reilly Sean E; Marcia Wagner; Kennedy, Kathryn; Barbara Clark; Mike Spickard; Danny Miller; Susan Serota; Banks Laura L - NTEU Chapter 9 President
Subject: Comments Requested on Staggered Determination Process - Response Due 12/11/09

Hello All,

The IRS Advisory Committee on Tax Exempt and Government Entities (ACT) is studying the determination letter application process and is interested in your feedback. Just click on the link below to provide your comments to three questions regarding the Staggered Determination Letter process.

Using this online form will allow you to anonymously provide your feedback. The sender's email address is automatically removed from the form when the "Send" button is pressed. If you prefer to receive a personal e-mail response, provide your e-mail address within the body of your message. Please complete and submit your feedback by 12/11/09. Thanks in advance for your participation.

http://tege.web.irs.gov/templates/EmpPlansHome.asp?MWContent=../content/EmpPlansMainWindow/linkedHtmlDocuments/determs/Survey_EP.htm

If you encounter any technical problems with the survey, contact Bill Anderson on (513) 263-4687.

Vickie Surguy
Manager, EP Determinations

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Appendix C. Transcript of EP Specialist Survey Results

The ACT Committee EP Determinations employee survey was administered on-line from December 1, 2009, through December 11, 2009. The survey requested anonymous employee feedback on three areas posed by the ACT committee. We have summarized the responses, but also included the verbatim comments for the following:

1. Remedial and interim amendment requirements.

2. Staggered timing of the current cycle filing process.

3. The determination letter process, including the time it takes to process an approval letter.

For each question, we received between 15 and 19 responses. With respect to the remedial and interim amendment question, we received 17 responses. The common theme seems to be that the current system is confusing and complex. In particular, there were comments indicating that the required amendment deadline is not always articulated clearly and that it would be helpful if there were an up-to-date listing of each amendment requirement for a given cycle, consisting of amendment deadlines and effective dates. A suggestion was also made that model language be published for each interim amendment. This listing could be maintained on irs.gov and be accessible to practitioners.

The staggered timing question received 15 responses. Again, the overarching theme is that the staggered filing system is complex and confusing. In particular, it was suggested that the 5-year cycle system contains too many exceptions, thereby adding to the confusion. Additionally, by having a mixed inventory of cycle uses, one agent noted that agents have to constantly "switch gears" as they work different cases from different cycles. As a result, agents are continually having to review materials in order to ensure that they are getting the correct requirements for a given cycle. Finally, a couple of responses noted the difficulties created by the lack of staffing necessary to properly handle the determination letter workload.

The determination letter processing question received 19 responses. Several of the responses focused on the technology (including TEDS) being used to process cases. These responses indicate that agents feel the current processing systems increase the amount of time it takes to process cases. Additionally, the responses noted that the practitioner community plays a significant role in timeliness of response. In particular, responders noted that the completeness of an application when submitted has an impact on the amount of time an application takes to process. Also, the tendency on the part of practitioners to file applications within 2 weeks of the end of a given cycle creates mini-spikes that are difficult for the Service to absorb.

The verbatim responses for each question are listed below.[149]

A. Remedial and Interim Amendments:

1. No Comment - this seems to be an area that should strictly be left to the comments by the Plan Sponsors & their representatives.

2. Legislation should be very clear as to when a plan must be amended for the applicable provisions. For example "end of the first plan year beginning on or after January 1, 2007" is clear, whereas "When Prop. Reg. §§ 1.430(f)-1 and 1.430(h)(3)-2 are finalized, those final regulations will not apply to plan years beginning before January 1, 2009" is not.

3. Confusing! Need a Web page that addresses all of them together with their execution deadlines and effective date deadlines. If you have a Web site on irs.gov you can continuously add new amendments as they are created. This is the biggest problem I have, it takes a lot of time to constantly request these and explain to POAs why they need certain ones. Something in plain English needs to be put in an easy place to find.

4. The requirements for remedial and interim amendments is cumbersome and as we progress with the cycles it becomes more and more burdensome.

5. Employee rights are derived from interim amendments. Plans should have to be amended annually (for discretionary amendments) and as required by law (interim amendments) so that employees can enforce their rights. This is a basic part of ERISA and is the backbone of a strong national retirement system. Bending over backwards to caveat letters to keep practitioners happy is another issue. That issue should be addressed separately and I resent that this survey rolled the areas together. It seems as if the intended results might be targeted. Remedial amendments are very necessary because practitioners do such a poor job with plan language. Removing the ability to correct language mistakes would result in many more disqualified plans and/or Voluntary Compliance submissions. It's odd that remedial amendments would be included as a source of concern or an area where suggested improvements might be needed unless the intention is to remove the current requirements on being eligible to make remedial amendments and open the process up. This would work to remove employee rights and remove stability from the system.

6. Concerned that we are inconsistent from group to group in what we caveat.

7. The interim amendment requirement added a whole new complexity to the determination letter requesting process with respect to a Qualified plan.

[149] A few typographical errors and obvious grammatical and wording errors were corrected in the transcript in order to promote readability of the responses.

8. These amendments should be included in the restated plan in a red-lined version to make them easier to locate.

9. I believe that the Interim and discretionary amendments are only setting people up to fail. One amendment not executed within the time frame, possibly yearly could cause the plan to fail 401(a) and it is only a matter of time before a plan will fail to execute a necessary amendment. People had a hard enough time executing the GUST document timely and accurately, much less interim amendments. More changes will require more administration of the plan and therefore more of a cost burden to the sponsor. The higher the cost, the more people will end their retirement plan.

10. It is too difficult to do this job with all the technical requirements having regular amendments and interim amendments all due at different times for different taxpayers. I don't feel this system is working nor does the outside from the amount of complaints I hear.

11. The amendments create qualification issues and add to errors on the DL. Get rid of these amendments.

12. Although I can appreciate the desire to have the plan document be as current as possible, I feel the interim amendment requirement is too burdensome for all involved. It might work better if the Service were in a position where it could issue model or sample language for each interim along with the deadline for adopting it. I feel there is just too much confusion over what is needed in the interim as well as the deadline to adopt. With regard to the Pre-approved Plans Program, you get into issues of which interims can be adopted by the sponsor/practitioner and which must be adopted by the employer. You then have issues with the Exam function having to verify the interims were done timely which becomes even more complicated on the pre-approved plan side due to sponsors/practitioners not signing the interims they adopted on behalf of their employers.

13. Please clarify and simplify the 5307's when the POA has the power to amend. Sometimes the POA will submit one or two interim amendments and not all. There has been confusion if we should go after those not executed by the employer.

14. These areas have been discussed repeatedly and blamed for all sorts of problems with the current determination program. Interim amendments are a no-brainer. They must be retained as they are one of the few real compliance controls in our nation's retirement system. The following is an abbreviated version of ERISA: "An employer amends a plan and, due to the amendment, the employees get current and enforceable rights against the plan and the employer under ERISA. The rights are based on the terms of the amendment". Knock out the amendment step and what can employees enforce? This is such a basic foundation of 'the retirement system' it is inconceivable that it would be removed. Perhaps this keeps getting discussed because removing the interim amendment requirement reduces the burden on employers and practitioners. Perhaps the idea is to reduce responsibility and liability (in contrast to the rest of ERISA). Eliminating interim amendments and removing all 'barriers' to always

have the ability to make a timely remedial amendment make it easier to get determination letters and billing points? Yes. However the importance of that does not override the importance of participant rights and a stable national retirement system. Eliminating interim amendments and providing carte blanche to make remedial amendments seriously undermines the concepts of ERISA. Eliminating caveats for interim amendments is a separate and distinct issue. The discussion of letter accuracy and time-saving for the IRS versus what the practitioner community wants. IRS loses on that basis. IRS, just don't take a stand on these time savers if it creates a 'customer service' issue. The discussion of having the practitioner supply a caveat date list always gets bogged down with "What if the list changes? Then they have to send a new list?" If the rest of the process can work, why is that a problem? What if they failed to amend their restated Cycle C document effective 1-1-2009 for JCWAA's 'severance from employment' effective 1-1-2002? They have to send a retroactive amendment. No big deal, it's a proposed amendment, no new list is needed. Remember that the list of amendments and dates comes in with the application. It should be certified as correct and submitted under penalties of perjury as part of the application. When we find issues, I doubt we will get too much grief on getting a correction. If we don't get what we need in a week or so we can close the case incomplete and answer the follow-up call with "yes, we mailed the entire application package to your client because we didn't hear from you".

15. It certainly has complicated the applicable remedial amendment period and the timely adoption of amendments necessary for qualification. To make the matter more complex, laws enacted such as PPA and HEART allow plans to operate and amend later.

16. There is much confusion both internally and externally on when these need to be adopted, what needs to be submitted for a ruling and then what should be listed on the determination letter.

17. The entire process is too complex. It's too easy to miss a required amendment etc.

B. Staggered Timing of Cycle Filing Process:

1. No comment - the old system didn't work & this doesn't appear to be a great improvement but I don't have any solutions.

2. Confusing when processing cases as your mindset must change from one case to another if working Cycle B cases and then getting an older Cycle A case assigned or mixing different cycle cases. Especially difficult with terminating plans being subject to current law not being ruled on in other cycle cases and then throw in off-cycle cases and M&P plans and each case is completely different and you cannot develop any momentum reviewing plans for similar requirements. Very confusing. Old method of everybody had the same deadline was much easier to process applications.

3. Bad thing is everyone waits until the deadline for that cycle to submit because the requirements are always changing.

4. The staggered approach does not work. It is confusing for everyone and has created more delays in processing cases, not less.

5. The idea to spread out the workload and break it into orderly segments is a good one. That does not mean that the current process of determining the stagger cannot be improved. It would likely be more efficient to stagger by practitioner/submitter instead of EIN. That way all of a firm's plans can be worked more efficiently from the Service point of view. The current process could be much improved by requiring the applicants to restate for the entire cycle. The Service would review one document that includes all changes, additions, deletions, etc. in context instead of the changes (interim and discretionary) to the prior document and then the restated document.

6. The new staggered timing cycle filing process creates a new set of problems by creating a log jam of cases we never seem to get to because they are submitted off-cycle. Each cycle seems to have a snow-ball effect on the subsequent cycle as we hold up cases pending the resolution of issues forwarded to Washington for guidance.

7. It appears that the staggered timing of current cycle plans should be different for new plan. In fact, the new plans should not have a staggered remedial amendment period.

8. I think this is a good idea, since it mandates that the plan is updated at least once every 5 or 6 years. However, there has to be a better way to update the plan other than yearly based upon interim or discretionary amendments. The expense to maintain plans has to be reasonable without too many pitfalls for (oops, I didn't execute the amendment last year).

9. I don't like the staggered process at all!

10. This has created a very complicated submission process which has not helped in the inventory levels. Rethink the entire process.

11. I think the staggered 6-year cycle system for pre-approved plan adopters works better than the staggered 5-year cycle system for individually designed plans. This is because the 6-year cycle does not have all the exceptions that exist under the 5-year cycle. Forms 5300 submitted under the 6-year cycle can get complicated as far as the plan's continued eligibility for the 6-year cycle or its conversion over to the 5-year cycle. With regard to the staggered cycle system spreading out the workload, I don't know how much has been realized here with most people waiting until the end of their particular cycle to submit for a D/L.

12. This is the only substantive change to the determination process since 1974 and was in response to the need to break the workload into manageable segments. IRS does not have the staff to do the work in bulk. IRS doesn't have the staff for the batches

in the current staggered situation - either more staff or more breakdowns of the work into manageable batches.

13. In general it has improved the overall inventory receipts at one time there are still so many exceptions that determining a proper filing cycle can be difficult to determine.

14. I do not believe it is working as it was intended. This is due to many factors which include our lack of staffing, not having the necessary materials in a timely fashion, and an inventory system which is less than adequate.

15. It seemed like a good idea in theory, but seemed to have complicated the entire process without the results that were promised. Specifically, it doesn't seem like the system is any more efficient.

C. The Determination Letter Process:

1. The cases are currently being optically scanned into TEDS (the TE/GE Determination System) which, if properly done, makes for efficient storage & ease of transferring cases as they can be shipped at the push of a button across the country. Unfortunately, the persons inputting have mostly lacked training & are haphazardly inputting 1 side only of 2 sided documents and burying anything & everything into "Other documents, amendments and other categories without noting where such items belong and whether or not the items are related to one another or not. Also, the system is impractical to work as an on-the-screen for the documents which are submitted with application Forms 5300 & 5310. The Form 5307 should require minimal review as they mostly have pre-approved documents. For the 5310 & 5300, often with 1 or more complete plan documents with more than 100 pages each and with as many as a dozen or more amendments of several pages each – these should be reviewed as hard copies which can be glanced at. Quickly flipped pages which can be spread out and compared is more efficient for both quality and speed of review as multiple computer screens are difficult to handle and read and not easy to flip. Getting hard copies to work such larger cases has been made nearly impossible as working paperless has been declared a great success by those who are promoting TEDS as a great success. And for transfer and storage (once those doing the optical scanning are properly trained – which also doesn't seem to be a priority), the system is good – the secretaries don't have to package & ship/ mail heavy boxes or requisition large numbers of file cabinets to hold them while flexi-place employees only have to tote their computer home rather than the computer & heavy cases. Also, on TEDS, It takes 6 steps to record a simple action. For example, if you receive a phone call from the Power of Attorney, instead of simply opening a physical folder & jotting down a comment to record your conversation, it takes 6 steps or so with a TEDS case. You need to log on to TEDS (TEDS logs you out within a few minutes so you cannot stay logged on) & then go through 3 or 4 screens. To get to the chronology of the case involved, you need to start at the "In-Box", then go to "My Cases", select the case which puts you at the Basic Case screen, then select the "Case Chronology" and then go up to "File" and click on "Create Case Chronology Entry" which then requires you to select a "Current Role" (usually "Specialist") & "Activity" (usually "Review Case" or "Request Information") in addition to creating the actual entry

and the time entry. When creating the Case Chronology Report, the TEDS system automatically places the report in the "Working" folder from which the report must be moved out of & moved to the "Non-Disclosable" folder or the case won't close. Also, the "Case Assignment Notices" which were sent to the Sponsor & their representative (if there was one) is automatically placed in the "Working" folder even though it clearly goes in the disclosable folder and may also temporarily block closing the case. There seems to be no sane purpose to the so-called "Working" folder other than to add steps to the process unnecessarily. If the amendments aren't relabeled and broken out, the closing letter will take longer to make up as each date must be identified properly. Previously, with paper files, one would staple such amendments individually & pencil the date on the 1st page so it could be easily identified and checked by anyone reviewing the file. For a 5307 review with an adoption agreement with only 1 or 2 amendments, the TEDS system is OK for review especially if the people inputting the documents for scanning would get proper training but otherwise the system was clearly designed with limited input from the end-users. As currently designed, TEDS adds hours to the case review time and makes accuracy of the closing letter (as the amendment, etc. dates are more difficult to accurately discern) less likely.

2. Once I receive the case file, it doesn't take long to process (unless the POA delays submitting a response). The delay seems to come before I receive the file. However, there are those applications that are so deficient that they take a long time to review, require numerous changes, may involve contacting the POA several times and delays other applications from being reviewed.

3. Administrative procedures need to be clear and in one central location like the H drive or the homepage. The thing that seems to confuse and discourage employees is the constant overwhelming inconsistency. For example: how to fill out certain forms, when to use each form, what amendments to secure, what to caveat for.

4. Cases coming in for determination letters often contain complex issues, numerous amendments, or a Demo 6, all of which take time to review for compliance, which slows down the process.

5. The submitter practitioners do not have enough responsibility placed on them to make the process more efficient. How is it possible that the Service has to secure amendments in cycle D for laws that were first effective in cycle A. The Service is getting the same mistakes in the door from the same practitioners. Submitters don't send the required information (prior law compliance/FDL, merger information, good faith amendments, proper user fee or they submit off cycle, on cycle and on cycle, off cycle with no explanation required. Receiving incomplete applications is extraordinarily inefficient for the Service and adds tremendous time to the entire process. Incomplete submissions should forfeit the user fee. The antiquated paper and or PDF file formats the Service uses to process documents is a joke and greatly adds time to what could be quicker. The Service receives plan documents electronically via fax, then prints the documents and then scans the printed documents that it received electronically into an imaged or PDF type file that cannot be manipulated or accessed with near the efficiency of a common word processing system-based file. What is even more amazing is that

upper management seems to think this is the best way to go. The Service needs to require a common format for Demos down to what information goes in what column and the ability to receive and review electronic spreadsheets as opposed to images of spreadsheets. Numerous practitioners try to slip things into determination applications to attempt to get them covered in a determination letter that make the entire process time consuming and slow. For examples - see cash balance conversions, ESOPs in general, Sub-S Corp ESOP, ROBS. Part of the slowness of the process is due to the Service dealing with these situations. The Service can handle all of this but it takes one heck of a lot of time. It should be noted that this slowness is caused by practitioners taking advantage of the system. More trained staffing on the part of the Service would speed things up.

6. I am concerned that quality is suffering in order to meet the quantity.

7. The application process is basically the same with new additional wrinkles. Is fairly quick if the correct information is filed.

8. Approval letters should be also classified also as actual determination letters to save time on processing pre-approved plans.

9. I believe that once we have a working and efficient system in place the cycle time will be reduced. However, when the TEDS/EDS system drops a plan the cycle time will go up. A case which sits on the shelf for a year (5310) without anything being done to the case is not a good system. If the TEDS system will be the official database of record, there needs to be a system of Internal Control to identify and handle cases anytime they are failed out of the TEDS system. Once everyone has mastered the TEDS system and all the bugs are out, then it will help save money in moving cases around. Well, that is my two cents worth, I hope it helped.

10. It takes me so much longer than ever because I have to research and double check everything I do on every case since nothing is uniform any longer.

11. Increase staffing.

12. This is dependent upon the tools (most notably the Alert Guidelines) being updated timely for each cycle's Cumulative List. The cycle system requires a different version of the Alert Guidelines to exist for each 5-year cycle. This becomes confusing to specialists. Additionally, with there being so many Alert Guidelines, updating or creating a different version of the Alert Guidelines for each cycle becomes a large task.

13. The process that is the most time consuming is the process before we get the plan. We have no control over that. perhaps there should be a liaison person between TE/GE and the processing center in Covington. There should also be set times set for POAs to respond before the case is sent back.

14. IRS must modernize its internal processing system. It is in the dark ages of technology. Some of this is due to previous security issues and concerns. However, if General Electric can file a 25,000 page tax return completely electronically, it seems

that the IRS could move past that for retirement plans applications. The current TEDS system is the foundation of a great idea. However, in practice, the process is really based on antique technology and practices. A great deal of time is added to the overall process for each determination letter because IRS tries to be all things to all customers. IRS spends time perfecting applications that are incomplete or don't have the right user fee. These could just be trashed to save time and a letter sent stating the defect. Currently, in order to 'process' an incomplete application that is to be returned the IRS has to order the paper case, wait for it to be found and prepare a package to return the material and user fee. It would be quicker to just send a letter. Practitioner copies can be resubmitted, the user fee is used due to the incomplete application. Alternatively, incomplete applications that need to be perfected could have a letter issued, be held for two weeks to wait for the needed info and charge 4 or 5 times the user fee (an incomplete penalty) if a letter is still wanted. Eliminate and/or penalize off-cycle filings to speed up the process. It is extraordinarily inefficient for the IRS to perfect applications and also have to file, track and store off-cycle applications. This all takes resources away from processing cases that could be worked and closed. Another inefficient use of resources is issuing individual determination letters for adopters of pre-approved plans that have no deviations from what is pre-approved. The ruling basically means that the practitioner filled in the allowable options in accordance with what was pre-approved. What a waste of time, but the practitioners want this service so the IRS continues to offer it. Coverage and nondiscrimination tests add to the processing time for several reasons- (a) Practitioners routinely do not submit all of the required information and agents try to work out or interpret the missing info from what is submitted. (b) the formats for providing the demonstration information are widely varied and do not clearly state each step or item of required information. Requiring a standard format for Demos would address about 90 percent of the testing work and greatly speed the process. The IRS and or the ACT could come up with a standard format (or two) and require that the standard format be used to get a ruling on nondiscrimination or coverage. A standard order of plan documents would be a help to more efficient processing. Putting some burden on practitioners to actually improve the work product that is submitted to the IRS would improve the speed of the process. Why is it the IRS's responsibility to keep requesting changes for items that should have been "corrected" after Cycle A? We are seeing plan documents submitted by larger volume practitioners and adopted by clients on 1-31-09 that have to be amended to comply with the JCWAA change to 416(g)(3) effective 1-1-02. What a huge waste of time and resources on the part of the IRS (but absolutely no burden on the practitioner). Charging a user fee or instituting a penalty of $5,000 for each change like that would reduce the amount of burdensome, nagging, process delaying changes that have to be handled. The IRS partners/customers should have to do their share to improve the time of the process. Fringe ideas and concepts also add time to the overall process for each application because these things require the IRS to apply top resources to address them. Practitioners (in general and as a stereotype) seem to have the mentality of "when in doubt, get a determ letter". Check out what's going on with S-corp ESOPs for an example of a huge delay to the process. An amazing number of items that should be the subject of extensive legal research and positioning and would be appropriate for the formal private letter ruling process are submitted in routine determination letter applications with the expectation that the IRS should hurry up and issue a determ letter. As a result, many of the most talented IRS processing staff are bogged down with those complex issues. Another example - cash balance conversions. The IRS should have the ability to elect not to provide determination letters in certain situations. If a practitioner wants to take their client into such a situation, no problem. However, it will be without the 'benefit' of a determination letter. If a bank won't lend to an ESOP without a determ letter, it's not the IRS's problem. The practitioner community has not done anything to address promoter schemes in a number of areas in employee plans work. Some harrumphing and throat clearing has occurred but not one item of formal admonishment or even caution has been publically issued by any formal practitioner based group or association (ALI-ABA, AICPA, ABC, etc). The IRS, in accordance with its mission, must spend resources on these schemes which slows down routine case processing. An impression would be that the ACT really isn't concerned with 'partnering' with the IRS to fulfill the IRS mission, or even contribute to an efficient system of providing determinations, or improving the material submitted to the IRS. The ACT just wants determ letters issued faster and its own members' burden reduced. No mention of case quality and compliance items, this survey is solely about burden on the practitioners (amending plans) and getting letters faster. Hopefully, the ACT will share its ideas and recommendations with the IRS staff for similar comment - and consider feedback - before issuing their final report/demand. This survey is likely just a step to gain information to say that IRS staff has 'common concerns' in support of the steps that the ACT will institute/propose to reduce practitioner burden and speed up getting determination letters (i.e., billing points and liability releases).

15. At present we only comment on amendments dated after the last determination letter. Sometimes amendments are done that could slip through the crack which could be important. Therefore I think everything not ruled on by the last determination letter REGARDLESS of date should be ruled on in the present letter.

16. The staffing at the Service has improved but most applications are not received until the last two weeks of the cycle. The Service has been behind and can not seem to catch up before the next cycle is due. If this could be improved so would timing.

17. We continually tell the public to file early in the cycle but it does not do anyone any good. We do not have the necessary materials or the staff to work these cases if and when they do come in early in the cycle.

18. Again, the system has become much too complex. The procedures are not always clear. The time to process a favorable determination letter does not appear to have gotten shorter.

Appendix D. Survey of IRS Determination Letter Filing Program for Retirement Plans

Approximately five years ago, the Internal Revenue Service (IRS) enacted a five- and six-year cycle plan document restatement and filing process for plans seeking a favorable letter of determination as to their tax-qualified status. This process radically changed the plan document amendment and restatement process. The IRS Advisory Committee on Tax Exempt and Government Entities (TE/GE) (the "ACT") is undertaking a study of the determination letter application process, how it is working, and how it might be improved.

As part of this effort, the ACT is particularly interested in the views of stakeholders, such as employers, benefits attorneys, third-party administrators, consultants, and M&P providers regarding their experience with the determination letter process as well as plan amendment and restatement requirements.

While all input is welcome, the ACT is particularly interested in the observations, concerns, and suggested improvements in connection with the following categories:

1. Remedial and interim amendment requirements.
2. Staggered timing of the current cycle filing process (for new plans and for restated plans).
3. The determination letter application process, including the time it takes to receive an approval letter.
4. Experience with IRS personnel who review the plan filings.

To shape the direction of the ACT's further analysis and recommendations, we would appreciate your input by September 30, 2009.

Please send your response in the form of a Microsoft Word document via email to mike.spickard@summitrps.com. In your response, please indicate the type of organization for whom you work or that you represent.

If you prefer, mail your response to:

ACT
c/o Summit Retirement Plan Services
Attn: Michael M. Spickard
13680 Cleveland Avenue NW
Uniontown, OH 44685

Also, if you would be willing to participate in further discussion by conference call or attend a stakeholders' meeting in Washington DC in October 2009 or January 2010, let us know in your response (and be sure to provide contact information).

As members of the ACT, we greatly appreciate your assistance with this project.

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Appendix E. Transcription of ACT Survey Results

In preparing this report, the ACT sought the views of employers, benefits attorneys, third-party administrators, consultants, providers of master & prototype documents, financial institutions, enrolled actuaries, and other stakeholders. Survey responses follow – minor typographical, grammar and wording changes have been made to promote readability.

Questions & Responses

Topic: Remedial and interim amendment requirements. Provide any observations, concerns, and suggested improvements you might have about the remedial and interim amendment requirements.

1. It would be helpful if IRS would specify early in the amendment period what needs to be amended. For example, it's not enough to say "415 provisions to comply with the final regs". Most practitioners focused on the definition of 415 compensation, and initially did not amend to eliminate plan correction provisions for 415(c) excess until IRS reviewers requested the change. A notice specifying what changes are required would have avoided heartache.

2. It would be helpful to small business if as many amendments as possible could be put into effect without involving the business owner and his or her legal counsel. Specifically, it would be helpful if the volume submitter organization could incorporate technical amendments that do not affect plan operations for all of its clients rather than having to reach out to each one to deal with something no one understands.

3. The logic and reasoning behind the structured cycle filing method was easy to understand and seemed like a very good idea. In practice, however, it has thus far proven to be as cumbersome as the old process in many ways. The current process of requiring interim amendments to be made, even when there are no discretionary elections for the Plan Sponsor, needs to be reviewed. The costs involved in drafting these interim amendments, regardless of whether the Plan Sponsor must sign or not, starts to add up for the small business owners. As a document provider, while we try to maximize available technology to help minimize the costs to the Plan Sponsors for producing these amendments, the cost becomes significant when you are dealing with mandatory amendments on a nearly annual basis. There should be some recognition for the cost savings, as well as environmental savings, of not requiring the issuance of interim amendments that are absent discretionary elections.

4. The whole cycle system was a mistake, a classic case of trying to fix something that was not broken. The fact that sponsors must wait so many years to get approval of their plan language creates operational difficulties and uncertainties.

5. Compliance with the interim amendment requirements is very burdensome for plan sponsors. If interim amendments continue to be required, the IRS should provide a

model amendment that may be adopted by plan sponsors (at least for purposes of compliance with the interim amendment requirements).

6. I think the remedial and interim amendment requirements are necessary and important. Without mandatory updates, plan documents would be neglected and become unenforceable.

7. General sense of uneasiness about what amendments need to be made by what date. Difficulty in determining whether a legal change is "discretionary" or not, i.e., portions of the 415 final regulations were discretionary and portions were not. It would be helpful if the IRS could issue a clear and specific list of interim amendments for each calendar year no later than September 1 of each year, which would give practitioners time to make sure that all interim amendments are timely adopted by their clients.

8. First, most importantly, there is a large gap in the system right now for sponsors who timely adopt interim amendment but miss their cycle. There is no way to correct this problem - which leaves more compliant plans at greater risk than those who fail to adopt interim amendments. Second, the line between required and discretionary amendments is very vague. Code section 415 regulations were a prime example of this confusion. Third, the timetables currently in use do not work for (1) governmental plans and (2) fiscal year taxpayers. Both groups have a very tough time navigating the various deadlines.

9. It is difficult and confusing to the clients to grasp the concept of restatement (EGTRRA) going on simultaneously with interim amendment adoptions (PPA). No matter how much we would like them to understand the legal requirements for doing this year's amendments in 2 steps, they don't get it. We need a better way to incorporate interim during the restatement period into the restatement (tag along at the back, one signature only required).

10. The remedial and interim amendment requirements are very difficult to manage. Consistent with what many record keepers do, the IRS should publish a simple explanatory checklist that plans are required to complete to reflect what the administrative practices are when a new provision must be implemented, and indicating whether or not an optional provision has been adopted and the applicable effective date. Then the required amendments should not have to be made until the time for filing during the cycle filing. Some guidance would be required to determine what SPD/SMM requirements are for disclosure purposes.

11. We are deeply concerned about remedial amendment periods that end before there is any opportunity for a determination letter review. Of greatest concern are requirements to conform to regulatory requirements with no specific statutory basis. We have clients with post-EGTRRA plans that will have had no opportunity for even an initial determination letter review before the tenth anniversary of their plan inception. Nevertheless they are being frightened into believing that the IRS can force them to pay enormous sanctions for failing to comply with fairly trivial plan language requirements.

12. The Internal Revenue Service does not provide timely guidance to employers and their counsel on new legislation. The Internal Revenue Service should issue model language for required amendments that plan sponsors can use as a template. Guidance should be issued at least 6 months before the initial effective date.

13. Issue #1: Unlike the uniform pre-approved remedial amendment cycle, the deadline for interim (required and discretionary) amendments is tied to both the plan year and the employer's tax filing deadline. This creates confusion and compliance difficulties for especially those small employers using pre-approved documents as well as for pre-approved plan sponsors attempting to help these employers maintain compliant plan documents. To ensure timely adoption of interim amendments, for example, pre-approved plan sponsors must be mindful of the possibility that plans may have short plan years that begin and end in the year for which the interim amendment is required. The prototype sponsor will be unaware of the deadline applicable to an employer's income tax return for the tax year at issue. Further, many amendments include discretionary and required provisions and therefore have different deadlines creating inefficiencies, confusion and potentially increased non-compliance.

Recommendation: Similar to the uniform 6 year remedial amendment cycle for pre-approved plans, there should be a uniform date for all prototype plan interim amendments.

14. Issue #2: The volume and frequency of interim amendments not only increases the costs of administration for the employers who use pre-approved documents but also increases the likelihood of plan document failures. While recognizing that amendments to pre-approved documents once every six years is too infrequent, we believe that annual amendments are excessive and unnecessary. Even those amendments that may be adopted by the pre-approved plan sponsor on behalf of the employers result in extra costs that ultimately are born by employers and are especially onerous to the many small employers who use pre-approved plans.

Recommendation: Reduce the number of items from the Cumulative List that require interim amendments and reduce the frequency to once every three years for pre-approved plans. Therefore, an interim amendment would be required midway through the remedial amendment cycle and another would be required when the employer adopts the restated plan at the end of the pre-approved remedial amendment cycle.

15. PPA and WRERA have amendment deadlines in the code. It would be helpful if the IRS clearly specified the amendment due dates for amendments specifically required by act of congress.

16. With the cycling of restatements, interim amendments are not necessary. Previously, so long as the plan operated consistently with whatever guidance or legislation, there was no need for interim or "good faith" amendments. Only an indication of an optional provision should be necessary and that can be reduced by applying an assumed default for each such option. The interim amendment process is

costly and a burden on the taxpayer. Most interim amendments are merely technical and require no discretion on the part of the Plan sponsor.

17. The need to amend the plan every time the law changes is fairly burdensome for both document providers (such as TPAs sponsoring their own prototypes) and employers (from a cost perspective). Allowing a restatement to cover all changes since the last restatement would simplify the process.

18. What is the purpose of having five year cycles if we constantly have to make interim amendments? I am particularly upset about the 415 regulations. The 415 rules were amended in PPA '06. Why wasn't the deadline for complying with the 415 regulations extended to the deadline for making PPA'06 amendments? I feel like the IRS keeps setting up traps for the unwary. It is extremely difficult to determine what is the deadline for making every required amendment, and IRS notices don't seem to be very helpful. I particularly dislike IRS notices in which the author assumes that the reader has a photographic memory of all prior notices.

19. Please make the deadline for the amendment execution simpler. For example, in the 5-year cycle, the deadline for restating and submitting is January 31 based on the EIN. Other than the numerous exceptions that were also applied to the 5-year cycle deadline, the deadline is easy to know, since January 31 is January 31 for everyone. Also, please provide ample time for the interim amendment execution. For example, the Final 415 Regulations execution deadline was completely messed up (I think) due to the way the limitation year instead of plan year was used for determining the deadline. Also, could the interim amendment deadlines be coordinated with the six-year cycle, such that most plan sponsors are not trying to draft and restate their plan at the same time they are trying to draft and review some interim amendment? For example, if December 31, 2002 would have been last year in a six-year restatement cycle (it's just a theoretical example, go with me on this), suppose that the next interim amendments cannot be due until January 31, 2004 for regulations released before October 31, 2002 (similar cutoff as is used for the LRMs). Then the next interim amendment deadline would be January 31, 2006 based on any regulations released before October 31, 2004. That would include the mandatory rollover language. After that, the next interim amendment deadline would be January 31, 2008 based on any regulations released before October 31, 2006. Then, no interim amendments are due again until January 31, 2012 based on any regulations released before October 31, 2010 that were not already included in the restatement done in the 2008-2010 period. Some form of the above would help to make it more manageable. You could still have deadline exceptions for government plans and church plans, but they aren't in the 6-year cycle anyway. I'm just throwing this idea out there hoping someone can run with it and make an even better suggestion.

20. Stop with the required interim amendments in between restatement periods. Let everyone run on good faith and simply amend every 6 years with all law changes / modifications inclusive.

21. This has just become a trap for the unwary. Furthermore, it requires significant time and effort from TPAs and document sponsors that either cannot be charged to the plan sponsor, or piles up needless plan administration expense. While I do not feel that the requirement should be eliminated, I would suggest that the IRS publish these amendments and adopt a procedure that treats the plans as having automatically adopted them (just as the prototype or volume submitter sponsor is permitted to adopt on behalf of the plan sponsor); after all, they are to a large extent boilerplate anyway. To the extent that variations are required, the employer could adopt by merely checking a box.

22. Go back to the Paul Shultz "White Paper" concept of no interim amendments.

23. The current process is very difficult and as a result, it is very easy for clients to make mistakes. In a large organization with multiple plans and multiple companies, and ongoing acquisitions, it is very easy for clients to fail to sign interim amendments on a timely basis.

24. I think that plans should be required to adopt interim amendments on an annual basis. However, I think the list should be published by the IRS prior to 12/31, and the amendments should be due by the 12/31 of the following year. I also think there should be model amendments for all of the interim amendments (published at the same time the list is published).

25. Frequency of interim amendments is administratively burdensome - almost annual amendments (automatic rollover IRAs in 2005, final 401(k) regulations in 2006, final 415 regulations in 2008, PPA in 2009, HEART in 2010, WRERA in 2011) are required for 600+ customers for whom we provide plan document service. Many of these amendments need extensive customization for plan provisions. It's additionally difficult to provide these interim amendments while at the same time trying to prepare EGTRRA restatements for pre-approved plans and results in some client confusion - "If I'm restating my plan, why am I also amending it?"

26. The current system is not practical with interim amendments. The whole stated benefit to the 6 year cycle (mostly volume documents in our shop) was that we would get out of the annual amendment process. However, due to the lead time on volume document submissions, the restatement is seriously out of date before it is ever used. As a result, we still have annual amendments or are trying to administer a plan for years without following the document. While a complete restatement might be appropriate every 6 years, I think the Service needs to be much more pro-active and timely on advice and model amendments for the interim years. Perhaps providing an option that "you do not need to amend if you are going to apply the rules this way -- if you want one of the other choices you need to amend." It is impractical as clients move from one TPA to another to expect a document done 4-6 years from now to be able to accurately reflect administrative procedures in the past. It is a great concept but not realistic. But then several of those years are already closed for audit by the time the document is amended and looked at under audit. Thus the only year that really counts is 1 or 2

before the document is signed. i.e., A document signed in 2009, would not be part of an audit until 2011 -- and then most of the earlier years are closed.

27. The current interim amendment requirements are unduly burdensome for employers, practitioners and IRS reviewers. Amendments should be required on a set schedule –annually or every second or third year in between cycles – so that employers have certainty and can plan ahead. In addition, the IRS should be required to disclose further in advance which amendments are necessary and timely provide sample amendment text. If no sample amendment text will be provided, IRS should be required to identify which items of interest must be addressed in each amendment. Without the changes described above, practitioners are inclined to include more information than is necessary and use regulatory/guidance text to be sure to satisfy IRS reviewers - neither of those are favorable results for employers. Amendment deadlines must also be simplified so that employers and IRS reviewers know exactly when an amendment is due. Critical to the simplification is 411(d)(6) relief and a uniform deadline for all amendments (discretionary and mandatory) where possible. The current rules, designed to promote compliance by having plan documents mirror plan operation, are actually having the opposite effect due to the unnecessary complexity. Another unintended result is the cost of so many amendments - its actually encouraging employers to terminate plans.

28. "Amend by" dates for interim amendments are often confusing, especially for tax-exempt or multiemployer plans. It would be helpful to either indicate the "amend by" date within the law, reg, etc, along with the effective date OR adopt universal "amend by" dates. Currently, there are so many exceptions to the general rule that it becomes difficult to determine the "amend by" date.

29. Plan sponsors don't understand the need for annual amendments (415 in 2008, PPA in 2009, HEART in 2010, WREA in 2011) to their plan and accuse service providers of trying to line their pockets. The ability to incorporate these required amendments into required restatements would provide substantial relief and would keep small employers from terminating plans as a result of document fees. If the IRS is not willing to allow plans to wait until the next restatement cycle to incorporate all required amendments, they should be limited to no more frequently than every 2-3 years.

30. The remedial and interim amendment requirements are a good idea in theory (plan language should reflect operation on a timely basis), but burdensome and perilous in practice. Many of the amendments that have been required are strictly technical and have no impact on plan operation. It is never quite clear what the Service is looking for in these amendments and without specific guidance and pattern language it is very easy to miss something. The requirement causes additional expense and burden to sponsoring employers and adds little value.

31. The timing requirement for interim amendments is onerous, especially for small plan sponsors. Can you at least consider a 2-year period instead of every year? The timing requirement for discretionary amendments is at odds with IRC section 412(d)(2) (previously 412(c)(8)), which allows a sponsor to adopt an amendment within 2 1/2

months after the end of the plan year, and treat it as having been adopted on the first day of the plan year. Please clarify that 412(d)(2) is an exception to the timing rule.

32. It would be much simpler and stronger to make a yearly plan revision the norm. This should be in the form of a restatement EVERY year, even if the restatement confirms that nothing is changed since the preceding year. People do well with regular activities that set up an opportunity to uncover what was missed in a preceding exercise.

33. Prior to 2006, plans, in operation, had to take into account all applicable law, but plans in general did not necessarily have to be amended. Now we are having to amend a plan annually, with 1 amendment in 2007 and 3 in 2008. This requires a lot of time on our and our clients' behalf along with substantial preparation costs for small plans. The interim amendments should not have to be in writing; rather plans should be required in operation to be in compliance.

34. Requiring an amendment almost every year is time consuming and expensive for both TPAs and clients. I greatly preferred the good old days with good faith compliance in operation and picking up all the provisions in the restatements. In these times of economic hardships, employers find it hard to be constantly charged for what they see as meaningless amendments especially while we are in the midst of the EGTRRA restatement process. They do not understand why the interim amendment language isn't part of the restatement

35. The current process is incredibly confusing to employers and is very complex. There is significant confusion and disagreement on what must be done and what is optional. Many times the debate is still continuing while the deadlines are passing for employers. The deadlines are so different for the various types of organizations and the different year ends that it is impossible to set up a simple computer program to track the deadlines for clients in any cost-effective manner. In the 25 years I have practiced law, I have never seen such rampant confusion and frustration.

36. I think that Interim Amendments are too burdensome for the small employer market. The snap-on amendments we did with the GUST restatement indicating how the plan was operated during the RAP were easy to explain and simple to prepare. Trying to explain to a small employer why an amendment is required EVERY year and having to charge him a fee EVERY year is getting to be a very hard sell. Already about 3% of our employers have terminated their plans as being too costly to continue. With the interim amendments getting worse and worse this number will only increase. In addition, it is very difficult to determine what is needed and when it is needed by.

37. The fact that the IRS has stopped providing model amendments for remedial and interim amendments is very inconvenient. Also, the fact that PPA amendments (especially for Cash Balance plans) are required by the end of 2009 and we have no regulations is beyond comprehension. There has to be a delayed effective date?

38. Interim amendment requirements are confusing and something of a trap for the unwary. In many instances the required interim amendment has no substantive implications for the plan - it's merely boilerplate that has to be in the plan but that doesn't change the benefits or the operation of the plan. But under the rules, failure to adopt the amendment by some deadline that is not obvious is a qualification defect. The defect can be corrected through the EPCS by adoption of a model amendment, but it costs $375 and attorney fees. It's an annoyance to be dinged for an unimportant amendment. Under the old system all of these "housekeeping" amendments could have been taken care of at once at the end of an extended remedial amendment period - what corresponds now to the staggered period. As most defined contribution plans are now in prototypes, the interim amendments are mostly an issue for defined benefit plans, which already have heavy regulatory burdens.

39. Unclear what happens if a good faith interim amendment is timely adopted and the plan is operated in compliance, but then some part of the amendment is determined to be incorrect.

40. We feel that the interim amendment requirements should be eliminated. The required restatement every 6 years is more than sufficient. Our 230 (mostly small) clients have difficulty enough understanding why we need to restate, and then to have to follow up with amendments that are technical in nature is confusing and burdensome. We need to do everything we can to stimulate the establishment of plans for small employers and this requirement is increasing cost for minimal (and I emphasize "minimal") benefit.

41. The interim/discretionary amendment requirements are extremely burdensome and the result has been nearly every plan having to be amended in some respect every year. I am also concerned about the PPA amendments for such things as funding based benefit restrictions when we have only proposed regulations and no model amendments.

42. The interim amendment requirements are confusing and unworkable, particularly since the IRS has been less than clear and direct both in terms of specific deadlines without unnecessary nuances (e.g., 415 amendments) and actual requirements as to content of amendments. The process should be simpler, clearer, and not "got-ya" traps.

43. I think the whole system is very hard to justify to clients. Why are they paying for a restated document from 5 years ago now and why do they have to adopt all the interim good faith amendments? We have to bill them for interim as well as a restated document each cycle.

44. It is not practical to continue to require adopters of MPP & VS plans to have to adopt interim amendments. There should be a RAP that would allow all interim amendments to be adopted at the time of the succeeding restatement. This problem has existed since the early 1980's and has not improved by the new cycle methodology.

45. I find the timing requirements for adoption of interim amendments to be confusing. For instance, the timing for adoption of the final 415 Reg amendments have, or had, so many caveats (plan year, tax year, anti-cutback, etc.) that made it difficult to track each client's required adoption date. At least the timing a discretionary amendment is clear and easy to convey to clients. My clients and I find it administratively burdensome for the need to adopt interim amendments on an annual basis, if not more frequently. Do all these amendments really help with the retirement savings and accrued benefits of the participants? Instead, these amendments add to administrative cost and hinder the continuation of sponsorship of qualified plans by small businesses. I suggest that we go back to "old days" when plans ran on good-faith compliance and require that interim amendments be adopted when the documents are restated. Pre-approved plans will still need tack-on amendments at the time of adoption.

46. There are too many amendments. We are amending plans every year. In this economy, this is causing clients to get irritated and frustrated. Couldn't remedial and interim amendments be made less frequently? Voluntary amendments are one thing, but amendments for legislation or regulation being an annual event is extremely unpopular with plan sponsors.

47. Interim amendment requirements are very confusing to clients who are also generally not happy about paying to have their plans amended every year. If you are late on a required amendment, the client has a hard time understanding the need to do VCP for late amender, and then understanding the importance of the VCP compliance statement for later determination letter applications. If a client misses the right cycle, there is no good alternative for the client to obtain a ruling on their plan.

48. While the staggered remedial submission cycle is helpful, the schedule for documenting interim and discretionary amendments remains burdensome. It would be beneficial to practitioners and clients if all amendments, or at the very least all interim amendments, were required to be documented at the end of the five-year staggered cycle. Clearly, plans would have to be operated in accordance with required changes as they became effective, but clients would not be burdened with the cost of annual plan amendments.

In the event that annual amendments remain the norm for interim amendments, we recommend that the deadline for documenting both interim and discretionary amendments be a single date that does not coincide with the last day of the plan year. Most plans operate on a calendar year basis, and December is generally hectic enough with transactional work, year-end projects and the holidays without the added challenge of documenting plan changes.

We suggest a simple execution deadline that either: (1) coincides with the extended due date of the tax return of the company for the year in which the plan year ends, regardless of whether the company actually files for the extension (instead of penalizing companies that timely file returns); (2) is 8½ months after the end of the plan year in which the amendment is due, taking the company's fiscal year out of the equation altogether; or (3) is a single due date each year (other than January 31 or December 31).

At any rate, the current method for determining the due date for adoption of some plan amendments (the 415 amendments, for example) is overly complex and a landmine for error. Imposing deadlines that are dependent on different events (i.e., plan year, calendar year, fiscal year, tax return due date, tax return due date plus extensions) results in countless hours (and our clients' money) spent trying to determine amendment deadlines.

49. For a sponsor of prototype plans, as well as a service provider to individually designed plans, the dual-cycle approach has been extremely time-consuming and confusing. Our plan clients are confused as well, and many complain they are overburdened by near-constant need for amendments and restatements. The old system was much better, more efficient and less burdensome. Of course, it is Congress, Treasury and DOL, not the IRS, which continues to change applicable requirements that results in the non-stop amendment treadmill.

50. I like the idea of having staggered RAPs - it is workable and makes for a more even flow of deadlines and compliance timing. However, a number of us find the interim amendments difficult to administer (e.g., working at various compliance deadlines). Perhaps we can consider alternatives to the interim process (e.g., even if they are required, maybe the due dates can be standardized).

51. Need to simplify plan amendment adoption date rules as this has become an unwieldy mess with different deadlines not only for required/discretionary/interim amendments, but also based on statutes vs. regs vs. later guidance.

52. The IRS should provide sample language for all amendments. The IRS should provide model plan documents for all types of qualified plans.

53. Generally, we believe that the remedial and interim amendment requirements are balanced. The only suggested improvement we have has to do with remedial and interim amendments for plans that have been merged into a successor plan, which often arises in the context of corporate mergers and acquisitions. In such cases, we believe it would make sense to clarify that an Appendix F filing under EPCRS is available with respect to the plans that had merged into the successor plan.

54. The staggered remedial amendment cycle together with interim amendment requirements has become extremely difficult to manage. We have a large number of clients with qualified plans, including a mix of private sector employers, public employers, individually designed plans, prototype and volume submitter plans, defined benefit, and defined contribution. The rules and deadlines are different for the various groups. One suggestion is for the IRS to set clear, simple deadlines for interim amendments.

55. It would reduce the burden on employers if the Service returned to providing model interim amendments. Right now, such amendments cannot be prepared for a

reasonable cost. Further, because the amendments tend to be so technical employers can't understand why they have to pay for an amendment that changes a few words in their plan but doesn't have any substantial impact on their operation of the plan. The concept of interim amendments versus discretionary amendments or restatements is confusing enough for employers to understand without adding a financial burden as well.

56. The staggered process, while beneficial in spreading out the work (see comment below), has created some inefficiencies in the timing of doing amendments for various clients.

57. I have several suggestions that I think would be helpful: 1. only require plan amendments at the five year cycles. I know the Service has taken the position that it cannot wait for the five year cycles for many required amendments; however, there is no sense to a five year filing process if many interim amendments are required. If amendments were only required every five years, practitioners could concentrate on educating plan sponsors on operational compliance instead of drafting and implementing complicated interim amendments 2. Alternatively, get rid of remedial amendment periods altogether and require plan amendments by the end of the Plan Year the provision is actually applicable to a Plan. This would provide a deadline that has a closer relationship to a plan's operational requirements. I advise many companies on interim amendments. Very rarely do they concentrate on compliance with new law or guidance until the amendment is actually made to the plan. For many, this is too late and operational errors are discovered after it is too late to easily fix them. If the Service is serious about requiring plan language in an effort to improve operational compliance, then let the amendments have a rational relationship to operational requirements. 3. No matter what strategy the Service chooses, provide a clear and unambiguous amendment deadline. Deadlines based on fiscal years and whether or not a tax extension was filed make no sense. The additional time that is provided to adopt the amendment is far outweighed by the additional time needed to determine what a Company's deadline actually is. 4. Allow more incorporation by amendment. I have spent hours crafting 415 language for companies who will never even approach contribution or benefit levels that will exceed the 415 limits. Every dollar that the company spends for me to read through the regulations to craft language that will have no operational effect is a wasted dollar and fails to serve plan sponsors or participants. 5. Finally, one entirely new approach: How about only penalizing companies for failure to adopt interim amendments that result in an actual error in plan operation; for all others, amendment is only required at the filing cycle. For example, if I have a DB plan that will never exceed the 415 limits, I only need to incorporate language from the final 415 amendments on the five year filing cycle. On the other hand, if the plan's operations will, in fact, be affected by the final regulations, the amendment can be due by the end of the plan year which will be affected.

58. These amendments are difficult for employers and practitioners. With the number of plan changes from Congress and the IRS, it seems as if every plan is being amended every year. The costs for employers are high. The risk of error among practitioners is also high. This is a problem this year with 6 year cycle plans that also

need PPA amendments -- For those not restated onto new documents by year end, PPA amendments are needed by 12/31/09.

59. I think there should be a set deadline (i.e., December 31, 2009) for all remedial and interim amendments. It is extremely complicated when limitation years, plan years, and fiscal years are not the same (i.e., 415 amendments) to determine when the amendment is due. I think there should be one due date for all plans (not based on the plan year) like there was for the automatic cash out provisions (amendment due December 31, 2006, effective date March 28, 2005).

60. The interim amendment requirement should be removed and a return to the rule of meeting the law in operation and amending retroactively at the end of the remedial period.

61. The whole point of a remedial amendment cycle was to allow people time to determine proper language/best practices and amend in an efficient manner. Requiring interim and good faith amendments in the meantime unnecessarily complicates the compliance process and adds undue burden onto plan sponsors.

62. I would suggest a uniform and specific due dates for interim amendments, similar to the 1/31 "cycle" dates, regardless of plan year - or alternatively, the plan year end without regard to when a tax or informational return is due or extended to. I would also suggest IRS provided model amendments - or alternatively, allow plans to incorporate more code/regulation provisions by reference and minimize the need for additional amendments as plan provisions automatically change.

63. Significantly confusing. Why could the 2007 Remedial Amendment be adopted by the Prototype plan sponsor on behalf of all adopting plan sponsors (unless they wanted to adopt different provisions), but the 2009 Remedial Amendment cannot?

64. Having to do interim amendments each year is quite cumbersome. If this could be streamlined so that plans only have to have at most one interim amendment during any six (or five) year cycle, it would help. Complying with any other law or regulatory changes could be done using a remedial amendment period.

65. The intent of the remedial and interim amendments requirements, as we understand them, was to keep all plan documents updated for all current legislation. However, laws are being passed that have future amendment deadlines which require that plans operate in compliance with the law, but not actually be amended for it, thereby going back to the prior "good faith compliance" standard used before the interim amendment concept was introduced. In addition, with these new requirements, a plan document is either restated or amended every plan year which creates additional expenses for plan sponsors and an administrative burden to keep track of each separate plan document until the applicable filing deadline. Some suggestions on improving the understanding and compliance with the determination letter program are listed below: Reduce the number of cycles for individually designed plans (possibly having just two cycles that would still require plans to be updated once every five

years). Identify the cycle by a single criteria by eliminating the exceptions (especially those issued after the beginning of the remedial amendment cycle as was just done for governmental plans). Issue the Cumulative List every two or three years to coordinate with delayed amendment deadlines as allowed in new legislation

66. The time that it takes from application to determination letter is too long. Also, there are way too many required interim amendments. It was nice when we could amend the plan with model amendments every few years to reflect law changes rather than constantly amending the plans every year.

67. I think the interim amendment requirement is more of a burden on employers than we need. In some cases they have individually designed plans and have to pay for the tack-on amendments every year. In other cases, the plan document sponsor adopts the amendments on behalf of the employers using their document. Even in this case, where it doesn't necessarily cost the employer anything, they now have to receive the tack-on amendment and explanation and keep a copy with their plan document. It's bombarding them with paper for no reason. I prefer the "old" way, where plan sponsors just complied operationally and then picked up the regulation changes with the next restatement. This is particularly difficult (from a TPA standpoint) for takeover plans. The employers often lose their tack-on amendments, and then we can't tell if they were ever done or not.

68. There has been one required each year lately which has been burdensome to both sponsors and practitioners. Also, the amendment cycles are based upon Cumulative Lists from years way back, so even "new" documents require several interim amendments by the time they are done.

69. I have received comments from clients on the need for an amendment every year and the involved cost. Several clients have terminated their retirement plan to eliminate those costs.

70. As a provider of an individually designed plan document, it became terribly burdensome to basically have to write a new document with each restatement cycle which incorporated those changes as released by the Service each October for the next cycle's restatement. Since the Service required a new document, rather than a conforming amendment to an existing document, we were faced with the challenge of not only preparing a new document each year, but also having to amend documents not in that particular restatement cycle to comply as well with law changes requiring interim amendments. As a result of this whole process, we have now abandoned our individually designed document and will no longer offer that choice of document to our clients.

71. Don't require plans to adopt the interim amendments on an annual basis. This is too costly for small plans. Have them comply with the changes but postpone the adoption until the next cycle or combine 3-4 years into one deadline.

72. The requirement to amend plans on almost an annual basis is a big problem for many of our plan sponsor clients. They do not understand the need to amend a DB plan in 2008 for 415, 2009 for PPA and then restate in 2010 for EGTRRA. And for practitioners, this generates a lot of busy work which does not provide value to the plan sponsor and creates a smokescreen of activity which tends to obscure the real work we do for our clients.

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Staggered timing of the current cycle filing process (for new plans and for restated plans). Provide any observations, concerns, and suggested improvements you might have about the staggered timing of the current cycle filing process for new plans and for restated plans.

1. OK, although off-cycle filings shouldn't be penalized.

2. I do not like the staggered timing. How do you explain to a small business owner that he or she will need to redo their plan document every five years? How do we estimate how much that will cost so the employer can evaluate the financial implications of adopting a plan? Additionally, the process is illogical. I understand that it creates efficiencies, especially for the IRS, but for those of us in the trenches it adds complications to an otherwise already complicated subject.

3. Staggering the timing of the restatements, in theory, was to alleviate the backlog and ensure that letters were received in a timely manner. A Cycle B filing, timely submitted by one of our clients, did not receive their favorable letter until over 1 year from the date of IRS submission. For the standard 6-year cycle Defined Contribution Plans, right off the bat the IRS was late in issuing the opinion/advisory letters. If the IRS was able to stick to the cycle deadlines that they have proposed, then it is highly beneficial to the entire benefits community to have structure to the restatement process. The ever floating deadline for the GUST restatements was confusing and cumbersome once a final date was reached and we were permitted to begin. So, in that respect, the new method is successful.

4. In theory, the staggered timing of the current cycle filing process should be efficient and effective. Unfortunately, I'm not sure this staggered schedule is working so well. First, the public plans were allowed to delay submission from Cycle C to a later cycle. This will most likely create a bottle neck for that cycle and back up the whole process.

5. Plan redesign changes should be permitted to come in off cycle without being thrown to the back of the pile. The new system creates huge uncertainty for sponsors who redesign their plans mid cycle.

6. In general, the staggered timing of the current cycle filing process is helpful and a good approach for plan sponsors, their advisors and the IRS. Continued tweaks to the process would increase its effectiveness. Consider permitting plan sponsors with a number of single and multiple employer plans to file either under the regular single

employer cycle or the cycle for multiple employers. Also, generally when the IRS issues guidance in a Q&A format, the guidance is very helpful and provides practical guidance. Consider areas in which the Q&A format (or sample filings/forms) may be used to clarify the process.

7. I like the staggered amendment procedure, it spaces my plans out nicely rather than having to submit all restatements by the same deadline.

8. I appreciate the January 31 (rather than December 31) deadline for each cycle. A key concern is that there is a gap in the Cumulative List process. Many sponsors use it to determine required amendments for a year, but, because of its structure, it can have gaps.

9. New plans should be permitted to file in the year of adoption or the following year even if off-cycle. Otherwise the staggered process is fine. It would be nice for a plan being merged to be filed off-cycle as to the years prior to the merger so that no one forgets to do that filing.

10. The staggered timing requirements should be done away with. It should not be necessary to wait such long periods of time to have serious qualification questions answered.

11. While the staggered timing of the current cycle filing process makes sense, the long lag time between filing and receipt of an approval letter makes it very difficult for benefits attorneys to "learn" from the filing process.

12. Issue: The differing cycles for pre-approved plans and individually designed plans create confusion and potential compliance issues for plans that switch from one to the other. The first restatement of a pre-approved plan under the remedial amendment cycle regime established by Rev. Proc. 2005-66 was the EGTRRA restatement based on the 2004 Cumulative List. Restatement of individual employer plans onto those prototypes will not be completed until April of 2010. Meanwhile, individually designed plans are subject to five different cycles (A through E, depending on the EINs of the sponsoring employers). In any event, a properly amended individually designed plan will be updated based on a much more recent Cumulative List. Therefore, an individually designed plan that is restated onto a pre-approved plan document will always be taken back in time regarding its form compliance status. With the end of each subsequent individually designed cycle, the problem will become more and more pronounced. The problem is not resolved by interim amendments made to the pre-approved plan after the last restatement as the interim amendments do not cover all items on the Cumulative List. What if the record keeper, and prototype sponsor, has not yet determined how the plan will be revised in several years (maybe six or more) to accommodate an item on the Cumulative List applicable to the converting individually designed plan? What if the backward movement creates issues under Code section 411(d)(6)?

Recommendation: The IRS needs to address this issue and provide relief for employers that convert from an individually designed document to a pre-approved plan.

13. Individually designed plan ("IDP") vs. preapproved plan approach is not ideal. Ideal would be that all plans are on a 6 year cycle: 2 yrs. DC; 2 yrs DB; 2 yrs. IDP (DB/DC)

14. This is fine with the following observations: 1. let new plans file for a determination letter at any time. 2. Don't complain that all the plans come in at the last minute--they will. Rather, accept human nature and think of the following year for processing this year's applications. Then it would be as if everyone filed on the first day. Once you embrace this concept the workload can be spread throughout the year.

15. The rules for determining which cycle a plan falls under are extremely complex and it is easy to make a mistake.

16. The 5-year cycle is a great idea. Too bad about how some of the effective dates of the laws and the requirements in the LRMs are not playing well together. As for the 6-year cycle, having the DB and the 401(k)/PS be on differing 2-year periods is a great idea. Please continue that with the 403(b) plans and have them go into the remaining 2-year slot so they also do not coincide with the DB plans or with the 401(k)/PS plans. Why do we have both prototype and volume submitter plans anymore? Wouldn't your review be reduced substantially if you just had "pre-approved" documents to review which were no longer called Prototype or Volume Submitter? However, if you go this route, then when you pick the language that you will allow and/or require, you'll need to lean more toward how the current volume submitter plan is now, otherwise you'll have tens of thousands of extra IDP submissions.

17. Works well with prototype plans and volume submitter plans. No comment for individually designed.

18. I think one date is good with a grace period or extension offered.

19. While I approve in principle, it is not working very well in fact. How can we still be looking to do EGTRRA restatements for DB plans at some time in the future when the legislation will be 10 years old and we will already have done PPA amendments?

20. Make it clear that to go from the 5-year cycle to the 6-year cycle all that is required is: 1. Completion of a Form 8905 prior to the end of the plan sponsor's current 5-year cycle; or 2. Adopting a pre-approved plan for the current 6-year cycle prior to the opening of the adoption window for the next 6-year cycle.

21. I think the staggered timing is a good idea.

22. The staggered amendment process is too complicated and cumbersome. Go back to the old way of everyone's restatements are due at the same time. And having to restate every 6-10 years is fine (especially since we have annual interim amendments). Don't make a distinction between prototypes, volume submitters or

individually designed plans. Employers sometimes hear about restatement deadlines by word of mouth. Even if it takes the IRS longer to issue letters, it's better. And it's too hard for practitioners. I want to restate all my ESOPs at the same time, not continually update the document every year because I get a client with a different ending EIN. I want each client to have the same basic document, not a different version depending upon their EIN.

23. The six year cycle for preapproved plans actually results in a very short window of time for our company to prepare all our preapproved EGTRRA restatements. The two year period is further shortened waiting for the major document providers to have their documents available for use. Although the restatement period begins in April, most providers didn't have their documents fully available until July or later. Also, the six year restatement cycle provides an unnecessary conflict with the 5 year deadline for restating SPDs that have been amended. The SPD revision process should be tied to the remedial amendment cycle process.

24. Not a major problem.

25. Staggered cycles for pre-approved plans are working well. Would like to see this program extended to other plan types (SEPs/SIMPLES/IRAs, etc.) to give some certainty to plans that often times seem overlooked.

26. I'd stagger multiemployer plans as well.

27. I think the staggered timing is working well, especially with the ability to file off cycle for new plans and for business reasons.

28. The staggered timing is helpful to spread out the work of restating plans. Unfortunately, it has added an unbelievable level of complexity in the context of controlled groups, mergers and acquisitions, changes in plan sponsors, adoption of new plans and for employers who maintain both individually designed plans and prototypes or volume submitters. In addition, the length of time that has passed since GUST for late Cycle filers is creating a great deal of problems.

29. We do few individually designed plans. I do appreciate the longer window for pre-approved plans, and separate windows for DB and DC.

30. Any plan-amendment cycle, staggered or not, that sets up a delay of putting a provision in writing after the plan sponsor adopted the provision by operation, summary plan description, or summary of material modifications increases the opportunities for errors.

31. I actually like the 6 year cycle. It gives TPAs a clear picture of when we will be required to go through this again. It gives plan sponsors clear expectations of their requirements and upcoming costs for maintaining the plan. With that regular cycle I would like you to reconsider the interim amendment requirements as they are time consuming and expensive

32. The current process is the most inefficient, confusing process I have ever experienced in my career. In particular, switching between multiple employer status and single employer/controlled group status causes plans to miss their filing deadlines without even knowing they missed it. In addition, the confusion between what is a prototype plan and an individually designed plan has caused us to treat almost all plans as individually designed to make sure we aren't treated as missing a deadline. The staggered deadlines for an attorney with multiple clients means that you are terribly inefficient in amending and filing plans with the IRS compared with the previous determination letter process. Also, the rules related to mergers of plans and changes in plan sponsors can cause a plan to not file for a determination letter for a very long time.

33. I think that all new plans should be able to file, not just those who are more than 2 cycles out.

34. Going back to the interim amendment issues, consider adding an exhibit for the Form 5300 that lists the interim amendments, and then asks if they have been adopted, and if not, allows a request for correction on the Form 5300? I got dinged with a $2000 penalty when I requested a determination letter for a plan that didn't include some top heavy language from EGTRRA. The $2000 could have been a $375 penalty if I'd disclosed the failure to adopt the top heavy language before or with the determination request. It's a disincentive to file for a determination letter if there's an interim amendment, even a purely technical one, that hasn't been adopted, and this sort of procedure might help. Of course getting dinged with a $2000 penalty is probably a good incentive to get it right in the future - but it's sort of ridiculous for a plan that is in full operational compliance.

35. The staggered timing cycle imposes significant burdens on those employers who find it desirable to have individually designed plans. It imposes similar burdens on prototype provider. This burden arises from the desire to have IRS review of design changes that sponsors as a business or legal matter deem necessary or desirable between cycles. It is in the interest of the IRS, as a policy matter, to have the opportunity to review these types of changes on a timely basis.

36. I generally am ok with the staggered filings if this helps the IRS process the applications but that has not proved to be the case for the bulk of the plans we have filed.

37. Staggering is a good idea and the 5-yr cycle is fine but Jan 31 is a bad date for the end of the cycle, given all of the other end of year deadlines. 5/31 would be better.

38. We use the volume plan so we have less than two years to consult and restate all of our plans. Our document vendor was not ready to go until six months after the approval. We have really 18 months to do all our DC plans. If you don't get the documents done in 2009 then we have all those interim amendments to sign for 2009. More time and expense to clients. Our clients complain that there is always a mailing with amendments or new requirements to sign. In this economy the restatements and amendments have been hardships and resulted in many clients terminating their plans.

39. Generally, I like the staggered timing of the new/current filing process. The only real downside I see is for the pre-approved plans. Because of the 2-year lag-time between the time IRS approves the documents with an opinion/advisory letter, and when sponsors need to adopt the plans, there is a need for tack-on amendments. Because of the tack-on amendments, I think the 3rd-party document vendors are finding it difficult to provide an up-to-date Summary Plan Description.

40. DB and DC volume submitter and prototype plans can't be submitted at the same time. Given the prevalence of db / dc pairs of plans in the small plan market, this is not ideal. Pairs of plans need to be able to be restated and submitted together. Another problematic area is that it took many plan document providers (i.e., Relius, Datair, etc.) several months to provide the software necessary to complete the restatements. Given that we only have 24 months to do the rewrites, if the software takes 3-6 months to deliver there isn't enough time. Additionally, the idea that we already have multiple amendments required to the restatement of the vol sub plans because of subsequent legislation is crazy. If we are going to restate, why aren't we restating to current law rather than the 2005 cumulative list?

41. The staggered timeline has worked particularly well for us.

42. The theory is good. The reality is no obvious improvement in turnaround time.

43. Clients who miss their cycle should be permitted to pay an extra filing fee (like a VCP fee) and submit their plans for a letter ruling. Clients do not understand the 5 year cycle concept. They find it difficult to understand why one entity's plan in an earlier cycle has a determination letter covering only certain items, while a plan sponsored by another entity in a later cycle has a letter covering additional items. They also seem to think that they used to have to go through the determination process only once every 8-10 years, whereas now they will have to do it every 5. Clients who are filing off-cycle for legitimate business reasons are subject to unfair delay in the processing of their applications. The confusion of the 5 yr cycle is causing more people to go on prototype.

44. Generally, the staggered remedial amendment cycle works well. It would be helpful if the rules that govern switching between cycles (e.g., from a multiemployer plan to a single employer plan or in the case of an acquisition or merger) were clarified.

It would also be helpful if EPCRS procedures could be expanded to include the case of a failure to submit a timely plan restatement. For example, it would be helpful to have EPCRS available in a scenario where on-cycle filing is missed due to having an incorrect EIN on file.

45. Allow longer cycles especially for prototype plans, with good faith amendments in between, and with a little more ability for off-cycle submissions when a sponsor wants to update for example to add new permissible features.

46. Seems to be working well; Cumulative Lists are immensely helpful but would suggest reconsidering whether optional provisions should be covered in Cumulative Lists (i.e., consider not listing an amendment until it is required).

47. The entire process is burdensome and unnecessary, it is only 'job security' for IRS agents, TPA's and law firms. The plan sponsor's don't understand why plans must be amended every year and then submit to the IRS every six years.

48. Overall, I think the staggered timing is good. I have two concerns with it. 1. It seems there is no reasonable remedy for employers who end up in the wrong cycle due to a misunderstanding about which tax id number they should be using and this places an undue amount of weight on the employer accurately communicating to its plan document provider the appropriate number. I've run into cases where there's more than one tax id number of there's a separate number for a trust and no one realizes that until the employer goes to do its first filing under a cycle. If the employer in good faith believes it should be in a later cycle, but learns too late it should've been in an earlier one, it seems there isn't much it can do. It might be helpful if the IRS provided a mechanism for correcting a one-time failure of this nature (possibly including a penalty) so that there's an incentive for the employer to get back onto the right cycle. 2. Issue the Cumulative List earlier and don't put things on it that aren't out yet. It further confuses the process and encourages practitioners to delay submitting documents if there's guidance on the list that hasn't been released yet. Also, I know the Service has expressed reluctance to do this, but it would be helpful if the requirements on the list were broken down into categories: language that must be in all documents, provisions that may need to be added or modified for certain types of plans and discretionary changes.

49. I like the staggered process of filings because it spreads out the burden of periodic filings and prevents the nightmare of having to file all the plans simultaneously.

50. I think it's a great idea. This has worked very well in my experience. Companies are able to better forecast benefits compliance expenses and it ties in nicely with the SPD restatement requirements.

51. There needs to be a system for dealing with plans that missed their cycle. VCP is not necessarily available since the failure to request a determination letter is not a qualification failure and the plan may not have any errors if all interim amendments were made. Maybe a special filing fee and the plan can be reviewed.

52. I think the staggered timing is working well.

53. There are too many exceptions to the basic rule. The rules should be changed to provide for no exceptions to the cycles. That means no exceptions to the type of entity or filer and no exceptions because it is a new plan. This would simplify the rules and remove much confusion and uncertainty.

54. The entire staggered process is too complicated and difficult for employers to know when they need to go in. The continued need for interim and good faith amendments makes the process unduly complicated and burdensome for employers. Either go with a cycle and send each employer/plan sponsor a letter for each plan

assigning schedule with the need to amend in accordance with that schedule, or go back to a common remedial amendment period for all.

55. 5 & 6 years are too frequent for a cycle, particularly when the main piece of legislation for which a plan is being updated is often already 5-10 years old. Also, rather than require individually designed plans to have fully restated provisions at the time of the on-cycle submission, I would suggest providing that a plan be restated for the major piece of legislation during the period (and all prior laws) and allow for such restatement and interim amendments to be submitted on cycle. This would also allow new plans adopted after major legislation (such as EGTRRA) but submitted during a later cycle to submit interim amendments for newer "minor" laws/regs instead of having to be restated only two or three years after adoption and to incorporate rather short amendments.

56. Very confusing and makes it much more difficult to ensure clients are in compliance. In many respects this multiplies the work by 5. That is, an updated document has to be produced every year (by the document provider), increasing their work AND their document maintenance fees. At my level (consultant/actuary) new procedures have to be written every year. For every Cycle plan there are a different set of Remedial Amendments that are required, so this takes more work when reviewing plans.

57. The staggered cycle has worked well for us because almost all of our plans our volume submitter plans. Having the DC plans on a different cycle than the DB plans is good because it helps spread out our workload.

58. The five cycle process for individually designed plans is complicated and confusing for plan sponsors, service providers and IRS reviewers. There is limited ability to file "off cycle" which creates concern for plan sponsors who want to make extensive plan design changes to accommodate changes in their workforce or the economy. The staggered amendment cycle process has complicated the process of updating plans for EGTRRA, PPA, and other legislation because it is now necessary to keep track of which provisions can be included in the restatements done each cycle and which provisions must be added to the plan by interim amendment. Plan sponsors now receive updated plan documents (restatements or amendments) at least once every year and those documents may not contain all the provisions under which they are currently operating because of delayed amendment dates contained in new legislation. The staggered timing makes it difficult to ensure that all plan documents meet the signature timing contained in Code Section 401(b). The staggered cycle filing process has also resulted in an increased number of requests for additional data from the IRS reviewers, which are usually referred to the document provider, thus increasing the cost to the plan sponsor to maintain the plan.

59. It is too complicated a system to know if a plan is an individually designed plan or not. Plus, cash balance plans should be kept on cycle with Volume Submitter documents. Since these plans can now be written as part of a Volume Submitter, they should be able to be submitted with Form 5307 rather than Form 5300.

60. I think we are more likely to miss a filing deadline with the staggered timing filing process, but otherwise it's OK.

61. The "new" documents are based upon Cumulative Lists that are already outdated. Cycles are short.

62. Same issues as above. Very difficult to prepare a document for a new plan that might need to adopt mid-year knowing that new requirements would be released at end of year which could necessitate revisions.

63. The staggered amendment period, while maybe helpful to the IRS, is extremely labor intensive for practitioners and plan sponsors. We now have documents in 8 or more stages of update (5 from the 5 year cycle for individually designed plans, 2 re the DC volume submitter plans and another 2 re the DB cycle, not to mention the government plans and multi-employer cycles) and interim amendments. This is a slow motion disaster.

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The determination letter application process, including the time it takes to receive an approval letter. Provide any observations, concerns, and suggested improvements you might have about the determination letter application process, including the time it takes to receive an approval letter.

1. It takes much, much too long. I was told last week (week of 8/10/09) that a request submitted in January, 2007 had not yet been assigned. Turnaround time should be no more than 6 months.

2. The time involved to get a determination letter is fine, even it took longer. Most plans are approved as submitted. Very few plans should need substantial changes after submission if they have deficiencies. Thus, most plan sponsors should not worry about the timing as long as they know they can rely upon the remedial amendment period to come into compliance.

3. The actual process of filing for a determination letter has been a challenge. The first inconsistency that should be addressed is whether the IRS wants Plan Sponsors to file or not. The reading of Rev. Proc. 2005-16, Section 19 indicates that certain adopters of pre-approved plans would still need to file for a determination letter if they had certain items which caused them to fail reliance (e.g., 401(a)(4), 410(b) etc.). However, during the ASPPA Web Cast in 2008, speakers from the IRS EP division made it clear that they didn't believe pre-approved plans should have to file to get reliance. We believe that the IRS needs to revisit the terms of Rev. Proc. 2005-16, Section 19, and determine which pre-approved plan adopters should really need to file in order to get reliance. If this gets clarified and fewer filings are required, this would free up the IRS resources as well as saving the clients and service providers considerable time and expense. The second challenge that was encountered was the announcement that the IRS was going to be revising the submission forms. The revised Form 5307, unfortunately, didn't come out until May 2008 with an effective date of

October 2008. This was over nearly 2 months after the approval letters were issued and the restatement project was underway. As most providers rely on an outside vendor for the IRS forms, this meant that the new forms weren't effectively available until August. The result of this ill-timed changeover was a period where production had to be halted to ensure that clients had proper time to review the IRS filing packages sent to them before submission to the IRS without crossing over the October switch to the new version of Form 5307. Once the new Form 5307 came out, it was clear that there were significant flaws in the forms and instructions. One example of these flaws was no instruction regarding the placement of Form 8905 or CAP letters in the package. Another example is the lack of explanation of the purpose or method for counting the number of amendments in 3h. We had to continually go back to the IRS for clarification. A third challenge with the process has been the new method the IRS has employed for front-end scanning documents. We have gotten numerous inquiries from IRS Agents indicating they were missing pieces that were included in the packages previously sent to the IRS. Primarily, prior plan documents seem to be lost frequently. Similarly, we have had problems with replies to IRS inquiries getting lost. In one instance, we had to resend a response four times, utilizing mail (Certified & Regular), fax & FedEx. Despite our proof of delivery, the IRS was consistently unable to locate the documents sent. The IRS Agents themselves commented on more than one occasion that they were aware of the problem and didn't like their new process. Finally, there have just been several little episodes that support the fact the IRS was simply unprepared for this restatement. In the Fall of 2008, the IRS upgraded their computer system which caused the Agents to be unavailable for over 2 weeks. Another example is that when an Agent was asked in October 2008 why no letters had been received yet, we were told that the IRS had not finalized the template yet and that the files were just piling up waiting. In the private sector, these incidents would have been completely unacceptable.

4. Our last determination letter request process from submission to approval letter took approximately two years. We submitted a request in Cycle C in January 2009 and have received only an acknowledgment of receipt of our submission.

5. Some applications have taken more than a year to get through the process, some (very few) have taken just a few months. Is there a way to standardize the time each application will take? It is still taking too long.

6. It now takes longer to receive a letter and the reviewers are far less knowledgeable than they used to be.

7. I have noticed some improvement in the time for receiving approval letters from cycle A submissions to cycle C submissions. I expected a greater improvement in timing of the approval letter from A to C primarily due to increased familiarity with the process for all parties. Hopefully, this trend will continue, especially with continued improvements for the process.

8. The IRS has failed to maintain a timely process. I have an individually designed plan that we have been waiting over two years for a response. I have written the application examiner several times and have failed to receive a determination letter or a

response from the examiner. I hope this lack of response from the IRS does not cause future issues for the plan with the IRS.

9. Wide variance; I had a few Cycle B plan favorable letters within 6 months and I have a Cycle A plan that still (as of August 18, 2009) does not have a favorable letter and for which we did not receive comments until a few months ago.

10. The determination letter application process is very dysfunctional when a previous application has been rejected. For example, our firm was engaged to take over the determination letter application for a new ESOP after a former application was rejected by the IRS because the application was adjudged to be "out of cycle." The attorney who had made the original application was not experienced in qualified plans. Subsequently, when our TPA/consulting firm tried to pick up the determination letter application, our efforts have also been rejected. It is now 3 plan years w/o a determination.

11. First, while it does take time, the system does appear to be working faster this day. Second, there is too much inconsistency/inflexibility in extensions to respond. With the Service not processing cases for 1+ years, to insist on 2 week or 4 week turnaround to inquiries, especially for entities that are restructuring or have complex governance is unworkable. Some agents are very flexible but others take firm positions. Often, their response is that they are under pressure to move the cases from above. Yet, when you go "up the chain", an extension is granted. So it is a tough balancing act. It is understandable from an administrative perspective that the Service needs processes/case management rules, but some more flexibility might be helpful.

12. The determination letter process from start to finish should take no more than 6 months maximum. It is not cost effective for the plan sponsors for the process to take longer.

13. In our view, the value of the determination letter process has greatly diminished over the years. Back in the 1970's the DL was called a "Letter of Advance Determination". The idea was that you could get an idea as to whether a particular plan was OK before you became irrevocably committed. The ordinarily English meaning of the word "plan" no longer applies, since IRS procedures have forced most of us to write documents that might be more aptly called "revisionist histories" of plan rules. In the old days, our administrators were trained to always read the plan document first to determine how to deal with plan administration problems. Today, the prevailing attitude is different. One frequently hears things like "Our plan document vendor hasn't yet received their EGTRRA opinion letter. Until then we can't do the "EGTRRA" restatement." This seems absurd given that EGTRRA was adopted over 8 years ago.

14. It takes entirely too long for determination letters to be issued. For example, I filed determination letter requests in February, 2007 and did not receive determination letters until June, 2009. I have received no determination letters on ESOPs submitted since 2007.

15. Issue #1: According to Section 19 of Proc. 2007-44, the majority of the pre-approved plan amendments adopted by employers other than to choose among the options offered by the sponsor will not cause the plan to be ineligible for the six-year remedial amendment cycle applicable to pre-approved plans ("Pre-approved RAP"). An exception is made for certain amendments to incorporate a type of plan not allowed in a prototype or volume submitter plan ("Prohibited Amendment"). If a Prohibited Amendment is made by the employer, the plan becomes ineligible for the Pre-Approved RAP at the end of the current cycle. However, if the Prohibited Amendment is made within one year after the date the employer initially adopted the pre-approved plan, the employer reverts to the individually designed cycle immediately. The "within one year rule" creates a potentially extreme situation for an employer where it may need to restate its plan twice within a very short period of time and an administrative issue for a pre-approved plan sponsor that suddenly has a client on a different restatement cycle than all other pre-approved clients.

Recommendation: The "within one year" rule should be eliminated and an employer that makes a Prohibited Amendment should remain on the Pre-Approved RAP for the remainder of the current cycle.

Issue #2: Among the most frequent Prohibited Amendments are amendments that "include so-called fail-safe provisions for § 401(a)(4) or the average benefit test under § 410(b)." Given the lack of specificity in this prohibition, such provisions are difficult to positively identify. As a result, it is possible that some Prohibited Amendments go undetected and other provisions are incorrectly labeled Prohibited Amendments and cause a plan to unnecessarily move off of the Pre-approved RAP.

Recommendation: "So-called fail-safe provisions for § 401(a)(4) or the average benefit test under § 410(b)" should be clearly defined with examples of prohibited and permitted language.

16. Online application with ability to upload info from a database would reduce errors and cost.

17. No problem except plans in determination purgatory because of special issues. I suggest you consider issuing a "but for" letter until the specific issue can be resolved or make a business decision and issue a letter and apply new standards with subsequent letters.

18. I have a Cycle B ESOP that has still not even been assigned to a reviewer. This is a much longer wait for a determination letter than in years past.

19. Why does the IRS not use e-mail? I keep getting questions about EGTRRA amendments that were included with GUST filings that the IRS appears to have no record of even though it issued determination letters. I would like to see the IRS set up electronic files for determination letter applications. Applicants could submit documents in the form of .pdf files, which the IRS would store electronically. If there were a

question as to whether an amendment were made, the IRS agent could pull up a .pdf file to get an answer. Such a system should save a lot of paper.

20. Those of us who "wait" to file until the end of January (we're not really waiting, that's just when it gets done) - we should not expect a fast turnaround on the D letter, so you should not need to tell us that we should expect a response to the acknowledgement letter within 145 days. We just want a response within 8 or 9 months so we can reply before we start working on the next cycle's restatements. Is it possible to submit a document and ask for only prospective reliance - some of the government plans especially, and maybe some of the non-electing church plans?

21. For a non-standardized prototype, even with a new comparability allocation formula should not need a determination letter. If a company operates their plan in compliance with the document, then there should never be a need to file for a determination letter, or termination for that matter.

22. Turn-around time is adequate.

23. It doesn't make a whole lot of sense if the responses to an on-cycle filing don't come back for almost two years. The system cannot be made very meaningful if you don't have the personnel to support it.

24. Our Company submitted 3 plans for determination letters in December, 2006. We continue to wait for response. Each time we check in with outside counsel (who has power of attorney for these submissions), we incur additional legal expense. I think going on 3 years for review & response is outrageous.

25. There is no standard time to receive an IRS determination letter. As explained in question 4 below, it depends on the individuals who are handling your case. I have had plans in Cycle A who received letters in nine months - others took more than 2 years (and then the letters were issued with errors and I am still waiting to have them corrected). There is no accountability within the system. When you call the IRS number and ask the status of your case, all you are told is that it is "unassigned." There is no individual who can assist you.

26. The favorable determination letter (FDL) process has become too long. Just look at the document being submitted, don't go back until the beginning of the plan. Many clients have properly complied with document updates, but due to mergers, etc. can't find the old documents. It's too time consuming & costly to collect all those old documents. If they didn't do the right document 20 years ago, who should care as long as they do it right now. Place a caveat on it for any situations where they don't have prior FDL. That allows the IRS to look at these clients during audit, and doesn't affect everyone for nothing.

27. More guidance on submitting termination determination letter applications when an EGTRRA application is currently pending. As more plans are terminated, this has been occurring more often and in some cases the initial application has not been

assigned yet. We're currently into Cycle D for individually designed plan restatements and the IRS reviewers who have contacted us are still working on Cycle A plans.

28. The time for the master letters for the volume documents seems unreasonably long and generates a significant amount of the problems listed in item 1. Possibly being able to add additional language for other legislative changes during the process so that the final document was more current would help.

29. Would like the material asked for by the IRS to be uniform no matter the reviewer assigned to the case. Would also appreciate limiting what is asked for to the last restatement rather than going back 2 or 3 restatements.

30. Why can't a plan sponsor rely on their prior determination letter? Plan sponsors are being audited and plan language is being disapproved of by the reviewing agent even when DL has been issued.

31. Concern: Time to receive approval letter takes too long. Suggested improvement: At a minimum, IRS should send a status report periodically, with new revised anticipated completion dates, if necessary. Observation: Here's how long it took for us to receive our approval letter. 1. We filed our qualification package on 1/31/2008, with a minor correction sent 2/14/2008. 2. IRS notified us that our package had been received on 3/6/2008, and that we could expect a determination within 145 days, i.e., 7/31/2008. 3. We did not hear from IRS again until we received a letter dated 2/13/2009. (Request for additional information.) This was more than 6 months after the 145 day response period had ended. 4. We received our favorable determination letter on 5/18/2009.

32. It seems to take much longer from the first contact to the final determination letter. It's almost as if the reply to the initial contact goes at the bottom of the pile - it's taking way too long to close out cases once opened.

33. It sure takes a long time. However, my biggest concern is the frequency of required amendments. I could easily live with the long determination letter review if we get relief from required amendments.

34. The process is taking too long. There are Cycle A plans that have not received rulings. The quickest turn around for individually designed plans which we have experienced is well over a year.

35. The biggest problem here is the time it takes to get a determination letter, especially for volume submitter or M & P plans.

For a plan that has a prior DL, it is really a simple process. In this cycle, plans without GUST DLs are problematic especially when dealing with the timing of the GUST adoption. Anything adopted after 2/28/2002 requires much more documentation. In a situation where a client has a new TPA it is often impossible to get verification of the prior plan document to prove eligibility for the extended RAP. While operation has been fine, lack of that one little piece of paper (Rev Proc 2000-20 certification) causes a lot of extra work.

36. I would suggest we return to the old determination letter process and amendment timing process. The prior process of having one determination letter deadline and making amendments all at the same time instead of every year or every time something changes was a much more efficient process. Clients are truly annoyed by having to make benefit plan amendments all the time. They don't understand what is changing because so many of the amendments are incredibly technical. In addition, it was easier to communicate the rules to clients and to tell whether a plan had been amended timely. Now it is so confusing even benefits lawyers cannot figure out easily if a plan has been kept up to date. It used to be that we could tell in about ten minutes or less whether a plan was missing amendments. Now it takes a couple of hours or more to determine the same thing.

37. It's taking way too long. I have several plans that were filed in January, 2008 and we have yet to hear anything, 19 months later.

38. I've had determination letter requests on hold at the IRS for 2 or more years. Don't get a thing in writing other than confirmation that the plan was received. Upon inquiry to Cincinnati, no information other than they have the plan and it's on some person's desk. No written response. There ought to be a time limit - or at least a written explanation that is on the record - for delays beyond 6 months.

39. The staggered cycle process does not seem to have been of benefit to many taxpayers. The time now necessary for IRS review, especially for complex plans, seems, if anything, to now be longer than under the prior system. For example, we now understand that for plans that were filed at 1/31/09, letters probably won't be received until late next year. The staggered cycles seem to encourage all affected plans to file at the same time, which may not increase efficiency.

40. What was expected to be a "processed in the order received" for on-cycle filings has not been the case. For example, an ESOP Cycle B filing made April 3, 2007 still hasn't been assigned to a reviewer 28 months later, I'm told because only certain GS 13 agents can do ESOPs. A multiple employer 401(k) on cycle B filed early in cycle B took almost 2 years while other plans filed later received their determination letters more quickly. The new retroactive requirement for submission of documents for all merged plans has proved to be a substantial issue for some clients with lots of acquired company merged plans because of the difficulty of locating prior vendors/historical documents.

41. Time varies wildly from case to case. Agents often fail to list all amendments in DL. Correcting DLs is difficult process. Agents should contact applicant or rep when case is assigned to them - this should be part of process.

42. The review process does not work in the case of submissions in connection with corporate transactions. The letters are not issued in any time frame that coincides with the needs of the parties to transactions.

43. We have not yet submitted for an FDL for our vol sub and prototype plans. However, it would be nice to have the notification or opinion letters count as FDLs. Under audit, the notification and opinion letters are not holding the same weight as the FDLs. As such, based on advice of ERISA counsel, we are strongly recommending that every client submit their restated vol sub document even though the FDL group at IRS has indicated there is no need. Audit and FDL departments of IRS need to deliver one message...either we need FDLs or we don't on the vol sub and prototype plans.

44. Unfair delay in processing determination letters off-cycle; most requesting letters have legitimate reasons for doing so.

45. Complex Plans. It takes too long to obtain determination letters for plans that are not "plain vanilla" plans. For example, a practitioner in our office submitted an ESOP in January 2008 that, to the best of our knowledge, has not yet been assigned to a reviewer, despite follow-up on our part.

Off-Cycle Filings. Currently, it is virtually impossible for a plan sponsor to submit a plan off-cycle and receive a timely review. For example, in June 2007, a practitioner in our office submitted to IRS a Cycle E plan that had been restated to reflect major design changes. In July 2008, we received a letter from the IRS which essentially stated that, since the plan had been filed off-cycle, the IRS would not review it until review of all on-cycle filings had been completed. We have not had further communication about this plan, and we expect we will have to re-submit the plan next year as an on-cycle filing.

This type of delay is of particular concern when major revisions have been made to a plan document. It would be helpful if the off-cycle filing rules were modified to allow off-cycle filing of plans that have been significantly redesigned (such as cash balance conversions or other major formula changes, or changes in major features such as the addition of safe harbor 401(k) provisions) to be treated as on-cycle filings. Another possible approach, either in addition to or in lieu of the first approach, would be to enable plan sponsors to request a timely off-cycle ruling by paying an additional user fee. An additional fee would discourage an excessive number of off-cycle filings, while still allowing determination letters to be received in a reasonable timeframe.

46. For prototype plans, it's pretty long, although I like the fact that all prototype sponsors pretty much receive approvals at the same time. This is one significant aspect of the new procedure which is very much an improvement.

47. In order to make the staggered filing period meaningful and to keep the system from getting completely off course, determination letters generally should be issued within one year of filing. Also, is there a hold on issuing determination letters for ESOPs?

48. It still takes 9 or more months to be contacted about the plans we submit and up to 1 year to get the determination letter. It can take up to 3 or more months after we provide the requested amendment to get a determination letter.

49. We continue to be frustrated by the length of time it takes to process determination letter applications. Currently, we are noticing about a 10 month delay between the submission of the application and the first response from the actual reviewer, and that is for plans that are not submitted in the last month of the cycle. We are surprised that the application is not submitted to a specific reviewer more efficiently.

50. Determination letter applications for ESOPs and other more challenging plans should be processed along with others. We have ESOPs from Cycle A that we are just now being reviewed by agents. We are now focused on the compliance requirements Cycle C and Cycle D filers.

51. Quite simply, it takes too long to get a determination letter. We submitted a couple volume submitter restatements early after the VS period opened and expected those would at least be processed quickly. However, to our great surprise, it took a year. Also, while my clients are all still electing to go in for one a restatement, very few elect to go in at termination of a plan because it's too long to wait. One final comment I have is that I think the consistency of the items agents object to could be improved. I've worked with three new clients in the last year that brought me plans with determination letters that approve plan language that shouldn't have been approved. For example, I have run across multiple plans with immediate forfeitures (not tied to a distribution) getting approved. It is much harder for me to convince a client they can't do something like this when they've received a DL approving it.

52. I have filed plans in multiple December/January time periods and never received a response earlier than October. This is not too much of a concern, just an observation of the timing of the queue. I have also filed a couple of plans off-cycle and have never received a response to those off-cycle filings (other than acknowledgment that they were received). I just filed on-cycle this past January a plan that I had filed off-cycle a few years prior. I have my fingers crossed that we will finally get a response this October. So, I'm worried that all resources are being used to review on-cycle and that off-cycle filings are not getting the attention they need.

For most determination letters, the process is fine. It takes too long to get a letter, but that is not usually a problem for most of the companies I work with. There are certain plans types, however, that lead to exceptions to my general satisfaction with the process. Specifically, ESOPs and cash balance plans. Both types regularly are sent to the "deep freeze" and letters are sometimes held up for years. During this time period, plan sponsors have no idea how they are permitted to operate their plans. In the case of ESOPs, some of these operational issues are significant. The timeframe for returning these types of plans is far too long. Plan sponsors are generally happy to comply with IRS guidance, but it must be given in a timely manner to expect any operational compliance.

53. The staggering process is fine, but we still have Cycle B's that have not been reviewed. The process is taking too long.

54. The time it takes to receive an approval letter is still too long.

55. If it was simplified as above the time between application and receipt of a letter would be expedited.

56. I'm still waiting on some Cycle A letters, when I should be thinking about amending plans for Cycle D. The timing for the process does not meet up with expectations as to timely review and action.

57. The time it takes to review a plan is extremely long. Determination letters are not received any more timely than in periods before the new 5/6 year cycles, and in those time periods more plans had to be submitted (no volume submitter reliance) and all plans were submitted in a much shorter time frame.

58. Timeliness of reviews has been pathetic. It took almost 18 months for us to get the first determination letter. Obviously this leaves NO possibility to get an off-cycle plan reviewed. This is flat wrong. Suppose that in the complexity of the filing rules a plan gets overlooked and misses its cycle. It then has to wait 5 years before it can be reviewed??

59. The time it has taken IRS to respond to the initial filing is very long. More distressing, from my perspective, is that some plan sponsors have had their plans (filed all under one cover letter) split among several agents, several locations. Plans of the same sponsor that have very similar designs and formats are being reviewed by agents 1,000s of miles apart, each asking for different things. A better arrangement should be in place before Cycle E (controlled group) filings. Thanks for the chance to comment.

60. The DL process for the volume submitter plans we have submitted has gone very smoothly. We usually receive a letter in 3 to 6 months. The cash balance plans are taking longer. It would be quite helpful if IRS would allow them to be done on a volume submitter basis.

61. While the application process is not too cumbersome, the time to receive an approval letter takes way too long. It has been 8 months since we submitted our application, and we have no news. We already looking at future plan amendments, but cannot move forward because we don't even know if our current plan document will be certified.

Even with the staggered cycles, there doesn't appear to be greatly improved timing on the issuance of determination letters. Most filings are done in the last few weeks of the remedial amendment period to insure the plan document being filed includes all necessary plan provisions and interim amendments. It is also more common now to receive IRS requests for additional data requesting provisions that are not applicable to the cycle for which the plan is being reviewed. Again, this is frustrating for plan sponsors and also increases the cost of maintaining the plan.

62. The process is taking too long. We are involved with a plan that requested a determination letter to terminate the plan (company was sold) over 14 months ago (or longer). We are fielding phone calls from participants wanting to know when they can request distributions. The IRS did request additional information -- and it was provided within the time frame requested -- but it has been months since there has been communication from the IRS.

63. Too long for determination letters for restatement and new plans. Not so long for terminating plans which is good. The agents need to be more consistent with the information that they are requesting. This may make the process shorter if we all know what the agents are looking for. The submission package is tedious and needs to be modernized as the instructions are not very complete.

64. Have not personally applied. We use volume submitter plans.

65. Ridiculous amount of time. MAKE CASH BALANCE PLANS VOL SUBS!!!

66. The first couple of cycles took longer than I experienced during the GUST restatement process. In some cases it took up to two years to receive a letter.

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Experience with IRS personnel who review the plan filings. Provide any observations, concerns, and suggested improvements you might have about your experience with IRS personnel who review the plan filings.

1. It varies. Perhaps requiring reviewers to have a JD, and perhaps more training, would raise consistency.

2. It has been a mixed bag. My experience goes back into the 1970's, so I have empathy for the personnel who have to deal with much more complicated matters than in the "old days." No complaints.

3. Our experience with the IRS personnel reviewing the filings has varied widely. On the one hand, the personnel in the Cincinnati office have been largely good to work with. Troy Werner, Tanya Huggins, Sherry Smith and Scott Lasillo are just a few of the Agents who have demonstrated tremendous knowledge and ability. However, outside of the Cincinnati office, it has been a tremendous challenge. There have been Agents unaware of Announcement 2008-23 and the impact on the submissions. When it was explained to one Agent that this Announcement meant we were not required to submit the interim amendments, he requested that we send him a copy. Another Agent requested that we amend our pre-approved document to incorporate the Final 415 Regulations. He didn't believe us when we explained that the Cumulative List covering the EGTRRA restatements didn't include the Final 415 Regulations and we had to send him a copy. Between the reviewers, there is also a lack of consistency regarding inquiries and procedures. While this is understandable to some extent, there is one Agent who will always ask for proof of GUST RAP, while another always requests copies of the interim amendments. For some packages where the client omitted the

$300 user fee, we have gotten a fax and were able to have it sent in to the IRS overnight within days. For another client, the entire filing package was rejected and had to be resubmitted. Some reviewers fax the inquiry directly to us per the Form 8821, which gives us the maximum time to respond, while others insist on posting the inquiry via U.S. Mail which can eat away 7–10 days of our response time. Overall, the favorable determination letter process has been slow and flawed. Many plans are taking 9 months or more to receive their letters and there is no discernable pattern as to why some sail through in 3 months. On a positive note, we do wish to commend the VCP program on the swiftness with which a standard non-amender, filing on Schedule F1, has been getting through the program. We have seen plans receive their Closing Agreement in less than 6 weeks.

4. The "senior agent' assigned to our review apparently was not very familiar with government DB plans and sent back pages of questions and requests. This resulted in a relatively expensive "educational" process between our pension counsel and the agent. The expense of this education process was, of course, the responsibility of the retirement system. The result was two extremely minor technical changes to our plan document which I'm not sure were worth the expense and time.

5. It doesn't seem that the process is standardized, some agents ask for certain things that other agents have not required. I would think each agent would have the same procedure and checklists to follow in processing the applications.

6. They seem to have insufficient training to recognize issues that are not on their checklists or when issues on their checklists are not relevant due to the plan's design.

7. All of the IRS personnel that I have worked with regarding client filings have been courteous and helpful. It is often difficult to connect by telephone. Consider email communications for certain issues in the future.

8. This is a very difficult area and the examiners that I have worked with lack experience and training.

9. Most of the agents are proficient but they sometimes overlook amendments that are in the restated document.

10. We have been confronted with delays when an IRS staffer who has been assigned to a determination application, or other issue, subsequently leaves IRS employment. A new agent is then appointed, and the completion time expectation is extended. On one case, we have had two staff terminations, with resulting delays in completion of the application process.

11. See comment in #3. IRS personnel are often excellent to work with and responsive. A suggestion for improvement would be a single contact point available to taxpayers to expedite requests for more time to respond when a field agent feels constrained to provide such. This approach could promote consistency.

12. The form letters and questions asked due to agents' lack of understanding of the plan provisions or plan history and prior reviews are making it cost prohibitive for sponsors to submit plans for determination. The lawyers are training agents because they have to respond in writing as to why the agent is wrong and that costs clients.

13. We just don't have the kind of meaningful interaction with IRS personnel anymore that we used to have. They are working within a system that seems to preclude thoughtful consideration of carefully drafted individually designed plans. Instead, they are simply looking for conformity to one of a half-dozen or so standardized prototype formats or volume submitter products from vendors who have a financial interest in generating the maximum amount of mindless amendment activity.

14. The IRS personnel who reviewed the filings were professional, reviewed proposed amendments submitted in response to their requests promptly, and closed cases quickly. I have no complaints other than the length of time from initial submission to the date on which the file was reviewed.

15. For the most part, the reviewers I have dealt with have been fair, knowledgeable, and helpful.

16. If we practitioners knew the position that is held by the IRS, then that's what we would do. However, certain issues are still handled differently depending on the office reviewing the matter. For example, DB plans with benefits offset by DC plans. Or another, the determination of the Otherwise Excludable Employee group when the entry dates are not semi-annual. We may have our preferences on what we would like your positions to be, but the more important concern to us (in my opinion) is that we be provided with a consistent position nationally. We do not know how that problem can be solved. We certainly cannot expect perfect agents either, - it is what it is - so we generally take the "no danger" approach.

17. The Agents that I have dealt with in this region have been professional, knowledgeable, and willing to listen and work with us if a plan has issues.

18. A standardized fee schedule per 3rd party administrators. It varies from free to $1000.

19. Generally, they are cooperative and helpful.

20. More training to achieve uniformly consistent reviews.

21. The current process is difficult because no one person has responsibility for the determination letter filing from start to finish. One person reviews the original filing, a second person does a quality assurance review and then a determination letter is issued. If there is a typo with the determination letter (and often times it is incorrect), you need to involve a third person to correct the letter. Correcting an IRS determination letter is a long difficult process. You cannot contact the agent who handled the case, explain the problem and have him or her re-issue the letter. Instead, you need to contact a new person who has to request your case, review it and respond. It is my

understanding that only two people are correcting determination letters. I sent a letter to the IRS in March requesting corrected letters. I recently received a response - in August - from the IRS acknowledging my letter. The process was more effective when you could have the letter corrected by the original agent. Some of the agents are very responsive but others are not. I have had reviewers retire and/or change departments while my determination letter is being processed. The reviewers never notify the public. You just have to wait until you are contacted by another new person.

22. This has been mostly favorable. I think it might make sense to assign an agent to a particular TPA or law firm so the same agent reviews all their plans. They would be familiar with the plans and their format and this would facilitate review. For example, if I send in 50 401k plans, have them all reviewed together. It would be faster.

23. The knowledge level varies greatly. All IRS requests for additional information should be made in writing rather than over the phone or on a voicemail message. We frequently need to request extensions for response time as two weeks isn't sufficient. We have difficulty getting responses/acknowledgements of our requests for an extension.

24. Would appreciate more consistency among reviewers and I believe IRS reviewers would benefit from more thorough technical training. Reviewers often times seem unfamiliar with technical topics are more likely to simply try to match a document provision to a checklist rather than understand the document provisions and how they relate to their checklists.

25. Concern: Reviewers are not accessible enough. Suggested improvement: Notify filers of whom they may contact to find out status of the process. Have reviewers be responsive to repeated inquiries for help in understanding what is really needed. Observations: COMMUNICATION METHODS: I do not recall speaking with our reviewer, although her phone number was listed on all of her letters and I did leave voice-mails. Our reviewer snail-mailed all of her requests for additional information, giving us a 14-day window from the date of the letter to respond. Now here's the problem--Every one of her letters was dated on Friday and postmarked the following Monday. The letters generally were received in our building on Wednesday and routed to me by Thursday noon. This gave us just about one week to consult, locate the information, and respond. CONTENT OF LETTERS - Letters requesting additional information were not clear enough for me to determine what was really being requested--they just listed quotes from various sections of law. Even consulting our benefits broker's 401(k) specialist and our record-keeper's IRS determination letter specialist, we still could not figure out exactly what was necessary. Each time we submitted an item or explanation, we just received back a similar request letter with the same quotes. FINALLY, we figured out that we needed another amendment.

26. One reviewer has come back 3 separate times with 3 separate issues. It would be helpful if the initial contact had contained a comprehensive list. We'd like to correct any deficiencies and close out the project but it almost seems as though the reviewer is searching for something, anything that will throw us into a closing agreement.

27. For the most part, I have found the staff pleasant and knowledgeable.

28. Some good, some not so good. I have found some agents to be responsive and there are others who do not return phone calls and do not provide documentation when promised. It is very awkward to try to press these agents to move more quickly.

29. Generally, we experience good results. Reviewers are better at returning voice mails than in years past, and email really speeds things up. We have had issues come up with the timing of discretionary amendments under 412(d)(2) (see above), but those applications have ultimately gone through.

30. The Service could simplify everything by adopting and publicizing a much broader policy on incorporation by reference. Any provision, required or optional, should be susceptible to incorporation by reference to the extent of what does not require the plan sponsor's choice. And for many of those choices, incorporation by reference of an alternative choice should be allowed and would be efficient. The Service should require only that each reference include enough detail so that there is not an ambiguity about which provision the plan states.

31. The level of knowledge seems to be dramatically less than it was 5 years ago.

32. Generally we have been happy. We do occasionally get a reviewer who clearly doesn't grasp the process but with a good response with cites to regs we have been able to resolve all differences so far.

33. IRS personnel are equally confused with whether plans have been updated timely and what is required. It is annoying to have to educate IRS personnel on the client's dime.

34. In general, they have been very cordial and responsive. However, it seems that every time we get a different reviewer, they end up asking for completely different things than the other reviewers. Why isn't there more consistency? And the fact that we cannot email responses to the reviewers is just plain stupid.

35. Good. They are helpful and pleasant. They're not as knowledgeable, and they don't have as much discretion as they used to have. They're tethered to checklists and supervisors. That may be fairer and result in more uniform results. But, look - if you audited 100 plans and looked closely for operational and document defects, at least 90 of them would have something - there ought to be some measure of discretion at even the lowest levels of review in favor of plans that are 95% in compliance and not structured to benefit owners and the highly compensated.

36. IRS personnel seem to be very well trained and generally responsive. On the other hand, issues are raised based on some sort of internal positions of which taxpayers have no knowledge. Perhaps we need more recognition that plans are not just compliance documents but contracts with employees that can impose non-qualification liabilities.

37. IRS personnel are generally quite knowledgeable and professional in the dealings I have had. I had only one isolated instance of a really bad experience with a reviewer who simply didn't seem to know what he was doing.

38. Experience with agents varies greatly. Some lack a basic understanding of the qualification rules, and others have difficulty in communicating in the English language. Electronic communication with IRS agents should be permitted and encouraged.

39. This is a mixed bag. Some reviewers are bright and practical, some have no business or common sense.

40. There seems to be a lack of consistency between reviewers. Some reviewers have come back with requests for amendments that are inapplicable to the operation of the plan.

41. We have had no plans go under review.

42. Many reviewers don't appear to understand plan provisions well (especially in defined benefit plans). Many also don't appear to read the file, such as the [required] statement/explanation of amendments since the last determination letter. As a result, reviewers ask for amendments that either are irrelevant to the particular plan, or already are included in the plan in a nonstandard form (that is, in a form different from the form on the checklist the reviewers use), and for information that already has been provided. The lack of required expertise is frustrating and results in truly unnecessary expense for some sponsors.

43. Great variance between agents in terms of degree of skill. Think things would go faster if they worked on one plan at a time, since we tend to spend a lot of time reminding the agents of open issues, and reminding them where we left off since last contact.

44. Generally, excellent. With recent filings I have found reviewers to be more knowledgeable and more helpful, as well as more pleasant and courteous.

45. A lot of clients complain about the cost of the restatement. We charge $1200. But some of these clients should not have 401k plans. They are too small, or they don't seem to care about the compliance aspect of the plan. The questions we receive are: 1. Is this restatement necessary? 2. I have to do this all over again in another 6 years? 3. Do I get anything out of this since I am paying $1200? 4. I am trying to find the value in this?

46. Although acknowledgment letters are timely, assignments are not (having a contact person, even if they have not yet begun their review, is important to practitioners); IRS personnel appear to be well-trained and generally are helpful.

47. The IRS agents never come back with the same requested changes even though our plan language is the same. Also, language which was approved as a volume

submitter language is being challenged by an agent so we need to revise just to appease her.

48. There seems to be a wide divergence in the quality of the specific IRS reviewers. Some are excellent, communicative and reasonable. Others, however, seem to be quite deficient in even basic understandings of qualification requirements. It appears that through the use of follow-up surveys that the IRS is attempting to deal with this problem. Hopefully in time we will see the results of this.

49. The level of reviewing agents' understanding of qualified plan requirements varies greatly. It is frustrating for everyone (and costly for clients) when an agent lacks basic knowledge of plan requirements. Agents also need to continue to be educated regarding governmental plan requirements.

50. For me, the biggest surprise has been how much the timing can vary depending on the agent working on the case. It's frustrating to have an agent work on a case and then leave it sit for months. More than once I've had an agent tell me they'd forgotten the application was still on their desk. In contrast, I've had other agents who I hear from a couple times in close succession and then complete the application within a few weeks of beginning work on it.

51. I've had very positive experiences with the IRS personnel who have reviewed the plan filings.

52. I often call and don't receive a response, even within a few days. Other than that, they are generally very informative and pleasant to work with.

53. It seems the IRS personnel who review the plan filings have a very limited checklist and do not actually read the plan. For instance, 415 regulations can be incorporated by reference, but if the IRS personnel goes strictly by their checklist there are about 6 things they state are not in the plan. However, if they read the plan these are covered.

54. They seem to know the law but the volume of work and number of personnel who review the plans tend to cause them to make short cuts that keep them from addressing issues that should be caught in the review.

55. Agents at this point have required selected Cycle C amendments for Cycle A plans as it is "easier to get through the system", which will only complicate the process of knowing what to amend next time around. Please stick with the proper Cycle for reviewing plans - a letter that is mostly Cycle A with a little Cycle C but no Cycle C protection is not helpful.

56. Some agents are very knowledgeable, understand the intricacies of various retirement plans, and will work with a sponsor's representative to resolve questions/problems efficiently. Other agents work rigidly off a checklist and, without sufficient retirement plan knowledge and/or a reasonable command of the English language (and I don't mean internationals), make unreasonable demands for language

modifications or amendments when the provision requirement is already in the plan but not worded exactly how it is on their checklist.

57. Overall the personnel are fine. However, I find that they frequently overlook items that are included in the original filing package. I also find that sometimes they are picky about some minor wording choice that does not change the meaning of the provision--and this wording choice has already been reviewed and passed on numerous occasions.

58. So far we have had no problems with the IRS personnel on the volume submitter plans. They have been processing our determination letter requests efficiently. Because of their complexity, cash balance plans have taken longer to process.

59. The requests for additional data being received from IRS reviewers are not always clear or concise, resulting in additional communication just to clarify the perceived document problem (which, again, increases the cost of the plan for the plan sponsor). The requests and acceptable responses are also inconsistent from reviewer to reviewer on similar plan provisions, in particular plan provisions required to be changed in individually designed plans by a few reviewers even though the wording was taken directly from the IRS wording contained in the applicable Listing of Required Modifications or provisions that are not required in approved prototype documents. There also appears to be a lack of experience and low comprehension levels that leads to lengthy discussions with the document provider on issues that are contained in the regulations or the alert guidelines checklists. Another issue that has become more common is the lack of a thorough review of the plan document before requesting additional data (for example, a request is received for an interim amendment followed by a second request with questions on vesting provisions, followed by a third request for an amendment to the contribution formula, etc.) This is extremely frustrating for the plan sponsor and can damage the relationship with the document provider, even when the document being reviewed turns out to be correct. Assigning a specific group of reviewers to plans provided by larger document providers has been suggested as a way to improve timing, increase experience, maintain consistency in plans written by a particular document provider, and provide a means of amending any disqualifying provisions in plans of the same design in an efficient and more effective manner. Sharing acceptable responses to the same data request with all reviewers could also reduce the number of multiple follow-up communications with the plan sponsor and unnecessary amendments.

60. As mentioned above, the agents are inconsistent with the information that they are looking for. If this was more streamlined, this could make the process easier for practitioners and could make the process shorter for the agents.

61. Can never reach them by phone, but overall they are getting the job done well.

62. Very inconsistent with comments. We would submit the same individually designed document for 15-20 clients during a restatement cycle and would receive inconsistent comments back from the reviewer for each plan. One reviewer might have

one or two issues to be addressed, a different reviewer would have different issues they would question. Some were very obviously technically inexperienced as the items they questioned were typically already covered in the document, they did not read or did not take the time to find it themselves. We would submit all our documents at one time, in one box with the hope that the same reviewer would get them all and thus be able to comment on the lot as a whole rather than receiving piecemeal inconsistent comments.

63. Generally knowledgeable although have encountered a few on plan terminations who appear to be lacking and ask for information no one else ever requests.

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Any other input. Provide any other input you might have about your experience with the determination letter process as well as the plan amendment and restatement requirements.

1. The more you can do to encourage the prototype format, i.e., an adoption agreement and a separate standard (not standardized) document the better everything will run. Volume submitter plans no longer make sense.

2. My experience in the public sector has been that many plans do not have determination letters for their plans and do not want to apply for determination letters for various reasons. In some cases, the cost is a major reason. In other cases, it may be the statutory special legislation which created the plan that causes some entities to feel they should not have to submit the plan to the IRS for a determination letter. I also think the perceived amount of time and effort is a deterrent.

3. Reviewers need more training.

4. Consistent with the IRS efforts to streamline the EPCRS process, consider the use of form applications, exhibits and form amendments to expedite filings, review and response letters.

5. Again, my biggest concern is identifying which amendments need to be made by when. Many plans have to be amended every year and the clients are not always appreciative about having to make another, "technical" amendment which many times has no impact on the administration of their plan.

6. Having been in the IRS-qualified plan field since 1972, I can state unequivocally that the response time from the IRS has suffered dramatically, especially during the past ten years or so. We attribute this to the relative scarcity of IRS staff that are qualified and/or well-experienced in this area. Our TPA firm has had simultaneous problems in identifying and hiring technicians experienced in Plan Administration tasks (IRS-qualification testing, trust accounting, Form 5500 preparation, etc.). It has become a classic Catch-22 situation: IRS regulations promulgated from continued Federal statutes have made qualified plan administration more and more complex, yet there are fewer and fewer qualified people at the Federal (IRS/DOL) and professional (TPA) level who are available to APPLY the pension laws. The result is that Plan Sponsors are

getting more and more unmotivated to establish and/or maintain qualified retirement plans - - which is entirely adverse to "national retirement policy."

7. One common gap these days in the process is that some reviewers are indicating that they will not review amendments that were adopted before the date of the last favorable DL. This position is a problem in that there is often no information that a DL letter is coming; further, some agents, when asked, will not add an amendment to a case that has just been closed even if the two "crossed in the mail" due to processing problems with this approach.

8. One issue is the content of the Determination Letter. While a Schedule Q is optional, when one is submitted the IRS is not referencing it in the determination letter. Andy Zuckerman said this was a policy decision they made. The Schedule Q should be referenced. Also, all amendments submitted should be referenced even if there has been a plan restatement.

9. The Internal Revenue Service should have issued some guidance as to the expected time from submission to receipt of a determination letter. Many benefits professionals had no idea what to expect. I certainly did not anticipate that it would take over two years for relatively uncomplicated filings.

10. I do not think the staggered cycles achieve the IRS' goal of smoothing out its workflow to the extent the IRS expected. There always will be bunching of determination letter applications because, human nature being what it is, many people will wait until the last possible moment (i.e., the deadline) to file.

11. It certainly seems like the restatement process collects all of the work and dumps it on us all at once. We generally have to have a full time and part time document only person during this restatement period. It would be great to somehow even out that workflow, but I don't see how that would be possible. I think this system works as well as it could.

12. It seems redundant for many plans.

13. I think the user fee to approve prototypes and volume submitter documents unfairly benefits the big document providers, compared with the small TPA firm that might have 100 plans but wants their own language. I always had my own VS plan, and controlled the language and options better than the big "include everything" vendors, but when they announced the $9000 fee, I bowed out. That's unfair, and produces more poorly drafted documents. I've been doing this since ERISA restatements, and it's just gotten too difficult. This is too important a service for the IRS to be discouraging requests for FDLs.

14. SEPs, SIMPLEs and IRAs - I have numerous outstanding opinion letter requests that have been outstanding with IRS for 1 1/2 - 2 years. My clients are upset about this and despite repeated requests to close these cases and assurances from IRS that they will be closed, they remain open.

15. The amendment process is somewhat confusing - it's difficult to get definitive answers on "amend by" dates for some of the interim requirements. Some of the reviewers let our responses to their initial requests sit for months before replying. There needs to be a way to expedite the process once the initial review has been completed.

16. This has been one of the more difficult determination letter phases I have experienced in more than 2 decades of practice. The Service has changed position and in some instances is refusing to honor previously issued favorable determination letters where all information was clearly disclosed. Coupled with the long period of time it is taking the Service to even respond to determination requests, this creates anxiety and uncertainty for plan sponsors, not to mention significant additional expense. In many instances sponsors are terminating their plans as a result of this approach by the Service. The Service should honor their prior determinations, respond promptly and mandate changes only on a go forward basis in these instances

17. One goal stated by Paul Shultz years ago, when the RAP process was being designed, was to lessen the number of pre-approved plans that submitted for DL's. This admirable goal is undermined by the volume of amendments and the timing requirements. It is near impossible to know whether a plan is really in compliance, even if you think you've done everything right. Simplification of the amendment timing rules is in order.

18. A plan's administrator cannot implement or administer a provision that is not stated by some writing. If it's not in some writing (which might include ERISA or the Internal Revenue Code), how would the administrator know what to administer? Some of my most challenging hours in advising plan fiduciaries have involved whether a fiduciary has authority to implement, or a duty to ignore, a plan "provision" that the employer says it intends to put in writing months or years later but wants the administrator to operate now.

19. The termination process and VCP are also taking way too long to complete. VCP filings are taking 8 months to even get opened. Termination filings are even longer.

20. Even the pre-approved plans should have DLs. Just dealing with the GUST RAP issues now in the EGTRRA process make it clear that if the IRS will be going backward in time for documentation we as TPAs need a mechanism to stop the clock.

21. The determination letter and plan amendment timing system is completely broken. Clients are so frustrated with the time and expense that they are either no longer obtaining determination letters, have terminated their plans, or are using free plans with no lawyer input. The disaster is getting worse by the year. Given the difficult economy and lack of funds to keep plans up to date, it is likely that many plans will miss deadlines this year thus flooding the EPCRS program.

22. I'm not really certain where this comment goes so I will put it here. We submitted a volume submitter plan on a Form 5307 that had some language modifications. The

submission was returned as the reviewer deemed the modifications were such that it needed to be resubmitted on a Form 5300. When we received the package back, all the various documents and amendments had had the signature pages removed and jumbled together. The pencil notations on the first page of each set of documents indicated the effective date and the execution date. These dates were incorrect as the signature pages were no longer associated with the correct set of amendments/documents. This disturbs me as I cannot imagine what the reviewer had in mind. Are they all this sloppy?

23. See above - but given the increase in user fees, individually designed and master/prototype plans might expect more timely service.

24. It would be helpful to have a longer period for interim amendments such as every two years; restatement requirements are reasonable.

25. It's a difficult process for practitioners and expensive for clients, but I can appreciate that it is challenging for the IRS to have a capable experienced staff that can cope with the volume given the complexity of the law and regulations.

26. Limit the number of times we need to amend plans! Amending the plan for required law changes every year is an expense most plan sponsors don't want to incur.

27. One recurring example of the problems identified in item 4: EGTRRA amendments that are included throughout a 2002 restated plan document, and timely adopted in that fashion, rather than being originally adopted as a snap-on model amendment. Reviewers do not get this, no matter how plainly it is explained in the filing.

28. Practitioners spend an enormous amount of energy tracking files/systems to ensure that clients don't miss all these deadlines, and I'm sure we miss some despite all the effort. Not sure a determination letter is needed every 5 or 6 yrs for many plans.

29. The real value of a favorable determination is continually being eroded. The review process continues to add more extensive caveats about what the Service will not review, reduces the ability to submit demonstrations with real review of facts on sometimes difficult issues. Also, in one instance, a client which had obtained a favorable determination letter subsequently found a defect which the IRS reviewer had missed-- but the Service's EPCRS division gave the favorable determination no effective meaning, required retroactive correction, and advised that if the client wanted to rely on the favorable determination to correct only prospectively, it had to go through the costly and cumbersome administrative appeals process after its plan was disqualified. There should be some benefit to diligently filing and obtaining a favorable determination. Based on this experience, frankly, there was none.

30. I take serious issue with the rules relating to timely adoption of plan amendments; personally, I think the earlier the better as benefits personnel rely on plan documents for administering their plans.

31. Keeping up with cycle determination letter filings and restatements and remedial amendment requirements has become cumbersome and all-consuming. In this economy, I suppose that is good for our business, but there is little time left for other work that needs to be done. We are also in a constant state of worry that we have missed some deadline!

32. Overall, my experience with the DL process has improved over time and I think that's largely due to the Service's increased focus on reaching out to the benefits community. I hope that will continue. Thanks for asking for input. We appreciate it.

33. There needs to be a way of correcting scrivener errors. Employers are unwilling to take errors to the IRS because the IRS will hold the employer to the error, some of which are quite expensive.

34. Now that cash balance plans have legal footing under PPA, the IRS should allow such plans to be generated through a volume submitter document.

35. Frankly, the old system was much more manageable. True, it created a bubble of work, but in so doing I believe it made for a much better and more efficient process. We on our end got geared up and set up our assembly line and got all plans restated with much less confusion, and on the IRS review end I believe there was also a more consistent and quality review achieved.

36. When taking over a plan that is on a brokerage house or large provider document, it is sometimes very difficult and time consuming to get copies of their opinion letter and signed interim amendments. This is especially a problem when a document provider merges into another entity or goes out of business. Since IRS has copies of all the opinion letters, it would be quite helpful if they were published online. Also, why doesn't IRS require that sponsors of prototype and volume submitter plans submit any interim amendments they execute that apply to the employers using their documents? These amendments could then be published online.

37. The current process is creating a trail of plan documents that is becoming increasingly difficult to maintain and to organize for a determination letter filing once every five or six years. The number of interim amendments, different signing deadlines, and lack of one complete plan document increases the chance of a form failure. This could be especially detrimental when identified during plan mergers required by corporate structure changes.

November 25, 2009

The Advisory Committee on Tax
Exempt and Government Entities (the ACT)
C/O Marcia Wagner
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Re: Additional Comments on Interim Amendments
and the Determination Letter Program

Dear Marcia:

At your request, ASPPA is submitting these comments to supplement oral comments made at the October 13, 2009 meeting of the ACT. These comments are divided into four primary areas: (1) interim amendments, (2) the 6-year cycle, (3) the 5-year cycle, and (4) the determination letter program.

ASPPA is a national organization of more than 6500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

I. Interim Amendments - Rationale

ASPPA has supported legislation to reduce and streamline the interim amendment requirements. The comments made by practitioners in attendance at the October 13th meeting of the TEAC indicated wide spread agreement that the current interim amendment requirements are a burden to all parties (the IRS, practitioners, and employers) and drive up plan expenses. Since expenses are normally paid out of plan accounts, participants ultimately bear this cost.

However, it is important to acknowledge the underlying reasons offered to support annual amendments. They include:

- Increased employer and practitioner awareness of changes in the law;
- Elections made with respect to the operation of the plan are memorialized, protecting participant rights and leaving a trail for others to follow; and

- When plans are restated in their appropriate cycle, the various retroactive provisions can more easily be included in the plan by virtue of the interim amendment "trail" left behind.

Problems with Interim Amendments

Although well intentioned, our experience has shown many problems with the interim amendment process as it presently exists. Among our concerns:

- The process of preparing and distributing the documentation for an interim amendment is both expensive and time consuming. It increases the burden and costs of maintaining a plan, which is felt disproportionately by small plans, where expenses of a relatively fixed nature are spread over fewer participants thereby driving up the per capita cost.
- The current process is incredibly complicated, with different amendment deadlines that vary based upon the type of amendment and the plan's fiscal year. This leads to mistakes being made by well meaning plan sponsors (who, in most cases, are voluntarily providing this benefit). Small plan sponsors in particular are shocked and surprised when asked to pay thousands of dollars in sanctions when an inadvertent amendment mistake is uncovered during an IRS audit.
- In many cases there is a lack of guidance or clarity on when amendments are needed and what the amendments must contain (e.g., the final 415 regulation; or the EGTRRA good-faith amendment drafted by the IRS prior to the passage of EGTRRA technical corrections).
    - The deadlines can vary from employer to employer.
    - Many times, the amendment includes both "discretionary" and "mandatory" provisions, thus there may be two different deadlines for a particular change in the law. There is a great deal of ambiguity in this area, much of which relates to how one interprets the rules on "integrally related" changes found in Rev. Proc. 2007-44.
    - The scope of the "anti-cutback" rules is not always clear and made even more confusing when applied alongside various exceptions enacted by Congress.
- Interim amendments create a drain on IRS and practitioner resources. Expensive time is spent in reviewing plans to ensure that all interim amendments have been timely adopted, which as described above, is much easier said than done.

ASPPA's Recommendations:

- The interim amendment rules should be modified to strike a balance between the need to hold down unnecessary costs and the desire to keep plan documents current. The current "default" approach is that an interim amendment is needed whenever there is a change in applicable law, unless otherwise provided. The "default" should be reversed so that an interim amendment is not needed unless otherwise specified (by law or by the IRS).

- A plan amendment (or restatement) should **only** be required at the mid-point of a plan's cycle and at the end of a plan's cycle (the deadline would not be tied to a sponsor's fiscal year or to the plan year). For example, for pre-approved plans, an interim amendment would be needed (for those provisions the law or the IRS states must be included) in year three (3) of the cycle and in year six (6) of the cycle (at the time the plan is restated). For individually designed plans, the deadline could be in year two (2) and in year five (5) of the plan's cycle.

- In order to address the concerns of the Treasury regarding the protection of participant rights, it was suggested at the October 13th meeting that in lieu of an annual amendment, an annual notice could be provided to participants regarding any changes in the law that affect the operation of the plan. If a participant notice is required in lieu of an annual amendment, then the notice should only be required when there are changes in the law that materially affects participants' rights under the plan. The intention would be to incorporate the same standard for disclosure that applies under Title I of ERISA and is typically met by distributing a "Summary of Material Modifications" or "SMM." Furthermore, in order to avoid many of the same issues practitioners are facing with respect to interim amendments, guidance would be needed to clarify the timing and content of the notices. For example, the deadline to distribute the notices should be uniform (i.e., not tied to a plan or fiscal year) and should be long enough to ensure that adequate time is available to prepare and distribute them.

- In order to help provide uniform deadlines, the Service should provide IRC §411(d)(6) relief until an interim amendment is required. We understand that the Service may not have authority to provide IRC §411(d)(6) for all changes in the law. However, the Service does have authority to provide IRC §411(d)(6) relief in certain situations and we ask that such authority be exercised where possible. For example, the Treasury provided IRC §411(d)(6) relief in order to provide uniform amendment deadlines in Treasury Decision 8781, 63 FR 47172-47174, Sep. 4, 1998 and Treasury Decision 8806, 64 FR 1125-1127, Jan. 8, 1999. More recently, IRS Announcement 2009-82 provides IRC §411(d)(6) relief in order to enable plan sponsors to comply with forthcoming guidance on hybrid plans.

- Where IRC §411(d)(6) relief is not possible, clarification on the interaction of the provision(s) in the interim amendment and the application of IRC §411(d)(6) should be provided.

- The Service should provide guidance on the provisions that the good-faith amendments must include. The best approach would be a list of all necessary amendments and sample language that will meet the good faith standard for interim amendments. This will help reduce the amount of time the IRS and practitioners spend determining whether an amendment sufficiently covers the provisions deemed necessary. ASPPA has also encouraged the Service to permit more provisions to be incorporated by reference. Where an interim amendment is required and there are optional provisions, guidance on which changes are "integral" to a change in the qualifications is needed. Again, this will help provide uniformity and consistency in determining applicable deadlines.

- The Service should also provide an ongoing list of provisions that are needed for all plans. Publishing a list of required provisions for terminating plans would be the all inclusive list. That list could then be scaled down to indicate which amendments are needed for ongoing plans and which amendments are needed for plans submitted for approval in a particular cycle (i.e., the provisions needed to reflect the most current Cumulative List).

II. 6-Year Cycle

ASPPA believes that the 6-year cycle for pre-approved plans is generally working well. There are clarifications and relatively minor corrections that need to made to the Revenue Procedure, but these are not systemic problems that require restructuring the program.

III. 5-Year Cycle

ASPPA did not support the 5-year cycle from the outset. Our primary complaint was the difficulty we anticipated plan sponsors would have in determining their correct "cycle." This is due to the complexity of the rules, particularly when there is an exception to be applied. Based on anecdotal reports from our members, it appears that this concern has come to fruition. We agree that the rules should be designed to prevent abuses. However, we believe that providing delays of one to two years in order to simplify the exceptions is a better approach, particularly since interim amendments will continue to be required.

An alternative approach might be to have all defined benefit plans on the same 6-year cycle (IDPs and pre-approved); all defined contribution plans, other than ESOPs, on the same 6-year cycle; and ESOPs and 403(b) plans each on their own separate 6-year cycles. Governmental plans might also merit a separate 6-year cycle. We would be happy to explore these thoughts further at your convenience.

IV. Determination Letter Program

Several problems with the determination letter program have been identified. They include;

- The time to receive approval of "off-cycle" submissions (e.g., plan terminations, new plans, etc.) has increased. This may be evidence that the staggered approach for individually designed plans is not working as planned.

- The requirement that employers using pre-approved plans provide copies of old plan documents (unless there has been actual determination letter issued) is creating an undue hardship. This issue arises on audit or when a plan is submitted for a determination letter. Many believe that it is a change in the concept that reliance on an opinion or advisory letter is the equivalent of having received a determination letter. If it is equivalent to a determination letter, then providing a copy of the latest document with an opinion or advisory letter is all that should be required. Alternatives that were discussed were to have a certification from the employer that a pre-approved plan has been utilized since inception of the plan or modifying Form 5500 to have elections made regarding the various interim amendments. We believe that modifying Form 5500 may work going forward, but due to our understanding of the contractual obligations regarding the processing of Form 5500s, changes such as this could not be implemented.

- There have also been situations where the determination letter program has been used to change policy (e.g., with cash balance plans). This also includes situations where the Service has determined that certain permissible and common plan designs are not permitted in pre-approved plans.

- ASPPA recommends that the Service move forward to expand the pre-approved plan program to include ESOPs, hybrid (e.g., cash balance) defined benefit plans, and plans described in IRC§ 414(x) (eligible combined plans). These types of plans have (or, in the case of IRC§414(x) plans, will) become common and the variations among the terms of the plans do not vary significantly. There does not appear to be any reason to consume additional IRS resources with these types of plans that can be accommodated in a pre-approved plan program. We understand that the Service uses the determination letter program to monitor whether any abusive situations are occurring (such as the establishment of place-holder ESOPs). However, there may be better ways to accomplish this without consuming the determination letter resources and slowing down reviews for everyone else.

These comments were prepared by ASPPA's Government Affairs Committee, and primarily authored by Robert M. Richter, APM. Please contact us if you have any comments or questions regarding the matters discussed herein. Thank you for your time and consideration of this matter.

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Appendix F. IRS Guidance Regarding Plan Amendments and Remedial Amendment Periods

Authority	Publish Date	Summary
Notice 2009-97	**12/11/2009**	**~Purpose:** To extended the amendment deadline for PPA '06 and WRERA '08 modifications.
Ann. 2009-89	**12/10/2009**	**~Purpose:** To provide notice of upcoming Rev. Proc. regarding IRC Sec. 403(b) plan determination letter process.
Rev. Proc 2007-44	**06/13/2007**	**~Purpose:** Restatement of Rev. Proc. 2005-66.
Notice 2005-95	**12/02/2005**	**~Reaffirmation:** In response to comment, reaffirms the distinction between Interim and Discretionary amendments. [Part II] **~Retroactive Annuity Start Date:** Pursuant to this notice, the deadline to adopt an interim amendment to comply with the final RASD regulations will be the later of the deadline under Rev. Proc. 2005-66 that would otherwise apply to the plan sponsor or employer or December 31, 2005. [Part IV] **~Automatic Rollover:** Under the transitional relief provided, the deadline will be the later of the deadline under Rev. Proc. 2005-66 or December 31, 2005. [Part IV]
Rev. Proc. 2005-66	**08/26/2005**	**~Purpose:** To finalize and implement the staggered determination letter program described in Ann. 2004-71. **~NOTE:** First use of the term 'Interim Amendment.' **~Necessary Amendments:** When a plan qualification requirement changes either due to a statutory change, a regulation, or other published guidance, causing a plan to no longer be qualified, a timely adopted interim amendment will generally be required. **Any other change to a plan must also be reflected in a timely adopted plan amendment.** If the timely adopted plan amendment (including any required interim amendment) does not satisfy the qualification requirements, then a remedial amendment must be adopted by the end of the remedial amendment cycle. [Part I, Sec. 3.03] **~Interim vs. Discretionary:** The deadline for the timely adoption of an interim or discretionary amendment with respect to any plan is determined as follows: (1) An employer (or a sponsor or a practitioner, if applicable) will be considered to have timely adopted a plan amendment with respect to a disqualifying provision described in section 5.01(1), if the plan amendment is adopted by the end of the remedial amendment period described in section 2.05.; (2) An employer (or a sponsor or a practitioner, if applicable) will be considered to have timely adopted a plan amendment with respect to a plan provision that is integral to a disqualifying provision as described in section 5.01(2), if the plan amendment is adopted by the end of the remedial amendment period described in section 2.05; (3) An employer (or a sponsor or a practitioner, if applicable) will be considered to have timely adopted a discretionary plan amendment (that is, a plan amendment not described in section 5.01), if the plan amendment is adopted by the end of the plan year in which the plan amendment is effective.

Authority	Publish Date	Summary
Ann. 2005-36	**05/09/2005**	**~Purpose:** To announce that the GUST 2 defined contribution pre-approved program will close as of June 15, 2005.
Rev. Proc. 2005-16	**02/18/2005**	**~Purpose:** This revenue procedure sets forth the Service's procedures for issuing opinion and advisory letters regarding the acceptability under § 401 and § 403(a) of the Internal Revenue Code (the "Code") of the form of pre-approved plans (that is, master and prototype (M&P) and volume submitter (VS) plans). [Part III, Sec. 1.01]
Notice 2005-5	**12/28/2004**	**~Deadline for Automatic Rollover Provision:** Plans that provide for mandatory distributions and that do not already include the automatic rollover provisions must adopt a good faith plan amendment reflecting the automatic rollover requirements by the end of the first plan year ending on or after March 28, 2005. [Q&A-16]
Notice 2004-84	**12/14/2004**	**~Designation of Disqualifying Provision:** Plan provisions relating to a retroactive annuity starting date are hereby designated as disqualifying provisions under § 1.401(b)-1(b)(3). This will allow plan sponsors to adopt retroactive annuity starting date amendments in the 2005 plan year. [Part V]
Ann. 2004-71	**09/13/2004**	**~Purpose:** Describes the Proposed Rev. Proc. detailing the new staggered determination letter process. ~**Effect:** The effect of this system is that plan sponsors of individually designed plans generally will need to adopt remedial amendments of disqualifying provisions, and will need to apply for new determination letters, only once every five years. [Sec. 1] ~**Extension of EGTRRA RAM:** This draft revenue procedure would also extend a plan's EGTRRA remedial amendment period as provided in the chart found in section 9.01, which is the Extension of the EGTRRA Remedial Amendment Period/Schedule of Next Five-Year Remedial Amendment Cycle. [Sec. 9]
Rev. Proc. 2004-25	**03/31/2004**	**~Extension of RAM:** The remedial amendment period with respect to disqualifying provisions described in § 1.401(b)-1(b)(1) that are put into effect (in the case of new plans) or adopted (in the case of existing plans) after December 31, 2001, is extended to the end of the EGTRRA remedial amendment period (the end of the plan's 2005 plan year). [Sec. 3]
Rev. Proc. 2003-72	**08/28/2003**	**~Purpose:** Extends the GUST RAM to 01/31/2004 for certain M&P and Volume submitter plans. [Sec. 1] **~IRC 409(a)(9a) Amendments:** The time by which defined contribution plans must be amended to comply with the final and temporary regulations under § 401(a)(9) is extended to the later of the last day of the first plan year beginning on or after January 1, 2003, or the end of the GUST remedial amendment period. [Sec. 3] **~GUST Non-Amender:** Provides streamlined compliance requirements. [Sec. 6]
Rev. Proc. 2003-44	**06/04/2003**	~Discusses EPCRS, modifying and superseding Rev. Proc. 2002-47. Appears not to modify or define remedial amendment period.
Rev. Proc. 2002-73	**11/19/2002**	**~Purpose:** IRS has extended time for making various amendments to qualified retirement plans. Generally, pre-approved plans will have until 9/30/2003 to comply with GUST. Plans will also have extension for complying with Community Renewal Tax Relief Act (CRA) of 2000 (P.L. 106-554; 12/21/200) until latest of end of first plan year beginning after 2001, end of GUST remedial period, or 6/30/2003.

Authority	Publish Date	Summary
Rev. Proc. 2002-47	**06/26/2002**	~Discusses EPCRS, modifying and superseding Rev. Proc. 2001-17. Appears not to modify or define remedial amendment period.
Rev. Proc. 2001-55	**11/15/2001**	**~Purpose:** To extend the GUST RAM to 02/28/2002 if the period would otherwise end before this date. This date is further extended to 06/30/2002 for those plans directly affected by the 09/11/01 terrorist attack. [Sec. 1]
Ann. 2001-77	**06/29/2001**	**~GUST RAM:** Permits M&P and Volume Submitter plans to take advantage of the Rev. Proc. 2000-20 extension without submitting a determination letter request. [Sec. II.E]
Notice 2001-42	**06/29/2001**	**~Purpose:** To provide guidance concerning EGTRRA amendments. "Changes made by EGTRRA to the Code provisions related to qualified plans include changes that require plan amendment to preserve qualification and changes that require plan amendment only if the plan sponsor chooses to change the plan." [Part I] **~GUST RAM:** Is not extended by this Notice. [Part I] **~EGTRRA RAM:** The RAM for a disqualifying EGTRRA provision shall not end prior to the last day of the first plan year beginning on or after 01/01/2005. [Part III] **~Good Faith EGTRRA Amendment:** A plan is required to have a good faith EGTRRA plan amendment in effect for a year if (1) the plan is required to implement an EGTRRA provision for the year or the plan sponsor chooses to implement an optional EGTRRA provision for the year, and (2) the plan language, prior to the amendment, is not consistent either with the provision of EGTRRA or with the operation of the plan in a manner consistent with EGTRRA. [Part III]
Rev. Proc. 2001-17	**01/22/2001**	~Discusses EPCRS, modifying and superseding Rev. Proc. 2000-16. Appears not to modify or define remedial amendment period.
Rev. Proc. 2001-6	**01/18/2001**	**~Purpose:** Described the procedure for obtaining a determination letter on a qualified plan. [Sec. 1.01.01] ~No RAM changes.
Ann. 2001-12	**01/11/2001**	**~Purpose:** IRS summarized rules for determining GUST remedial amendment period for employers who use M&P or volume submitter specimen plans. **~Normal GUST RAM:** The GUST remedial amendment period generally ends on the last day of the first plan year beginning in 2001 ("the regular GUST remedial amendment period"). **~Later GUST RAM:** Employers may have a later deadline if the requirements of section 19 of Rev. Proc. 2000-20, 2000-1 C.B. 553, as modified by Rev. Proc. 2000-27, are met. To be eligible for a later deadline under section 19 of Rev. Proc. 2000-20, an employer must either: (i) adopt an M&P or volume submitter specimen plan (regardless of whether the plan has a TRA `86 opinion or advisory letter); or (ii) jointly certify with an M&P sponsor or volume submitter practitioner that the employer intends to amend its plan for GUST by adopting the sponsor or practitioner's M&P or volume submitter specimen plan after the plan has received GUST approval.

Authority	Publish Date	Summary
Rev. Proc. 2000-27	**06/12/2000**	~**Purpose:** To extent the GUST RAM until the last day of the first plan year beginning on or after 01/01/2001. [Sec. 1.01] **~Government Plans:** Also extends RAM for government plans. [Secs. 4.01, 4.04] **~Rev. Proc. 2000-20:** Also extends RAM for and employer to adopt a M&P or volume submitter plan. [Sec. 4.03]
Rev. Proc. 2000-20	**01/24/2000**	**~**Covers the M&P and Regional Prototype determination letter program. ~**Purpose:** To assure that employers will have 12 months after an M&P plan or volume submitter specimen plan is approved for GUST in which to adopt the approved plan as a timely GUST restatement. [Sec. 19.01] **~Extension:** If all requirements have been satisfied, the RAM for the employer's plan will not expire before the end of the 12th month beginning after the date on which a GUST opinion or advisory letter is issued for the specimen plan. Within this period, the employer must amend or restate its plan by adopting the GUST-approved M&P or volume submitter specimen plan.
Rev. Proc. 2000-16	**01/24/2000**	**~**Describes EPCRS; appears not to modify or define remedial amendment period.
Rev. Proc. 99-23	**04/06/1999**	**~Purpose:** To extend the RAM for GUST changes as specified in Rev. Procs. 97-41 and 98-14. The time frame is extended until the last day of the first plan year beginning on or after 01/01/2000. [Sec. 1.01] **~Notice 99-5:** RAM extended until end of GUST Remedial Amendment Period. **~Notice 98-52:** RAM extended until end of GUST Remedial Amendment Period.
Notice 99-5	**12/23/1998**	**~Purpose:** To provide administrative relief for plan administrators who are concerned that will be unable to accommodate changes to the general rule for eligible roll-over distributions. [Part I] **~Extension:** The relief granted allows both section 401(a) plans and section 403(b) annuities to delay implementation of the exception as it applies to distributions occurring before January 1, 2000. [Part VI]
Notice 98-52	**10/29/1998**	**~Purpose:** To delay the date design-based 401(k) safe harbor methods must be adopted. [Part I, Sub-Section ~**Rule:** If a plan uses the safe harbor methods for the plan year beginning in 1999, the plan generally must be amended no later than the end of the plan year, retroactive to the first day of that year, to reflect the safe harbor methods. [Part XI, Sub-Part B]

Authority	Publish Date	Summary
Rev. Proc. 98-14	**01/12/1998**	**~Purpose:** To open the determination letter process for GATT, TRA 97, SBJPA and USERRA changes. ~**Disqualifying Provisions:** Certain provisions required by TRA 97 are considered to be disqualifying provision. [Sec. 4.02] **~Extended RAM:** The Remedial Amendment Period for TRA 97 is extended to the last day of the first plan year beginning on or after January 1, 1999. [Sec. 4.01] ~**RAM for Government Plans:** Updates Rev. Proc. 97-41 to extend the RAM to (1) the last day of the plan year beginning before 01/01/2001, or (2) the last day of the plan year beginning on or after the 1999 legislative date.
Reg. Sec. 1.401(b)-1	**08/01/1997**	~**Commissioner Discretion:** The Commissioner has the discretion to extend the remedial amendment period. Absent such discretion, standard rules apply. [Treas. Reg. Sec. 1.401(b)-1(f)] ~**Standard Rule:** A plan that fails to satisfy the requirements of Sec. 401(a) solely as a result of a "disqualifying provision" need not be amended to comply with those requirements until the last day of the remedial amendment period, provided the amendment is made retroactively effective to the beginning of the remedial amendment period. [Treas. Reg. Sec. 1.401(b)-1] **~Remedial Amendment Period Begins:** The date on which the change becomes effective with respect to the plan or, in the case of a provision that is integral to a qualification requirement that has been changed, the first day on which the plan was operated in accordance with the provision as amended. [Treas. Reg. Sec. 1.401(b)-1T(b)(3)] **~Remedial Amendment Period Ends:** The later of (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins or (2) the last day of the plan year that includes the date on which the remedial amendment period begins.
Rev. Proc. 97-41	**07/31/1997**	**~Rule:** Under this Rev. Proc., qualified plans have a remedial amendment period under Sec. 401(b) with respect to certain amendments for SBJPA, GATT or USERRA through the last day of the first plan year beginning on or after January 1, 1999. Thus, these amendments will not have to be adopted before the last day of the plan's 1999 plan year. [Sec. 1.02(1)] ***Note:*** *This represents an extension.* **~Disqualifying Provisions:** Certain provisions required by GATT and SBJPA are considered to be disqualifying provisions. [Sec. 6.01] **~Extended RAM for GATT and SBPJA:** With respect to the GATT and SBJPA disqualifying provisions, the remedial amendment period is extended to the last day of the first plan year beginning on or after January 1, 1999. [Sec. 6.04] ~**All Other Disqualifying Provisions:** With respect to all other disqualifying provisions adopted or effective after December 7, 1994, the remedial amendment period is extended to the last day of the first plan year beginning on or after January 1, 1999. [Sec. 6.04] **~Government Plans:** SBJPA changes to 403(b) plans that are government plans must be adopted before the last day of the first plan year beginning on or after the 1999 legislative date , that is, the 90th day after the opening of the first legislative session beginning on or after January 1, 1999 of the governing body with authority to amend the plan, if that body does not meet continuously.

Authority	Publish Date	Summary
Rev. Proc. 96-49	**10/07/1996**	**~USERRA:** The Uniformed Services Employment and Reemployment Rights Act of 1994 revised and restated the federal law protecting veteran's reemployment rights. **~Plan Amendments:** Plan amendments to reflect the provisions of USERRA and Sec. 414(u) will not be required to be made before the date plan amendments will be required to be made under Sec. 1465 of SBJPA ("Small Business Jobs Protection Act of 1996"). [Sec. 2.07]
IRC 401(b)		A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of subsection (a) for the period beginning with the date on which it was put into effect, or for the period beginning with the earlier of the date on which there was adopted or put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing the return of the employer for his taxable year in which such plan or amendment was adopted (including extensions thereof) or such later time as the Secretary may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period.

Appendix G. Designation of PPA, HEART and WRERA Amendments as "Core" or "Non-Core"

Each required and optional plan amendment under the Pension Protection Act of 2006 ("PPA"), the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART") and the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), as summarized in the charts below, has been designated as either a "Core" or "Non-Core" plan amendment. The following designations were made by the ACT for illustrative purposes, and a brief explanation for each designation has also been included.

1. Required PPA Provisions for Defined Contribution Plans

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Economic Growth Tax Relief and Reconciliation Act of 2001 ("EGTRRA") Permanence	August 17, 2006. No effective date is provided by PPA.	Plan must only be amended if the document references the EGTRRA sunset provisions, which were eliminated by PPA.	Deemed to be non-core as such references are being eliminated in the plan and therefore not needed. Moreover, the EGTRRA operational provisions that will continue should currently be in the affected plans, so there is no take-away.
Freedom to divest/diversify publicly traded employer securities (Internal Revenue Code ("Code") Section 401(a)(35))	Effective for plan years beginning after December 31, 2006 (delayed effective date for collectively bargained plans). Plan must be amended prior to the last day of the 2009 plan year.	For salary deferral contributions and after-tax contributions, participants must be allowed to diversify out of company stock and into other investments immediately. For employer contributions, the participant must be permitted to diversify upon the completion of three or more years of service. IRS Notice 2008-7 extends certain transitional guidance and relief provided to certain defined contribution plans that hold publicly traded employer securities under Notice 2006-107. Proposed regulations published January 3, 2008 may be relied upon until final regulations are issued.	Deemed to be core if the plan has such securities as it involves a benefit, right or feature ("BRF") of importance to the participant and participant action is required.
Elimination of "gap period" income for excess contribution and excess aggregate contributions	Effective for plan years beginning after December 31, 2007. Plan must be amended prior to the last day of	Gap period income must be distributed for the 2006 and 2007 plan years, as previously required under the Final 401(k)/401(m) regulations.	Deemed to be non-core as purely operational and ministerial in nature.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
(Code Sections 401(k)(8)(A)(i) and 401(m)(12))	the 2009 plan year.	PPA eliminates these gap period income requirements, and WRERA (please see below) eliminated another.	
Rollovers by Nonspouse beneficiaries (Code Section 402(c)(11))	Effective for distributions beginning after December 31, 2006. Plan must be amended prior to the last day of the 2010 plan year.	Under the PPA, a plan was permitted (not required) to allow a nonspouse beneficiary to roll over a death benefit to an inherited IRA. However, WRERA made this provision mandatory (please see below). If implemented operationally prior to 2010, plan must be amended by last day of 2009 plan year; otherwise by the last day of the 2010 plan year.	Deemed to be non-core as it does not affect benefits. It is an operational issue, where notice should be sufficient.
Vesting for Employer Non-elective contributions (Code Section 411(a)(2)(B))	Effective for contributions made in plan years after December 31, 2006 (delayed effective date for collectively bargained plans and ESOPs). Plan must be amended prior to the last day of the 2009 plan year.	Plans that provide for employer contributions, such as profit sharing contributions, must have a vesting schedule that, at a minimum, will (1) either fully vest participants upon the completion of 3 years of service (a "three year cliff"), or (2) vest at least 20% per year for each year of service beginning with a participant's second year of service (a "six-year graded schedule"). The "new" vesting schedules can be applied to all employer contributions or only to employer contributions made for the 2007 plan year and thereafter. Notice 2007-7 clarified that the faster vesting schedule applies to contributions made for *plan years beginning* in 2007 and thereafter.	Deemed to be core as it is a BRF. Furthermore, any time there is a change that affects eligibility, vesting or material change to benefit amount, this should be considered a core amendment.
Qualified Optional Survivor Annuity (Code Section 417(g)) ("QOSA")	Effective for plan years beginning after December 31, 2007 (delayed effective date for collectively bargained plans). Plan must be amended prior to	Plan sponsors of money purchase pension plans or those plans that have been merged with money purchase pension plans must now offer a 75% joint and survivor annuity. In addition, if the plan's current joint and survivor annuity benefit provides a survivor annuity for the life of	Deemed to be non-core as it is de minimis for most participants. This is operational in nature, where notice should be sufficient.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
	the last day of the 2009 plan year.	the spouse that is greater than or equal to 75% of the annuity payable during the joint lives of the participant and spouse, the plan must also offer a 50% joint and survivor annuity benefit. A written explanation required to be provided to a participant with respect to a QJSA must include the terms and conditions of the QOSA (Code Section 417(e)(3)(A)(i)).	

2. Optional Pension Protection Act Provisions for Defined Contribution Plans

The following are <u>optional</u> "plan design" amendments permitted by the Pension Protection Act of 2006 ("PPA") which must be included in a defined contribution plan document when it is submitted to the IRS for a "Cycle D" determination letter to the extent that the optional provision has been elected by the plan sponsor:

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Qualified Automatic Contribution Arrangement (Code Sections 401(k)(13) and 401(m)(12)) ("QACA")	Effective for plan years beginning after December 31, 2007. Amendment must be adopted on or before the beginning of the plan year in which the plan design is implemented.	"Qualified Automatic Contribution Arrangement" ("QACA"), provides a safe harbor whereby the plan will avoid having to perform annual 401(k) and 401(m) nondiscrimination testing and avoid top heavy testing. Implementing the QACA impacts various parts of the Plan: • *Salary deferrals:* The QACA provides for automatic enrollment of eligible employees who fail to make any salary deferral election (eligible employees who became participants prior to the effective date may be excluded). The QACA provides for a minimum deferral percentage of at least 3% of compensation for all eligible employees during the period beginning on the date of plan entry and ending on the last day of the following year, with an	Deemed to be <u>core</u> due to its pervasive impact on the plan and its dependence on the participants' elections to opt out.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
		automatic increase of 1% each year, up to at least 6% (but not to exceed 10%). • *Employer contributions and vesting:* The plan provides for matching contributions to be made in an amount equal to 100% of the first 1% of compensation deferred, and 50% of the next 5% of compensation deferred (a maximum of 3.5% of compensation). In the alternative, the plan can provide a nonelective contribution equal to 3% of all eligible non-highly compensated employees compensation. Matching contributions fully vest after two years of service and are subject to withdrawal restrictions. • *Qualified Default Investment Alternatives:* In the absence of an investment election, contributions must be invested in a qualified default investment alternative (see applicable DOL regulations, § 2550.404c-5). This requirement was eliminated by WRERA (see below). • *Notice:* Plan sponsor must provide annual notice within a "reasonable period" (at least 30 but no more than 90 days before the beginning of the plan year) to eligible employees informing them (1) of their right to modify their election or to opt out, and (2) how automatically enrolled contributions will	

Pension Protection Act	Effective Date	Comments	Core or Non-Core
		be invested in the absence of the participant's direction. The IRS has issued a model notice to assist with compliance with the QACA notice requirements (72 C.F.R. 63144). • The IRS issued proposed regulations (Treasury Regulation 115699-09) that would permit employers that sponsor safe harbor defined contribution plans to reduce or suspend safe harbor nonelective contributions and safe harbor nonelective contributions under qualified automatic contribution arrangements (QACAs) after the start of the plan year if the employer has incurred a substantial business hardship and certain other requirements are met. Suspension of the matching contribution formula was previously permitted.	

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Eligible Automatic Contribution Arrangement/Rescinding (Code Section 414(w)) ("EACA")	Effective for plan years beginning after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	*Rescinding contributions:* A participant who is automatically enrolled can choose to withdraw his salary deferrals (and earnings/losses on those amounts) within 90 days after being automatically enrolled; in such event, attributable matching contributions allocated to the participant's account are forfeited. Any such withdrawal is not eligible for rollover. Alternatively, a participant may choose to stop his deferrals as of any payroll period, or modify his deferral percentage quarterly. The IRS issued final regulations regarding the QACA (see above) and the EACA effective for plan years beginning on or after January 1, 2008 – although the requirement to utilize a safe harbor definition of compensation is delayed and not effective until plan years beginning on or after January 1, 2010 (Treasury Decision 9447).	Deemed to be <u>core</u> due to its dependence on the participants' elections, and that this provision directly affects benefits.
Hardship Withdrawals (Code Section 401(k)(2))	Effective date unclear. Appears to be effective for plan years beginning after August 17, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	Plans are now permitted to make hardship distributions to a participant's "primary beneficiary" under the plan for specified reasons (e.g., medical expenses, tuition expenses and burial and funeral expenses). The "primary beneficiary" must have an unconditional right to all or a portion of the participant's account balance upon the participant's death. (See also Notice 2007-7). Announcement 2007-59 provides that a plan will not fail to satisfy hardship safe harbors if implemented mid-year. This change is also significant in the area of domestic partnership law because many, if not most, domestic partners do not meet the Internal Revenue Code definition of "dependent," and same-sex spouses do not qualify as "spouses" under federal law due to the federal Defense of Marriage Act.	Deemed to be <u>non-core</u> as it is de minimis for most participants. This is operational in nature, where notice should be sufficient.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Qualified Reservist Distribution (Code Section 401(k)(2)(B)(i)(IV))	Effective for distributions made to participants called to active duty after September 11, 2001 and prior to January 1, 2008. Plan must be amended by the last day of the 2009 plan year.	A plan may permit in-service distributions of salary deferral contributions to a reservist who is called to active duty for a period that equals at least 180 days (or for an indefinite period) between September 11, 2001 and December 31, 2007. The 10% early withdrawal penalty under Code Section 72(t) will not apply. The HEART Act (see below) extended the applicability of such distributions to those individuals ordered or called to active service after December 31, 2007.	Deemed to be <u>non-core</u> as it has de minimis impact on most participants. This is operational in nature, where notice should be sufficient.
Rollover to Roth IRA (Code Section 408A(e)	Effective for distributions after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	A distribution from a qualified retirement plan under Section 401(a), 403(b) or 457(b) can be rolled directly into a Roth IRA, subject to the same rules that apply to rollovers from a traditional IRA. A participant with an adjusted gross income of $100,000 or more cannot take advantage of the new rollover provision until 2010.	Deemed to be <u>non-core</u> as it has de minimis impact on most participants. This is operational in nature, where notice should be sufficient.
Rollover of After-Tax Contributions (Code Section 402(c)(2)(A))	Effective for tax years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	The PPA expanded rollover options to allow a rollover of after-tax contributions by a participant from a qualified plan to a 403(b) plan or defined benefit plan provided that the plan that is receiving the rollover separately accounts for the after-tax rollover contribution.	Deemed to be <u>non-core</u> as it has de minimis impact on most participants. This is operational in nature, where notice should be sufficient.
Distribution Explanations	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to	Prior to the enactment of the PPA, plans subject to Code Section 417 were required to provide an explanation of distribution options available under the plan no less than 30 days and no more than 90 days before the distribution is to be made. The PPA provides that this	Deemed to be <u>non-core</u> because it is operational in nature and notice should be sufficient. Moreover, no amendment is required.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
	the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	explanation may be provided up to 180 days before the distribution is to be made.	
"Special Tax Notice Regarding Plan Payments" (Code Section 402(f))	Effective for plan years beginning after December 31, 2006. No plan amendment needed.	The PPA provides that the "402(f) notice" may be provided up to 180 days before a distribution is to be made. Notice 2007-7 clarifies that the 30 to 180 day notice period for "402(f) notices" applies only to distribution notice periods after the effective date of the PPA. IRS issued Notice 2009-68 and two safe harbor notices for use for participant distribution elections when (1) a distribution is not from a designated Roth account, and (2) when the distribution is from a designated Roth account.	Deemed to be <u>non-core</u> as it does not affect benefits, and no plan amendment is needed.

3. <u>Required Pension Protection Act and Other Provisions for Defined Benefit Plans</u>

The following chart summarizes those amendments required by the Pension Protection Act of 2006 ("PPA") and other authority that <u>must</u> be included in a defined benefit plan document when it is submitted to the IRS for a "Cycle D" determination letter:

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Qualified Optional Survivor Annuity (Code Section 417(g)) ("QOSA")	Effective for plan years beginning after December 31, 2007 (delayed effective date for collectively bargained plans). Plan must be amended by the last day of the 2009 plan year.	Pension plans must offer a 75% joint and survivor annuity in addition to the 50% joint and survivor annuity that was, and still is, required.	Deemed to be <u>non-core</u> as it is de minimis in its use by participants. It is operational in nature and notice should be sufficient.
Rollovers by Nonspouse beneficiaries (Code Section 402(c)(11)	Distributions beginning after December 31, 2006. Plan must be amended prior to the last day of the 2010 plan	Although this change in the tax qualification rules for nonspouse rollovers is currently discretionary, WRERA makes it mandatory (see WRERA summary below). If implemented operationally before 2010, plan	Deemed to be <u>non-core</u> as it does not affect benefits. It is an operational issue, where notice should be sufficient.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
	year.	must be amended by the last day of the 2009 plan year; otherwise by the last day of the 2010 plan year.	
Minimum Lump Sums (Code Section 417(e))	Effective for plan years beginning after December 31, 2007. Plan must be amended by the last day of the 2009 plan year.	Lump sum benefits under defined benefit plans cannot be less than a minimum amount calculated using the "applicable interest rate" and the "applicable mortality table." Revenue Ruling 2007-67 specified the mortality table that defined benefit plans must use to calculate such minimum lump sum distributions for plan years beginning in 2008. Notice 2008-30 stated that for plan years beginning on or after January 1, 2008, PPA changed the definition of the "applicable interest rate" to be the adjusted first, second, and third segment rates for the applicable look-back month.	Deemed to be <u>core</u> as it affects benefits.
Maximum Lump Sums (PFEA)	Effective for plan years beginning after December 31, 2005. Deadline for plan amendments to comply with PFEA was changed to the PPA amendment deadline (plan must be amended by the last day of the 2009 plan year.)	The Pension Funding Equity Act of 2004 ("PFEA") required defined benefit plans to use a 5.5% interest rate assumption when calculating the maximum lump sum benefit permitted by Code Section 415 in limitation years beginning in 2004 and 2005. The plan amendment deadline to comply with the PFEA interest rate change was initially the last day of the first plan year beginning after 2005. For limitation years beginning after 2005, the interest rate to be used is the greatest of 5.5%, the rate specified in the plan or the rate that provides a lump sum benefit that is not more than 105% of the lump sum benefit that would have been provided if the interest rate were the applicable interest rate used for determining minimum lump sum benefits.	Deemed to be <u>core</u> as it affects benefits.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Underfunding Restrictions (Code Sections 430 and 436)	Plan years beginning after December 31, 2007. Plan must be amended prior to the last day of the 2009 plan year.	A defined benefit plan that is less than 80% funded may not be amended to increase benefits. If the plan is less than 60% funded, benefit accruals must be frozen and the plan may not make lump sum payments or other payments that exceed what would be paid under a single life annuity. For plans funded between 80% and 60%, higher distributions are allowed (based on a formula in PPA).	Deemed to be <u>core</u> as it affects benefits and distribution options.
Normal Retirement Age (Code Sections 401(a) and 411(d)(6)	Effective for plan years beginning after December 31, 2006. Plan must have been amended for good faith compliance by the date prescribed for filing the employer's income tax return for the 2007 taxable year (including extensions). If done, the plan's remedial amendment period will be extended to the end of the plan's remedial amendment cycle.[150]	IRS final regulations that modified prior guidance now generally require that the normal retirement age in a pension plan be an age that is not earlier than the "earliest age that is reasonably representative of the typical retirement age" for the industry in which the covered workforce is employed. A normal retirement age of 62 to 65 would always be acceptable. However, a normal retirement age lower than 62 must be determined to not be earlier than the earliest age that is reasonably representative of the typical retirement age based on all of the facts and circumstances. If the plan sets the normal retirement age between age 55 and 62, the employer must apply a good faith analysis to determine if that age is reasonable under the applicable facts and circumstances. Generally, a normal retirement age below age 55 will be presumed to be unreasonable unless demonstrated otherwise. Notice 2007-69 was subsequently published to clarify that plans may not provide normal retirement ages	Deemed to be <u>core</u> due to its material affect on the timing and the amount of benefits.

[150] Certain relief is provided under Notice 2007-69, 2007-35 I.R.B. 468.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
		conditioned upon the employee's completion of a stated number of years of service (this would violate vesting and/or accrual rules).	
Conversion From Traditional Defined Benefit Formula to a Cash Balance Lump Sum Based Formula (Code Section 411(b)(1))	Effective for plan years beginning after January 1, 2007. Plan must be amended prior to the last day of the 2009 plan year.	One method of plan conversion from a traditional defined benefit plan to a cash balance plan involves the calculation of the benefit for employees under both the defined benefit plan formula and the cash balance formula, and then providing benefits under the formula that provides a benefit that is the "greater of" the two formulas. The IRS had indicated in the past that this "greater of" formula could violate rules that are designed to prevent an employer from providing disproportionately higher benefit accruals to participants in later years of service (referred to as "backloading"). This "backloading" could result in discrimination in favor of highly compensated employees. The IRS issued proposed regulations (I.R.B. 2008-32) clarifying how defined benefit plans converting to cash balance plans that utilize the "greater of" formula can satisfy the "backloading" rules. PPA addressed these plan conversions, but it did not require or prohibit specific methodologies used for conversions. Revenue Ruling 2008-7 addressed how accrual rules apply to the "greater of" benefit calculation and offered transitional relief for failing to meet the "backloading rules." As part of a conversion, certain participants who met set age and service requirements were "grandfathered" into the	Deemed to be core as it materially affects benefits, and benefit plan design.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
		traditional defined benefit plan formula. Other employees began participating in the new cash balance plan formula. Plan participants were divided into certain categories: (i) those employed post-conversion and who would receive benefits under the new plan, (ii) those who accrued benefits under the traditional defined benefit plan and the new cash balance plan who had yet to meet age/service requirements as set forth in the plan, and (iii) "grandfathered" participants. Benefit formulas must be aggregated (and the net result tested) to determine whether the plan meets certain prescribed accrual rules, but all participants in the plan do not have to satisfy the same accrual rule (provided one of three accrual rules with respect to each group of participants – the 3%, 133 1/3% or fractional method – is met). Certain plans that had received favorable determination letters were provided with temporary relief from plan disqualification and would be permitted to continue to use the "greater of" formula until 2009.	

Pension Protection Act	Effective Date	Comments	Core or Non-Core
Final 415 (b) Limitations on Benefits	Effective for limitation years beginning after July 1, 2007. Remedial amendment rules under 1.401(b)-1 apply.	Code Section 415(b)(2)(E)(ii) establishes limits on the annual benefits that may be provided under a defined benefit plan by providing that the interest rate used to adjust a benefit payable in a single lump sum distribution (or other form subject to the minimum present value requirements of Code Section 417(e) must not be less than the greatest of (i) 5.5%, (ii) the rate that provides a benefit of not more than 105% of the benefit that would be provided using the Code Section 417(e)(3) interest rate assumptions, or (iii) the rate specified under the plan. Notice 2007-7 sets forth three corrective measures whereby a plan sponsor can correct distributions that exceed the permissible limit, including a corrective measure available under the Employee Plans Compliance Resolution System.	Deemed to be <u>core</u> as it materially affects benefits.
Interaction Between "Anti-Cut Back Rules" (Code Section 411(d)(6)) and the Nonforfeitability Requirements (Code Section 411(a)	Effective August 9, 2006. Applicable for plan amendments adopted after December 31, 2006.	A qualified plan cannot eliminate or reduce certain early retirement benefits, retirement-type subsidies, or optional forms of benefit that created significant burdens and complexities for the plan unless such an amendment adversely affects the rights of any participant or beneficiary in a de minimis manner. In light of the United States Supreme Court decision, <u>*Central Laborer's Fund v. Heinz et al.*</u>, (541 U.S. 739) the Department of the Treasury issued Treasury Decision 9280, which was intended to reflect the holding in <u>*Heinz*</u> and to set forth final regulations to establish a "utilization test," which is a permitted method of eliminating optional forms of benefit that are burdensome to the plan and of de minimis value to plan participants and beneficiaries.	Deemed to be <u>core</u> as it involves anti-cut back rules.

4. Optional Pension Protection Act Provisions for Defined Benefit Plans

The following are optional "plan design" amendments permitted by the Pension Protection Act of 2006 ("PPA") which must be included in a defined benefit plan document when it is submitted to the IRS for a "Cycle D" determination letter to the extent that the optional provision has been elected by the plan sponsor.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
In-service Distributions at Age 62 (Code Section 401(a)(36))	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	A plan can allow in-service distributions at age 62, even if age 62 is earlier than the plan's normal retirement age. As a matter of plan design, amending a plan to allow in-service distributions at age 62 is appropriate should a plan sponsor find it desirable to allow phased-retirement for older workers.	Deemed to be non-core as it is optional in nature and notice should be sufficient.
Rollover to Roth IRA (Code Section 408(A)(e))	Effective for distributions after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	A distribution from a qualified retirement plan under Section 401(a), 403(b) or 457(b) can be rolled directly into a Roth IRA, subject to the same rules that apply to rollovers from a traditional IRA. A participant with an adjusted gross income of $100,000 or more cannot take advantage of the new rollover provision until 2010 (see WRERA summary below).	Deemed to be non-core as it has de minimis impact on most participants. This is operational, where notice should be sufficient.
Distribution Explanations (Code Section 417)	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	Prior to the enactment of PPA, defined benefit plans were required to provide an explanation of distribution options available under the plan no less than 30 days and no more than 90 days before the distribution is to be made. PPA provides that this explanation may be provided up to 180 days before the distribution is to be made.	Deemed to be non-core because it is operational in nature and notice should be sufficient. Moreover, no amendment is required.
"Special Tax Notice Regarding Plan Payments" (Code Section 402(f))	Effective for plan years beginning after December 31, 2006. No plan amendment required.	The PPA provides that the "402(f) notice" may be provided up to 180 days before a distribution is to be made. Notice 2007-7 clarifies that the 30 to 180 day notice period for	Deemed to be non-core as it does not affect benefits, and no plan amendment is needed.

Pension Protection Act	Effective Date	Comments	Core or Non-Core
		"402(f) notices" apply only to distribution notice periods after the effective date of the PPA. IRS issued Notice 2009-68 with two safe harbor notices for use with participant distribution elections.	

5. The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act")

Deemed to be non-core as it has de minimis impact on most plan participants and is operational in nature where notice is sufficient.

In the 2008 Cumulative List, the IRS stated that while plans submitting in Cycle D may be amended for the HEART Act, the IRS will not consider the HEART Act provisions in issuing determination letters. The HEART Act contains many provisions that affect military personnel. Those listed below impact qualified retirement plans under Code Section 401(a). Although none of a plan's participants may be performing qualified military service, all plans are required to include language reflecting the HEART Act. In general, plans must be amended to reflect the required provisions of the HEART Act by the last day of the first plan year beginning on or after January 1, 2010. However, the following changes are generally effective as of January 1, 2009:

- An individual who is in "qualified military service" (as defined in 414(u) of the Code) for at least 30 days must be treated as if he or she severed from employment for purposes of receiving an in-service distribution from a plan that would otherwise be prohibited. Such an individual cannot make elective contributions during the 6-month period beginning on the date of the distribution.

- A plan must provide that a participant who dies while performing qualified military service on or after January 1, 2007, must be treated as if he or she died during covered employment for purposes of accelerated vesting or any other death benefits under the plan.

- An employee on active duty who receives differential wage payments must be treated as if he is currently an employee of the employer making the payment, and the differential wage payment must be included in compensation.

6. The Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA")

Deemed to be non-core as it is operational in nature, where notice should be sufficient.

WRERA contains provisions affecting qualified plans and technical corrections to the PPA that affect such plans. The following is a listing of such provisions:

- 2009 Required Minimum Distribution ("RMD") relief including:
  - Waiver of RMDs for 2009;
  - Clarification that the 2009 calendar year is disregarded for calculating and applying the 5-year rule for death payments;
  - Plans can continue to process participant directed and/or plan-initiated distributions of 2009 calendar year RMDs in the same manner as they would if the 2009 waiver was not in place (subject to participant election to not receive 2009 calendar year RMDs), except that the participant may have the ability to roll over the amounts (since they are not RMDs under the relief, they are "eligible rollover distributions" for certain purposes under the Code); and
  - Relief is not mandatory, but in order to take advantage of the 2009 RMD waiver, plans have until the last day of the first plan year beginning on or after January 1, 2011 to amend.
- Technical Corrections to PPA under WRERA:

• For plan years beginning after December 31, 2009, nonspousal beneficiaries must be given the opportunity to perform a direct rollover to an IRA	Deemed to be non-core as it has de minimis impact on most plan participants and is operational in nature where notice should be sufficient.
• Eliminates the requirement that an EACA (see above) use a qualified default investment alternative as a default investment option	Deemed to be core if the sponsor makes the change since participant action is needed to opt out of QDIA.
• The $100,000 adjusted gross income limit to rollovers to Roth IRAs does not apply for 2010	Deemed non-core since it does not affect benefits, and is operational in nature, where notice should be sufficient.
• Elimination of the requirement that 402(g) excess deferrals refunded after the close of the calendar year include "gap period" income	Deemed non-core since it affects participants in de minimis manner, operational and administrative in nature, where notice should be sufficient.
• For underfunded defined benefit plans subject to the benefit restrictions in Section 436(d) of the Code, an exception has been created that allows such plans to make involuntary cash-out distributions of $5,000 or less. This is effective as if included in PPA (i.e., for plan years beginning after 2007).	Deemed to be non-core since operational in nature, where notice is sufficient.

Appendix H. Sample Notice of Due Dates of Amendments for IRS Consideration

As discussed under the Recommendations in Section VI. B. of this Report, the ACT proposes that the Internal Revenue Service provide guidance that is presented in chart form akin to the below showing: (i) a reference to the applicable Code section and/or new law that pertains to each change, (ii) a brief description of the required change, (iii) its effective date, (iv) the due date for adoption of the interim amendment, (v) whether the change is discretionary or mandatory, and (vi) commentary concerning the nature of the amendment. The chart should be printed twice in the proposed Notice, once organized by Code section, and a second time organized by due date. An updated Notice (which would include an updated chart) should be published for any new change in the law or published guidance requiring a plan amendment, and annually.

I. Request for a Determination Letter Under Cycle D for Qualified Plans

A request for a determination letter is the method by which a plan sponsor of a qualified plan seeks approval from the Internal Revenue Service ("IRS") that its retirement plan complies with legal tax-qualification requirements.

The IRS has implemented a revised determination letter program for plan sponsors of individually designed plans, based on their federal Employer Identification Number ("EIN"), by which the plan sponsor must file for a determination letter in accordance with the five-year cycle into which it falls. With certain exceptions (see Exceptions below)[151], the IRS has announced that the 12-month submission cycle for "Cycle D filers" – employers of qualified plans whose EINs end in a "4" or a "9" – opened February 1, 2009, and will close January 31, 2010.

Near the end of each year, the IRS issues guidance on the tax-qualification requirements that must be included in plans that will be submitted for determination letters in the next cycle. The guidance for Cycle D plans was issued in the form of IRS Notice 2008-108, which contains the "Cumulative List of Changes in Plan Qualification Requirements" ("the 2008 Cumulative List"). The 2008 Cumulative list includes regulatory, statutory and other guidance that must be included in the plan when it is submitted for a determination letter on its tax-qualified status. While the IRS stated that it would not consider Pension Protection Act of 2006 ("PPA") provisions for Cycle A, B

[151] Exceptions:

- Multiemployer plans must be filed under Cycle D; and
- Certain "non-calendar year plans" (i.e., a Cycle D plan whose first plan year begins after January 1, 2009 and ends on or after February 1, 2010) may opt to file under Cycle E.
  - Such plans will be reviewed under the "2009 Cumulative List."
  - Such plans will only be treated as Cycle E filers for this initial cycle and will revert to Cycle D for all subsequent submissions.

or C filers, the 2008 Cumulative List makes it clear that the IRS will consider PPA changes when issuing a determination letter for Cycle D plans, and such letters can be relied upon with respect to provisions of the PPA included in the plan.

In addition, the 2008 Cumulative List identifies regulatory, statutory and other guidance that the IRS will not consider when issuing a determination letter for Cycle D filers.

The attached chart sets forth the plan provisions that are mandatory and optional for otherwise timely amended Cycle D filers. It provides the effective dates of the changes, and the time by which plans must be amended along with a description of the changes. The availability and use of such a chart will minimize prohibitive errors, reduce the strain on the Employee Plans Compliance Resolution System ("EPCRS"), and assist examiners in determining when deadlines have been met and help train them.

II. Required PPA Provisions for Defined Contribution Plans

The following chart summarizes those amendments required by the Pension Protection Act of 2006 ("PPA") that must be included in a defined contribution plan document when it is submitted to the IRS for a "Cycle D" determination letter:

Pension Protection Act	Effective Date	Comments
Economic Growth Tax Relief and Reconciliation Act of 2001 ("EGTRRA") Permanence	August 17, 2006. No effective date is provided by PPA.	Plan must only be amended if the document references the EGTRRA sunset provisions, which were eliminated by PPA.
Freedom to divest/diversify publicly traded employer securities (Internal Revenue Code ("Code") Section 401(a)(35))	Effective for plan years beginning after December 31, 2006 (delayed effective date for collectively bargained plans). Plan must be amended prior to the last day of the 2009 plan year.	For salary deferral contributions and after-tax contributions, participants must be allowed to diversify out of company stock and into other investments immediately. For employer contributions, the participant must be permitted to diversify upon the completion of three or more years of service. IRS Notice 2008-7 extends certain transitional guidance and relief provided to certain defined contribution plans that hold publicly traded employer securities under Notice 2006-107. Proposed regulations published January 3, 2008 may be relied upon until final regulations are issued.

Pension Protection Act	Effective Date	Comments
Elimination of "gap period" income for excess contribution and excess aggregate contributions (Code Sections 401(k)(8)(A)(i) and 401(m)(12))	Effective for plan years beginning after December 31, 2007. Plan must be amended prior to the last day of the 2009 plan year.	Gap period income must be distributed for the 2006 and 2007 plan years, as previously required under the Final 401(k)/401(m) regulations. PPA eliminates these gap period income requirements, and WRERA (please see below) eliminated another.
Rollovers by Nonspouse beneficiaries (Code Section 402(c)(11))	Effective for distributions beginning after December 31, 2006. Plan must be amended prior to the last day of the 2010 plan year.	Under the PPA, a plan was permitted (not required) to allow a nonspouse beneficiary to roll over a death benefit to an inherited IRA. However, WRERA made this provision mandatory (please see below). If implemented operationally prior to 2010, plan must be amended by last day of 2009 plan year; otherwise by the last day of the 2010 plan year.
Vesting for Employer Nonelective contributions (Code Section 411(a)(2)(B))	Effective for contributions made in plan years after December 31, 2006 (delayed effective date for collectively bargained plans and ESOPs). Plan must be amended prior to the last day of the 2009 plan year.	Plans that provide for employer contributions, such as profit sharing contributions, must have a vesting schedule that, at a minimum, will (1) either fully vest participants upon the completion of 3 years of service (a "three year cliff"), or (2) vest at least 20% per year for each year of service beginning with a participant's second year of service (a "six-year graded schedule"). The "new" vesting schedules can be applied to all employer contributions or only to employer contributions made for the 2007 plan year and thereafter. Notice 2007-7 clarified that the faster vesting schedule applies to contributions made for *plan years beginning* in 2007 and thereafter.

Pension Protection Act	Effective Date	Comments
Qualified Optional Survivor Annuity (Code Section 417(g)) ("QOSA")	Effective for plan years beginning after December 31, 2007 (delayed effective date for collectively bargained plans). Plan must be amended prior to the last day of the 2009 plan year.	Plan sponsors of money purchase pension plans or those plans that have been merged with money purchase pension plans must now offer a 75% joint and survivor annuity. In addition, if the plan's current joint and survivor annuity benefit provides a survivor annuity for the life of the spouse that is greater than or equal to 75% of the annuity payable during the joint lives of the participant and spouse, the plan must also offer a 50% joint and survivor annuity benefit. A written explanation required to be provided to a participant with respect to a QJSA must include the terms and conditions of the QOSA (Code Section 417(e)(3)(A)(i)).

III. Optional Pension Protection Act Provisions for Defined Contribution Plans

The following are optional "plan design" amendments permitted by the Pension Protection Act of 2006 ("PPA") which must be included in a defined contribution plan document when it is submitted to the IRS for a "Cycle D" determination letter to the extent that the optional provision has been elected by the plan sponsor:

Pension Protection Act	Effective Date	Comments
Qualified Automatic Contribution Arrangement (Code Sections 401(k)(13) and 401(m)(12)) ("QACA")	Effective for plan years beginning after December 31, 2007. Amendment must be adopted on or before the beginning of the plan year in which the plan design is implemented.	"Qualified Automatic Contribution Arrangement" ("QACA"), provides a safe harbor whereby the plan will avoid having to perform annual 401(k) and 401(m) nondiscrimination testing and avoid top heavy testing. Implementing the QACA impacts various parts of the Plan: • *Salary deferrals:* The QACA provides for automatic enrollment of eligible employees who fail to make any salary deferral election (eligible employees who became participants prior to the effective

Pension Protection Act	Effective Date	Comments
		date may be excluded). The QACA provides for a minimum deferral percentage of at least 3% of compensation for all eligible employees during the period beginning on the date of plan entry and ending on the last day of the following year, with an automatic increase of 1% each year, up to at least 6% (but not to exceed 10%). • *Employer contributions and vesting:* The plan provides for matching contributions to be made in an amount equal to 100% of the first 1% of compensation deferred, and 50% of the next 5% of compensation deferred (a maximum of 3.5% of compensation). In the alternative, the plan can provide a nonelective contribution equal to 3% of all eligible non-highly compensated employees compensation. Matching contributions fully vest after two years of service and are subject to withdrawal restrictions. • *Qualified Default Investment Alternatives:* In the absence of an investment election, contributions must be invested in a qualified default investment alternative (see applicable DOL regulations, §2550.404c-5). This requirement was eliminated by WRERA (see below). • *Notice:* Plan sponsor must provide annual notice within a "reasonable period" (at least 30 but no more than 90 days before

Pension Protection Act	Effective Date	Comments
		the beginning of the plan year) to eligible employees informing them (1) of their right to modify their election or to opt out, and (2) how automatically enrolled contributions will be invested in the absence of the participant's direction. The IRS has issued a model notice to assist with compliance with the QACA notice requirements (72 C.F.R. 63144). • The IRS issued proposed regulations (Treasury Regulation 115699-09) that would permit employers that sponsor safe harbor defined contribution plans to reduce or suspend safe harbor nonelective contributions and safe harbor nonelective contributions under qualified automatic contribution arrangements (QACAs) after the start of the plan year if the employer has incurred a substantial business hardship and certain other requirements are met. Suspension of the matching contribution formula was previously permitted.

Pension Protection Act	Effective Date	Comments
Eligible Automatic Contribution Arrangement/Rescinding (Code Section 414(w)) ("EACA")	Effective for plan years beginning after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	*Rescinding contributions:* A participant who is automatically enrolled can choose to withdraw his salary deferrals (and earnings/losses on those amounts) within 90 days after being automatically enrolled; in such event, attributable matching contributions allocated to the participant's account are forfeited. Any such withdrawal is not eligible for rollover. Alternatively, a participant may choose to stop his deferrals as of any payroll period, or modify his deferral percentage quarterly. The IRS issued final regulations regarding the QACA (see above) and the EACA effective for plan years beginning on or after January 1, 2008 – although the requirement to utilize a safe harbor definition of compensation is delayed and not effective until plan years beginning on or after January 1, 2010 (Treasury Decision 9447).
Hardship Withdrawals (Code Section 401(k)(2))	Effective date unclear. Appears to be effective for plan years beginning after August 17, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	Plans are now permitted to make hardship distributions to a participant's "primary beneficiary" under the plan for specified reasons (e.g., medical expenses, tuition expenses and burial and funeral expenses). The "primary beneficiary" must have an unconditional right to all or a portion of the participant's account balance upon the participant's death. (See also Notice 2007-7). Announcement 2007-59 provides that a plan will not fail to satisfy hardship safe harbors if

Pension Protection Act	Effective Date	Comments
		implemented mid-year. This change is also significant in the area of domestic partnership law because many, if not most, domestic partners do not meet the Internal Revenue Code definition of "dependent," and same-sex spouses do not qualify as "spouses" under federal law due to the federal Defense of Marriage Act.
Qualified Reservist Distribution (Code Section 401(k)(2)(B)(i)(IV))	Effective for distributions made to participants called to active duty after September 11, 2001 and prior to January 1, 2008. Plan must be amended by the last day of the 2009 plan year.	A plan may permit in-service distributions of salary deferral contributions to a reservist who is called to active duty for a period that equals at least 180 days (or for an indefinite period) between September 11, 2001 and December 31, 2007. The 10% early withdrawal penalty under Code Section 72(t) will not apply. The HEART Act (see below) extended the applicability of such distributions to those individuals ordered or called to active service after December 31, 2007.
Rollover to Roth IRA (Code Section 408A(e))	Effective for distributions after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	A distribution from a qualified retirement plan under Section 401(a), 403(b) or 457(b) can be rolled directly into a Roth IRA, subject to the same rules that apply to rollovers from a traditional IRA. A participant with an adjusted gross income of $100,000 or more cannot take advantage of the new rollover provision until 2010.
Rollover of After-Tax Contributions (Code Section 402(c)(2)(A))	Effective for tax years beginning after December 31, 2006. If currently	The PPA expanded rollover options to allow a rollover of after-tax contributions by a participant from a qualified plan to a 403(b) plan or

Pension Protection Act	Effective Date	Comments
	implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	defined benefit plan provided that the plan that is receiving the rollover separately accounts for the after-tax Rollover contribution.
Distribution Explanations	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	Prior to the enactment of the PPA, plans subject to Code Section 417 were required to provide an explanation of distribution options available under the plan no less than 30 days and no more than 90 days before the distribution is to be made. The PPA provides that this explanation may be provided up to 180 days before the distribution is to be made.
"Special Tax Notice Regarding Plan Payments" (Code Section 402(f))	Effective for plan years beginning after December 31, 2006. No plan amendment needed.	The PPA provides that the "402(f) notice" may be provided up to 180 days before a distribution is to be made. Notice 2007-7 clarifies that the 30 to 180 day notice period for "402(f) notices" applies only to distribution notice periods after the effective date of the PPA. IRS issued Notice 2009-68 and two safe harbor notices for use for participant distribution elections when (1) a distribution is not from a designated Roth account, and (2) when the distribution is from a designated Roth account.

IV. Required PPA and Other Provisions for Defined Benefit Plans

The following chart summarizes those amendments required by the Pension Protection Act of 2006 ("PPA") and other authority that must be included in a defined benefit plan document when it is submitted to the IRS for a "Cycle D" determination letter:

Pension Protection Act	Effective Date	Comments
Qualified Optional Survivor Annuity (Code Section 417(g)) ("QOSA")	Effective for plan years beginning after December 31, 2007 (delayed effective date for collectively bargained plans). Plan must be amended by the last day of the 2009 plan year.	Pension plans must offer a 75% joint and survivor annuity in addition to the 50% joint and survivor annuity that was, and still is, required.
Rollovers by Nonspouse beneficiaries (Code Section 402(c)(11)	Distributions beginning after December 31, 2006. Plan must be amended prior to the last day of the 2010 plan year.	Although this change in the tax qualification rules for nonspouse rollovers is currently discretionary, WRERA makes it mandatory (see WRERA summary below). If implemented operationally before 2010, plan must be amended by the last day of the 2009 plan year; otherwise by the last day of the 2010 plan year.
Minimum Lump Sums (Code Section 417(e))	Effective for plan years beginning after December 31, 2007. Plan must be amended by the last day of the 2009 plan year.	Lump sum benefits under defined benefit plans cannot be less than a minimum amount calculated using the "applicable interest rate" and the "applicable mortality table." Revenue Ruling 2007-67 specified the mortality table that defined benefit plans must use to calculate such minimum lump sum distributions for plan years beginning in 2008. Notice 2008-30 stated that for plan years beginning on or after January 1, 2008, PPA changed the definition of the "applicable interest rate" to be the adjusted first, second, and third segment

Pension Protection Act	Effective Date	Comments
		rates for the applicable look-back month.
Maximum Lump Sums (PFEA)	Effective for plan years beginning after December 31, 2005. Deadline for plan amendments to comply with PFEA was changed to the PPA amendment deadline (plan must be amended by the last day of the 2009 plan year.)	The Pension Funding Equity Act of 2004 ("PFEA") required defined benefit plans to use a 5.5% interest rate assumption when calculating the maximum lump sum benefit permitted by Code Section 415 in limitation years beginning in 2004 and 2005. The plan amendment deadline to comply with the PFEA interest rate change was initially the last day of the first plan year beginning after 2005. For limitation years beginning after 2005, the interest rate to be used is the greatest of 5.5%, the rate specified in the plan or the rate that provides a lump sum benefit that is not more than 105% of the lump sum benefit that would have been provided if the interest rate were the applicable interest rate used for determining minimum lump sum benefits.
Underfunding Restrictions (Code Sections 430 and 436)	Plan years beginning after December 31, 2007. Plan must be amended prior to the last day of the 2009 plan year.	A defined benefit plan that is less than 80% funded may not be amended to increase benefits. If the plan is less than 60% funded, benefit accruals must be frozen and the plan may not make lump sum payments or other payments that exceed what would be paid under a single life annuity. For plans funded between 80% and 60%, higher distributions are allowed (based on a formula in PPA).
Normal Retirement Age (Code Sections 401(a) and 411(d)(6)	Effective for plan years beginning after December 31, 2006. Plan must have been amended for good faith	IRS final regulations that modified prior guidance now generally require that the normal retirement age in a pension plan be an age that is not earlier than the "earliest age that is reasonably representative of the typical retirement

Pension Protection Act	Effective Date	Comments
	compliance by the date prescribed for filing the employer's income tax return for the 2007 taxable year (including extensions). If done, the plan's remedial amendment period will be extended to the end of the plan's remedial amendment cycle.[152]	age" for the industry in which the covered workforce is employed. A normal retirement age of 62 to 65 would always be acceptable. However, a normal retirement age lower than 62 must be determined to not be earlier than the earliest age that is reasonably representative of the typical retirement age based on all of the facts and circumstances. If the plan sets the normal retirement age between age 55 and 62, the employer must apply a good faith analysis to determine if that age is reasonable under the applicable facts and circumstances. Generally, a normal retirement age below age 55 will be presumed to be unreasonable unless demonstrated otherwise. Notice 2007-69 was subsequently published to clarify that plans may not provide normal retirement ages conditioned upon the employee's completion of a stated number of years of service (this would violate vesting and/or accrual rules).
Conversion From Traditional Defined Benefit Formula to a Cash Balance Lump Sum Based Formula (Code Section 411(b)(1))	Effective for plan years beginning after January 1, 2007. Plan must be amended prior to the last day of the 2009 plan year.	One method of plan conversion from a traditional defined benefit plan to a cash balance plan involves the calculation of the benefit for employees under both the defined benefit plan formula and the cash balance formula, and then providing benefits under the formula that provides a benefit that is the "greater of" the two formulas. The IRS had indicated in the past that this "greater of" formula could violate rules that are designed to prevent an employer from providing disproportionately higher benefit accruals to participants in later years of

[152] Certain relief is provided under Notice 2007-69.

Pension Protection Act	Effective Date	Comments
		service (referred to as "backloading"). This "backloading" could result in discrimination in favor of highly compensated employees. The IRS issued proposed regulations (I.R.B. 2008-32) clarifying how defined benefit plans converting to cash balance plans that utilize the "greater of" formula can satisfy the "backloading" rules. PPA addressed these plan conversions, but it did not require or prohibit specific methodologies used for conversions. Revenue Ruling 2008-7 addressed how accrual rules apply to the "greater of" benefit calculation and offered transitional relief for failing to meet the "backloading rules." As part of a conversion, certain participants who met set age and service requirements were "grandfathered" into the traditional defined benefit plan formula. Other employees began participating in the new cash balance plan formula. Plan participants were divided into certain categories: (i) those employed post- conversion and who would receive benefits under the new plan, (ii) those who accrued benefits under the traditional defined benefit plan and the new cash balance plan who had yet to meet age/service requirements as set forth in the plan, and (iii) "grandfathered" participants. Benefit formulas must be aggregated (and the net result tested) to determine whether the plan meets certain prescribed accrual rules, but all participants in the plan do not have to satisfy the same accrual rule (provided one of three accrual rules with respect to each group of participants – the 3%, 133

Pension Protection Act	Effective Date	Comments
		1/3% or fractional method – is met). Certain plans that had received favorable determination letters were provided with temporary relief from plan disqualification and would be permitted to continue to use the "greater of" formula until 2009.
Final 415 (b) Limitations on Benefits	Effective for limitation years beginning after July 1, 2007. Remedial amendment rules under 1.401(b)-1 apply.	Code Section 415(b)(2)(E)(ii) establishes limits on the annual benefits that may be provided under a defined benefit plan by providing that the interest rate used to adjust a benefit payable in a single lump sum distribution (or other form subject to the minimum present value requirement of Code Section 417(e) must not be less than the greatest of (i) 5.5%, (ii) the rate that provides a benefit of not more than 105% of the benefit that would be provided using the Code Section 417(e)(3) interest rate assumptions, or (iii) the rate specified under the plan. Notice 2007-7 sets forth three corrective measures whereby a plan sponsor can correct distributions that exceed the permissible limit, including a corrective measure available under the Employee Plans Compliance Resolution System.
Interaction Between "Anti-Cut Back Rules" (Code Section 411(d)(6)) and the Nonforfeitability Requirements (Code Section 411(a)	Effective August 9, 2006. Applicable for plan amendments adopted after December 31, 2006.	A qualified plan cannot eliminate or reduce certain early retirement benefits, retirement-type subsidies, or optional forms of benefit that created significant burdens and complexities for the plan unless such an amendment adversely affects the rights of any participant or beneficiary in a de minimis manner. In light of the United States Supreme Court decision, *Central Laborer's Fund v. Heinz et al.*, (541 U.S. 739) the Department of the Treasury issued Treasury Decision 9280, which was intended to reflect the holding in *Heinz* and to set forth final regulations to

Pension Protection Act	Effective Date	Comments
		establish a "utilization test," which is a permitted method of eliminating optional forms of benefit that are burdensome to the plan and of de minimis value to plan participants and beneficiaries.

V. Optional Pension Protection Act Provisions for Defined Benefit Plans

The following are optional "plan design" amendments permitted by the Pension Protection Act of 2006 ("PPA") which must be included in a defined benefit plan document when it is submitted to the IRS for a "Cycle D" determination letter to the extent that the optional provision has been elected by the plan sponsor.

Pension Protection Act	Effective Date	Comments
In-service Distributions at Age 62 (Code Section 401(a)(36))	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	A plan can allow in-service distributions at age 62, even if age 62 is earlier than the plan's normal retirement age. As a matter of plan design, amending a plan to allow in-service distributions at age 62 is appropriate should a plan sponsor find it desirable to allow phased-retirement for older workers.
Rollover to Roth IRA (Code Section 408(A)(e))	Effective for distributions after December 31, 2007. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which	A distribution from a qualified retirement plan under Section 401(a), 403(b) or 457(b) can be rolled directly into a Roth IRA, subject to the same rules that apply to rollovers from a traditional IRA. A participant with an adjusted gross income of $100,000 or more cannot take advantage of the new rollover provision until 2010 (see WRERA summary below).

	implemented.	
Distribution Explanations (Code Section 417)	Effective for plan years beginning after December 31, 2006. If currently implemented operationally, amendment must be adopted prior to the last day of the 2009 plan year; otherwise by the last day of the plan year in which implemented.	Prior to the enactment of PPA, defined benefit plans were required to provide an explanation of distribution options available under the plan no less than 30 days and no more than 90 days before the distribution is to be made. PPA provides that this explanation may be provided up to 180 days before the distribution is to be made.
"Special Tax Notice Regarding Plan Payments" (Code Section 402(f))	Effective for plan years beginning after December 31, 2006. No plan amendment required.	The PPA provides that the "402(f) notice" may be provided up to 180 days before a distribution is to be made. Notice 2007-7 clarifies that the 30 to 180 day notice period for "402(f) notices" apply only to distribution notice periods after the effective date of the PPA. IRS issued Notice 2009-68 with two safe harbor notices for use with participant distribution elections.

VI. The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act")

In the 2008 Cumulative List, the IRS stated that while plans submitting in Cycle D may be amended for the HEART Act, the IRS will not consider the HEART Act provisions in issuing determination letters. The HEART Act contains many provisions that affect military personnel. Those listed below impact qualified retirement plans under Code Section 401(a). Although none of a plan's participants may be performing qualified military service, all plans are required to include language reflecting the HEART Act. In general, plans must be amended to reflect the required provisions of the HEART Act by the last day of the first plan year beginning on or after January 1, 2010. However, the following changes are generally effective as of January 1, 2009:

- An individual who is in "qualified military service" (as defined in 414(u) of the Code) for at least 30 days must be treated as if he or she severed from employment for purposes of receiving an in-service distribution from a plan that would otherwise be prohibited. Such an individual cannot make elective contributions during the 6-month period beginning on the date of the distribution.

- A plan must provide that a participant who dies while performing qualified military service on or after January 1, 2007, must be treated as if he or she died during covered employment for purposes of accelerated vesting or any other death benefits under the plan.

- An employee on active duty who receives differential wage payments must be treated as if he is currently an employee of the employer making the payment, and the differential wage payment must be included in compensation.

VII. The Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA")

WRERA contains provisions affecting qualified plans and technical corrections to the PPA that affect such plans. The following is a listing of such provisions:

- 2009 Required Minimum Distribution ("RMD") relief including:
  - Waiver of RMDs for 2009;
  - Clarification that the 2009 calendar year is disregarded for calculating and applying the 5-year rule for death payments;
  - Plans can continue to process participant directed and/or plan-initiated distributions of 2009 calendar year RMDs in the same manner as they would if the 2009 waiver was not in place (subject to participant election to not receive 2009 calendar year RMDs), except that the participant may have the ability to roll over the amounts (since they are not RMDs under the relief, they are "eligible rollover distributions" for certain purposes under the Code); and
  - Relief is not mandatory, but in order to take advantage of the 2009 RMD waiver, plans have until the last day of the first plan year beginning on or after January 1, 2011 to amend.

- Technical Corrections to PPA under WRERA:
  - For plan years beginning after December 31, 2009, nonspousal beneficiaries must be given the opportunity to perform a direct rollover to an IRA;
  - Eliminates the requirement that an EACA (see above) use a qualified default investment alternative as a default investment option;
  - The $100,000 adjusted gross income limit to rollovers to Roth IRAs does not apply for 2010;
  - Elimination of the requirement that 402(g) excess deferrals refunded after the close of the calendar year include "gap period" income; and
  - For underfunded defined benefit plans subject to the benefit restrictions in Section 436(d) of the Code, an exception has been created that allows such plans to make involuntary cash-out distributions of $5,000 or less. This is effective as if included in PPA (i.e., for plan years beginning after 2007).

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Exempt Organizations:
Getting It Right – An Online Guide to
Setting Executive Compensation for Charities

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Mary Rauschenberg
Fred Goldberg
James Joseph
Daniel Gary

June 9, 2010

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DESCRIPTION OF THE PROTOTYPE AND IMPLEMENTATION GUIDELINES

Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.

—Sir Winston Churchill, November 1942

We've got the vision, Now let's have some fun

—MGMT, Time to Pretend from Oracular Spectacular, January 2008

During the last 18 months, the country has been engaged in an ongoing dialogue over what constitutes appropriate levels of compensation for all levels of society; both in the exempt and for-profit arenas. The most recently available IRS statistics indicate that, on average, compensation-related expenses account for about 40% of the total expenses incurred by charitable organizations.[1] It comes as no surprise that the reasonableness of compensation paid by charitable organizations in particular is being scrutinized.

Congress has granted the IRS special tools to police the reasonableness of compensation—the intermediate sanctions. These sanctions address situations where compensation is deemed excessive and provide a structure for corrective action. They also provide a set of procedures that taxpayers may follow in establishing reasonable processes around compensation-setting practices. Under appropriate circumstances, the IRS may invoke the private benefit or private inurement doctrines to revoke a charity's tax-exempt status.

During the last seven years, Congress has shown particular interest in the executive compensation paid by charitable organizations.[2] Likewise, the IRS has had an interest in this area. In 2007, the IRS completed a compliance study focused on executive

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[1] Paul Arnsberger, 2008 Statistics of Income Bulletin, available at http://www.irs.gov/pub/irs-soi/08fallbulteorg.pdf. This study is based on tax return filings for the 2005 tax year.

[2] Senate Finance Committee, Press Release from Senator Charles Grassley regarding Private College Salaries Soar as Tuition Goes Up (November 2, 2009), available at http://finance.senate.gov/press/Gpress/2009/prg110209.pdf; Senate Finance Committee, Press Release from Jill Gerber for Senator Charles Grassley regarding College President Salaries (November 14, 2008), available at http://finance.senate.gov/press/Gpress/2008/prg111408a.pdf; Senate Finance Committee, Press Release from Senator Charles Grassley regarding Seeking Information from Six Media-Based Ministries (November 6, 2007), available at http://finance.senate.gov/press/Gpress/2007/prg110607.pdf; Senate Finance Committee, Press Release from Senator Charles Grassley regarding Smithsonian Board of Regents Governance Committee's Report (June 18, 2007), available at http://finance.senate.gov/press/Gpress/2007/prg061807.pdf; Senate Finance Committee, Press Release from Senator Charles Grassley regarding Non-Profit Hospital Responses to Finance Committee (September 12, 2006), available at http://finance.senate.gov/press/Gpress/2005/prg091206.pdf; and Senate Finance Committee, Press Release from Senator Charles Grassley regarding GAO Survey on Nonprofit Hospitals' Executive Compensation (July 28, 2006), available at http://finance.senate.gov/press/Gpress/2005/prg072806a.pdf.

compensation.[3] Its 2009 hospital compliance report contained a segment focusing on compensation.[4] In 2010, the IRS is expected to release a compliance report focusing on colleges and universities. The initial questionnaire used to gather data for that project contained a series of questions regarding compensation.[5]

Taken together, all of these events, reports, and studies demonstrate a keen interest in the question of executive compensation paid by charities. Given this interest and the magnitude of expenditures on compensation, we believed that all charities could benefit from additional assistance that would help them not only comply with the tax law when setting executive compensation, but also to make better decisions.

Although all organizations that are exempt from taxation pursuant to Section 501(c)(3)[6] are subject to the intermediate sanctions, many small and mid-size charities do not have sufficient resources to hire professionals to assist in complying with the complicated regime set up by Congress and embodied in the regulations. Accordingly, we developed a resource to assist such organizations and their advisors in complying with requirements of the Code and regulations when setting compensation.

We are aware of the IRS's presence on the Worldwide Web (the Web) and its efforts to increase that presence. We reviewed the 2002 report of the Life Cycle of a Public Charity Project Group, the widely used and informative "Life Cycle of a Public Charity" and other material posted on the IRS Web site.[7] According to IRS statistics, in 2005—the first full year for which it was online—the Life Cycle material posted on the Web received 82,080 visits, with 216,249 page views. By 2009, annual visits had almost doubled (172,947), as had page views (425,369). These numbers suggest that the exempt community is receptive to information provided by the IRS through the Web.

Encouraged by those and other statistics, we developed an instructional guide regarding executive compensation designed to reside only on the Web. The resulting "Webinar" is an on-line tutorial designed to help managers and board members of charities better understand the tax rules that govern executive compensation and their role in setting that compensation. A prototype of the tutorial has been provided separately to the IRS's Tax-Exempt and Government Entities Division on a DVD.

The tutorial provides step-by-step, plain language advice for managers, boards and advisors of charities to assist them in a wide range of areas, including:

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[3] Report on Exempt Organizations Executive Compensation Compliance Projects—Parts I and II (March 2007), available at http://www.irs.gov/pub/irs-tege/exec._comp._final.pdf

[4] IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report February 12, 2009), available at http://www.irs.gov/pub/irs-tege/frepthospproj.pdf

[5] Information about this compliance project is available at http://www.irs.gov/charities/article/0,,id=186865,00.html.

[6] Unless otherwise indicated, all references to sections are to sections of the Internal Revenue Code of 1986, as amended through May 1, 2010.

[7] Available at http://www.irs.gov/charities/charitable/article/0,,id=122670,00.html

- developing internal procedures and compensation comparables,
- reporting salary information in their IRS Form 990 filings, and
- maintaining appropriate records necessary to meet the rebuttable presumption of reasonableness and comply with the regulations promulgated pursuant to Section 4958.

Those using the prototype can proceed through it sequentially or by selecting individual modules or screens, making it useful to individuals with varying knowledge and experience. It also contains a full-text search function, providing another pathway to information. The prototype includes interactive questions and diagrams, and a series of FAQs. It also includes specific direction for adopting procedures to ensure compliance with the regulations, case studies, references to related state law issues and links to documents and information posted on the IRS Web site. Selective screen captures have been included as an exhibit to this report.

Issues Covered

The Webinar examines a number of tax law issues, including:

- the intermediate sanctions,
- revocation of tax-exemption,
- taxation of fringe benefits, and
- compensation-related disclosures required by the Form 990.

Other areas addressed are compensation and audit issues relevant to churches and compensatory below-market rate loans. With regard to the intermediate sanctions, it addresses the basic rules, the rebuttable presumption, and automatic excess benefits. Because state law requirements for setting executive compensation have significant overlap with the federal tax law rules (particularly the requirements for satisfying the rebuttable presumption under the intermediate sanctions), the Webinar addresses the process for setting compensation from the governing board's standpoint and specific state law requirements. Also discussed are ten common pitfalls that organizations often encounter when setting executive compensation. This Webinar is designed to offer some best or preferred practices drawn from experts who regularly advise organizations on setting compensation.

Finding a Voice

As the project developed, we found that the most difficult problem we encountered was not with the technology or the law, but, rather, with finding the appropriate editorial voice. We asked ourselves the following—Should the Webinar:

- be written from the IRS's viewpoint, with a focus on enforcement issues?

- focus on just tax issues, or include a consideration of business and legal matters?
- offer suggestions regarding recommended or best practices?
- include humor and a more chatty tone, or be neutral and institutional?

We decided to cover both tax and business considerations because we believe the good business practices make tax compliance more likely. For that same reason, we pointed out some preferred or best practices that we believe most boards should at least consider. We also believe a less formal voice, punctuated with some humor, will better hold the attention of board members and charity managers.

We understand that the IRS will subject our product to extensive review before it considers posting a final product on the IRS Web site.

Suggested Rollout

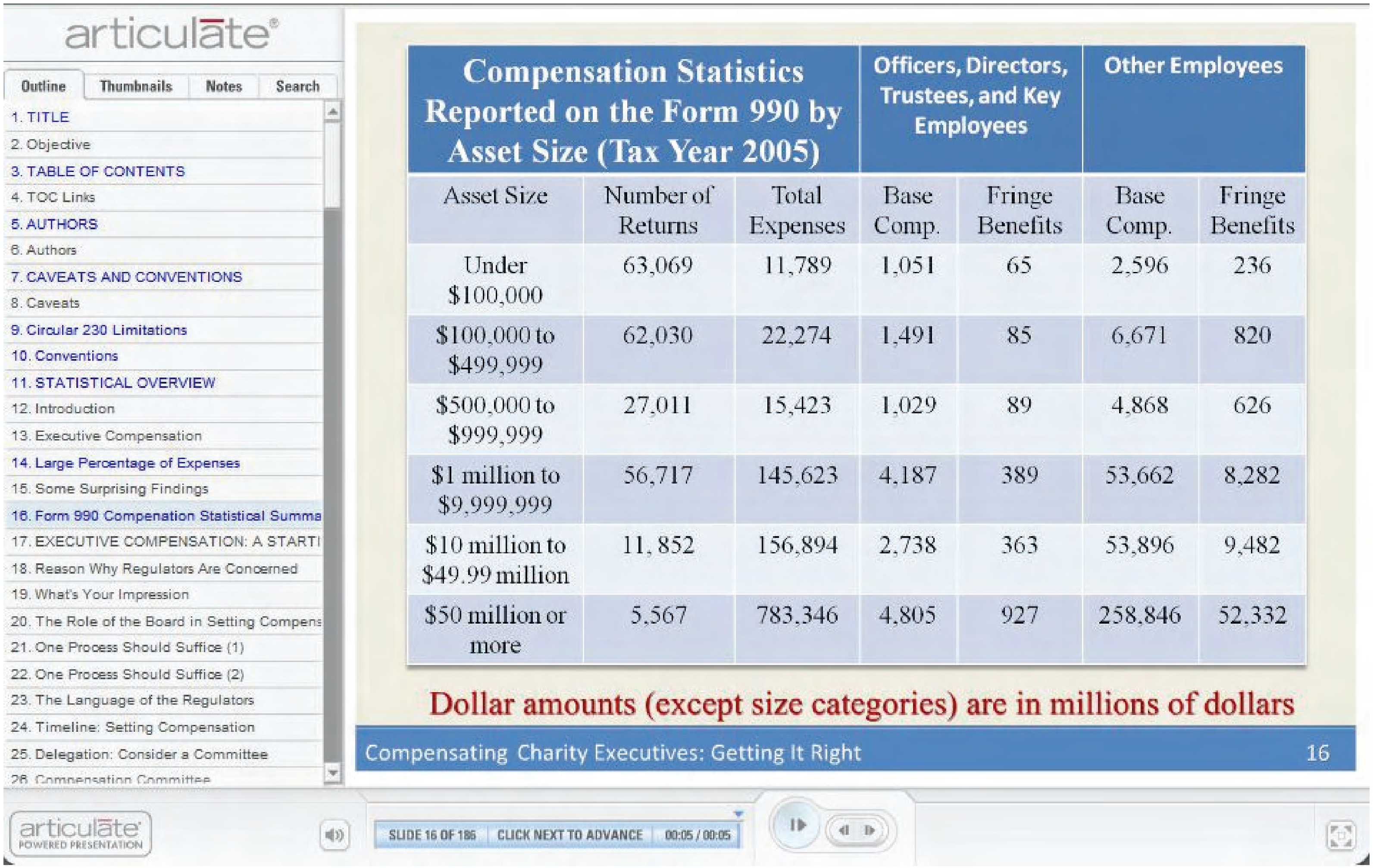
There are many groups within the nonprofit sector that are interested in well-managed nonprofit organizations. These groups include the American Bar Association, American Institute of Certified Public Accountants, Association of Regional Grantmakers, BBBWise Giving Alliance, BoardSource, Council on Foundations, GuideStar, Independent Sector, National Association of State Charity Regulators, National Council of Nonprofits, state nonprofit associations, trade associations, and various university nonprofit management programs. We believe the IRS should coordinate its efforts to rollout the Webinar with these organizations, first providing these organizations with a demonstration and then asking them to promote the Webinar to their stakeholders. We would also encourage the IRS to develop a strategy encouraging these organizations to link to the Webinar and other material on the IRS Web site.

Conclusion

We pointed out in 2002 “the increasing reliance by charitable organizations on the IRS' Web site as a source of information.” In the intervening eight years, that reliance has increased substantially, and the IRS has devoted significant resources and talent to improving and regularly updating its Web site. We applaud the IRS for its commitment to its public outreach programs that already assist hundreds of thousands of charities in this country. We recommend that the IRS provide further assistance to charities by adopting the Webinar, or a version of it, as part of its public education program.

SCREEN CAPTURES

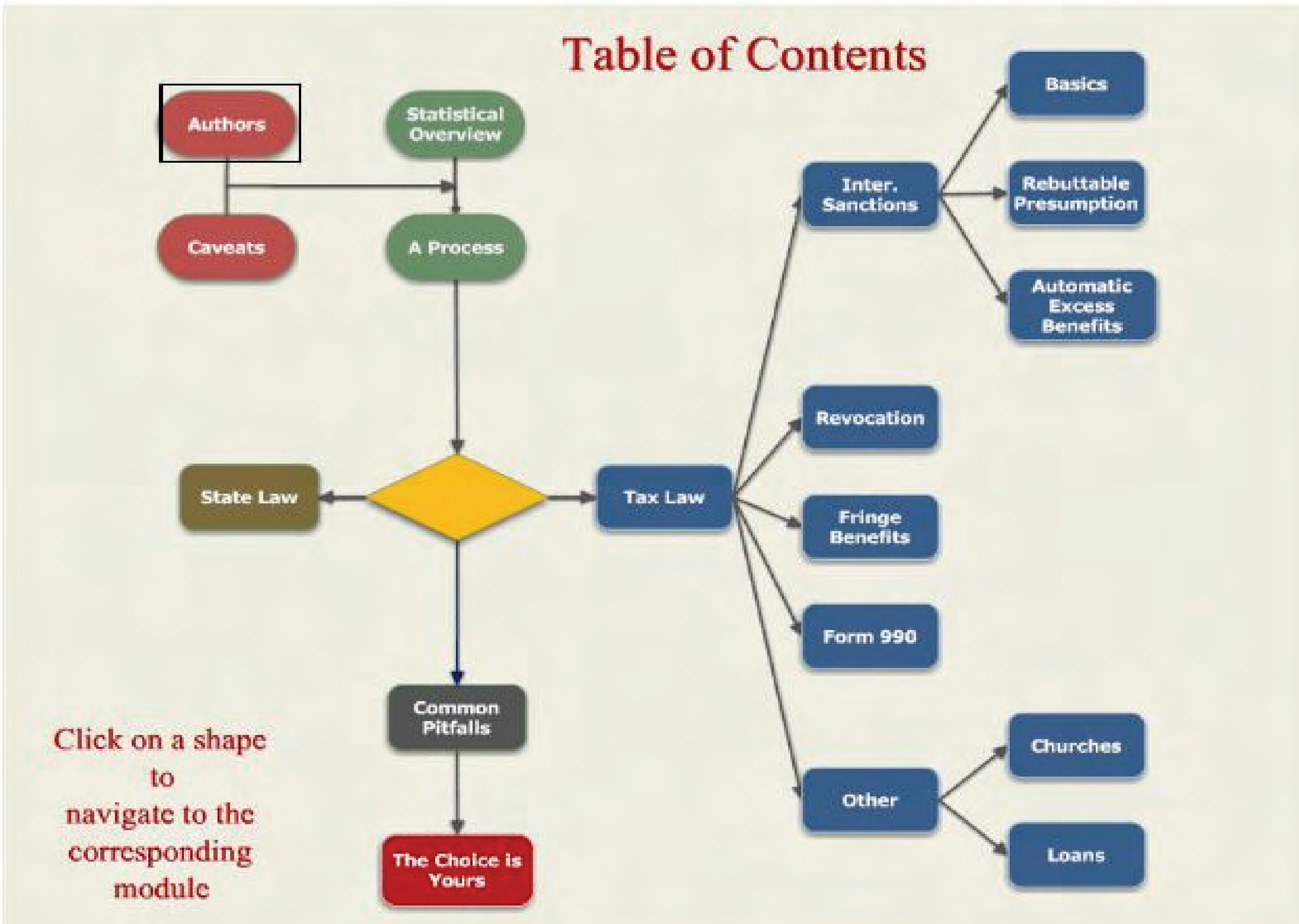
1) Overview—The Interface



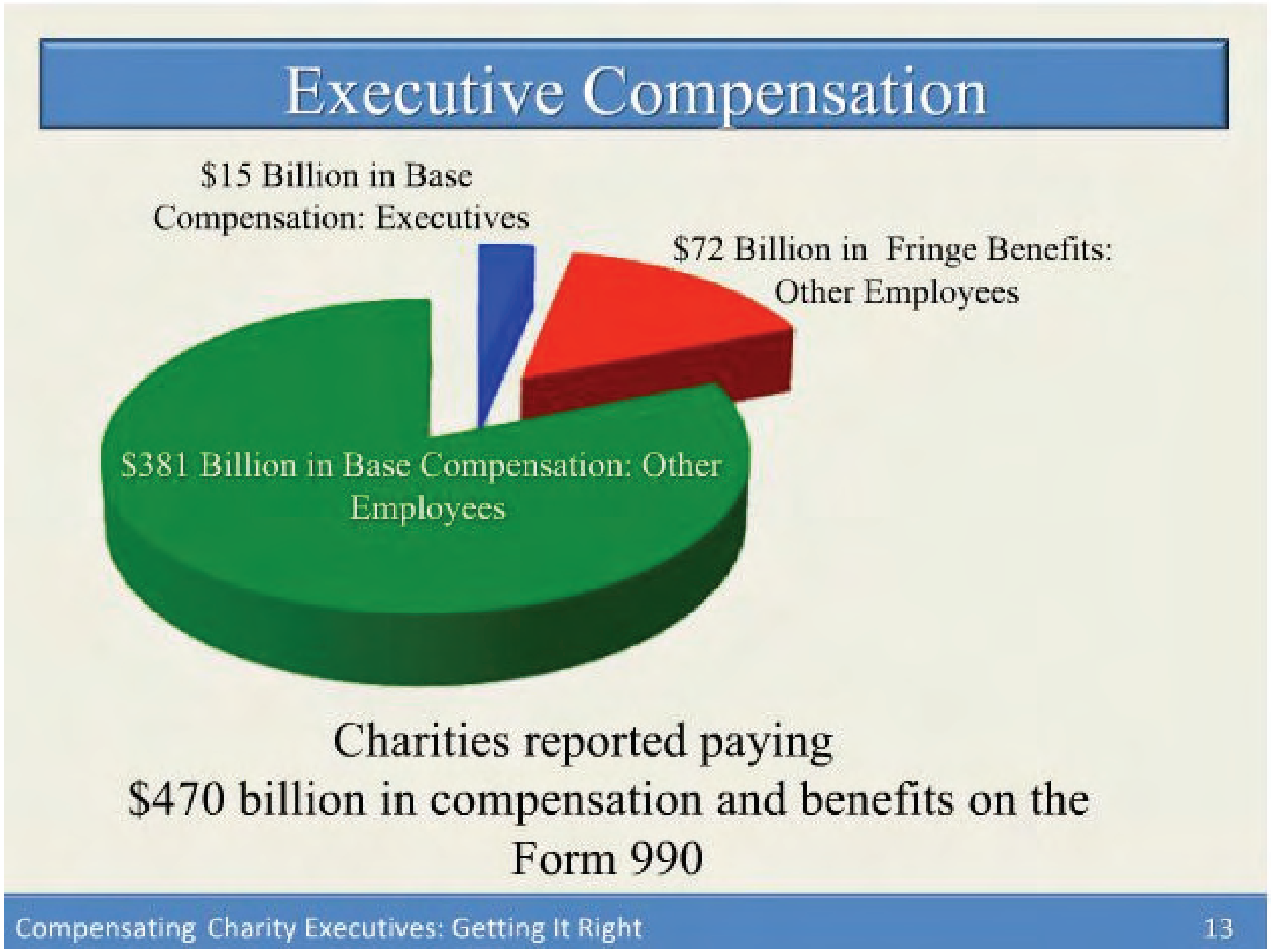
Compensation Statistics Reported on the Form 990 by Asset Size (Tax Year 2005)			Officers, Directors, Trustees, and Key Employees		Other Employees	
Asset Size	Number of Returns	Total Expenses	Base Comp.	Fringe Benefits	Base Comp.	Fringe Benefits
Under $100,000	63,069	11,789	1,051	65	2,596	236
$100,000 to $499,999	62,030	22,274	1,491	85	6,671	820
$500,000 to $999,999	27,011	15,423	1,029	89	4,868	626
$1 million to $9,999,999	56,717	145,623	4,187	389	53,662	8,282
$10 million to $49.99 million	11, 852	156,894	2,738	363	53,896	9,482
$50 million or more	5,567	783,346	4,805	927	258,846	52,332

Dollar amounts (except size categories) are in millions of dollars

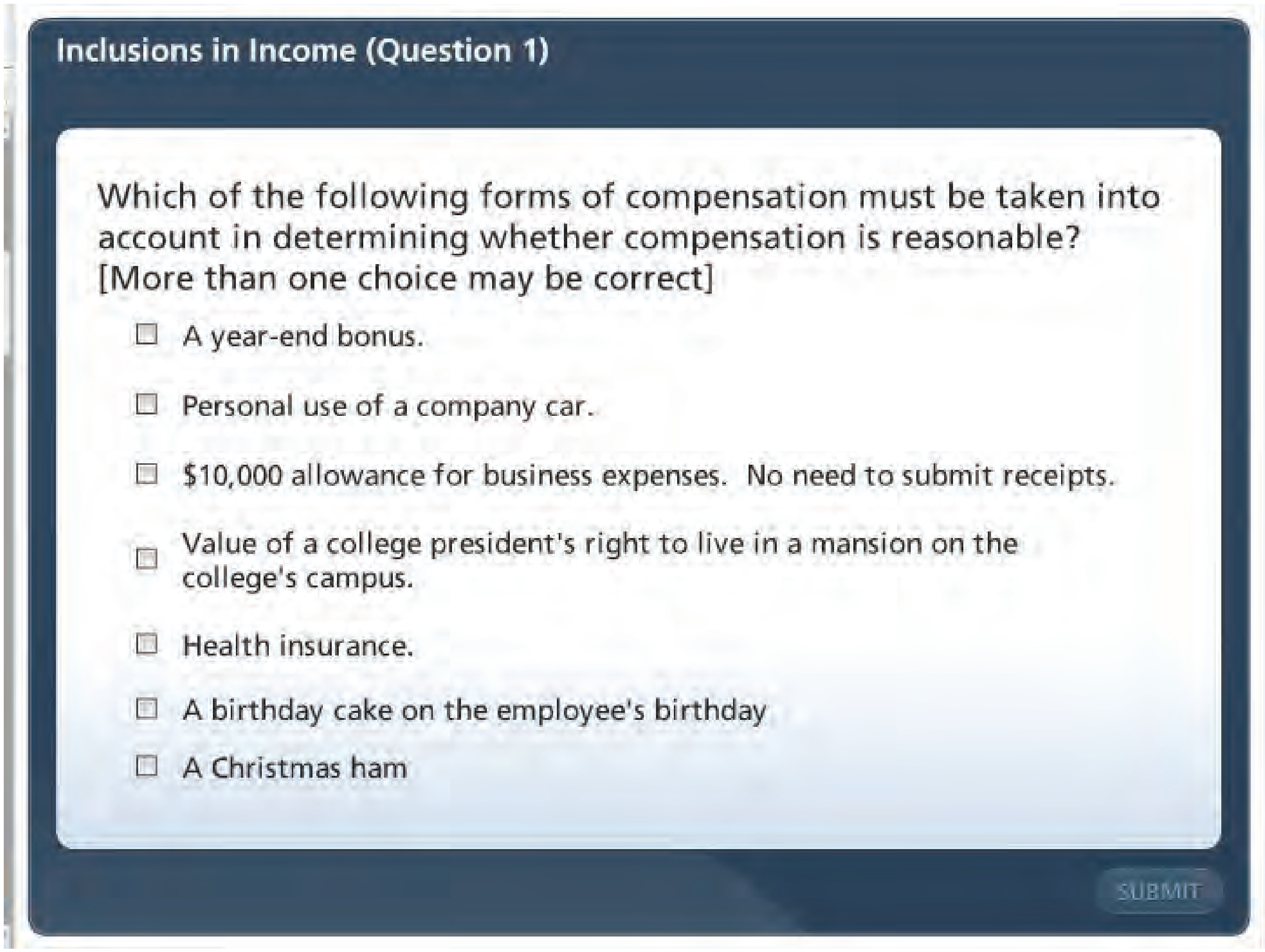
2) Table of Contents



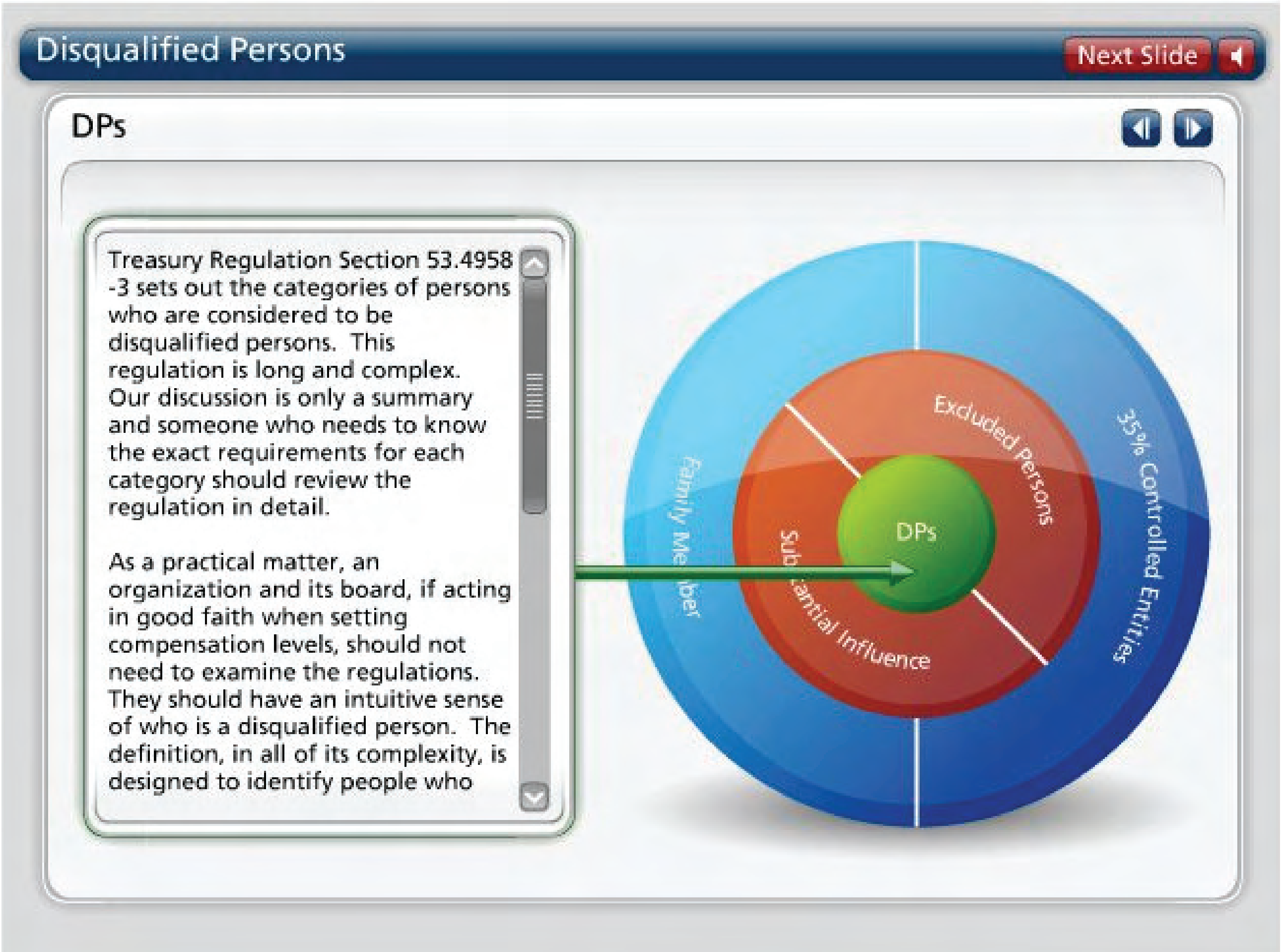
3) Basic Screen



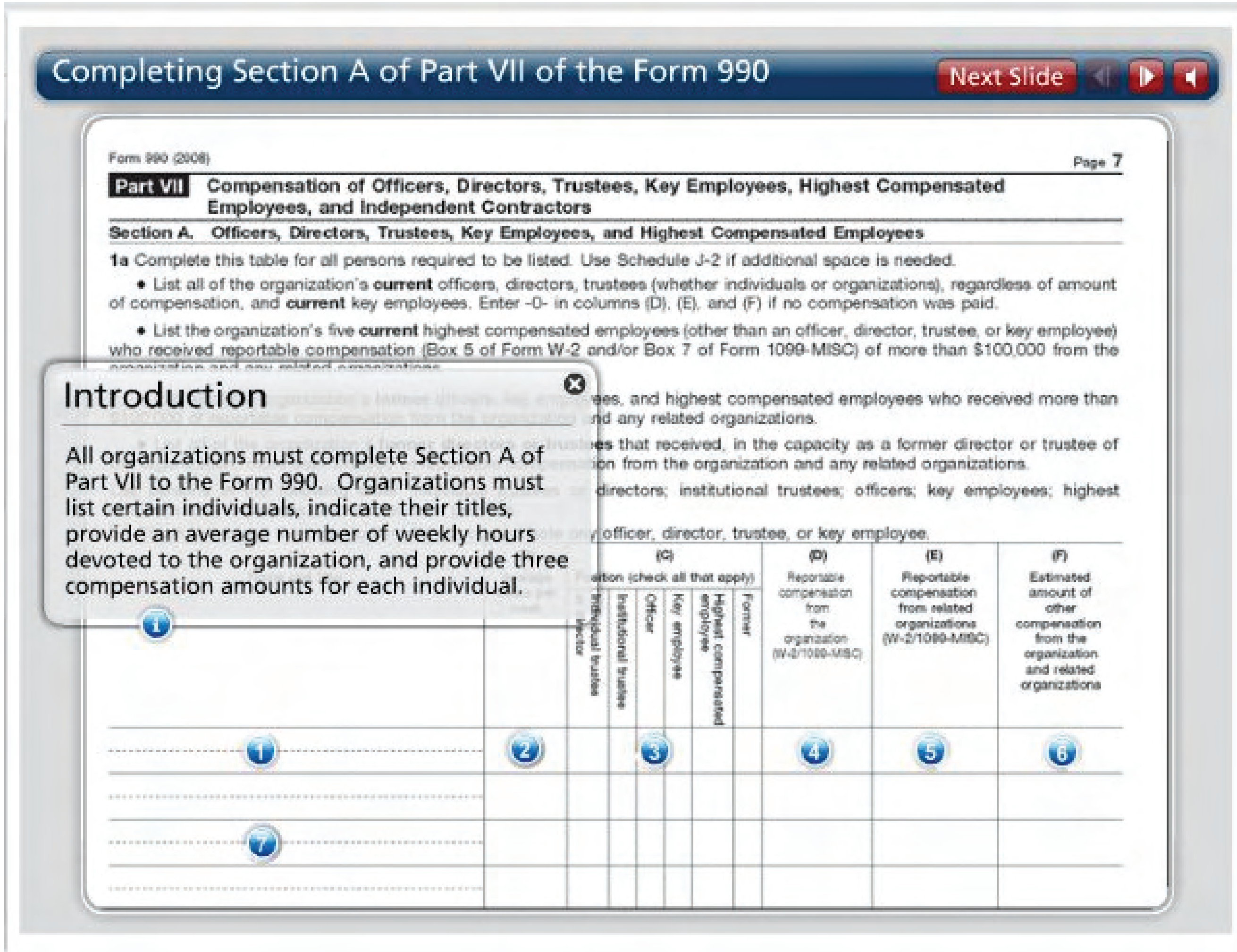
4) Interactive Question



5) Interactive Diagram—Intermediate Sanctions, Disqualified Persons

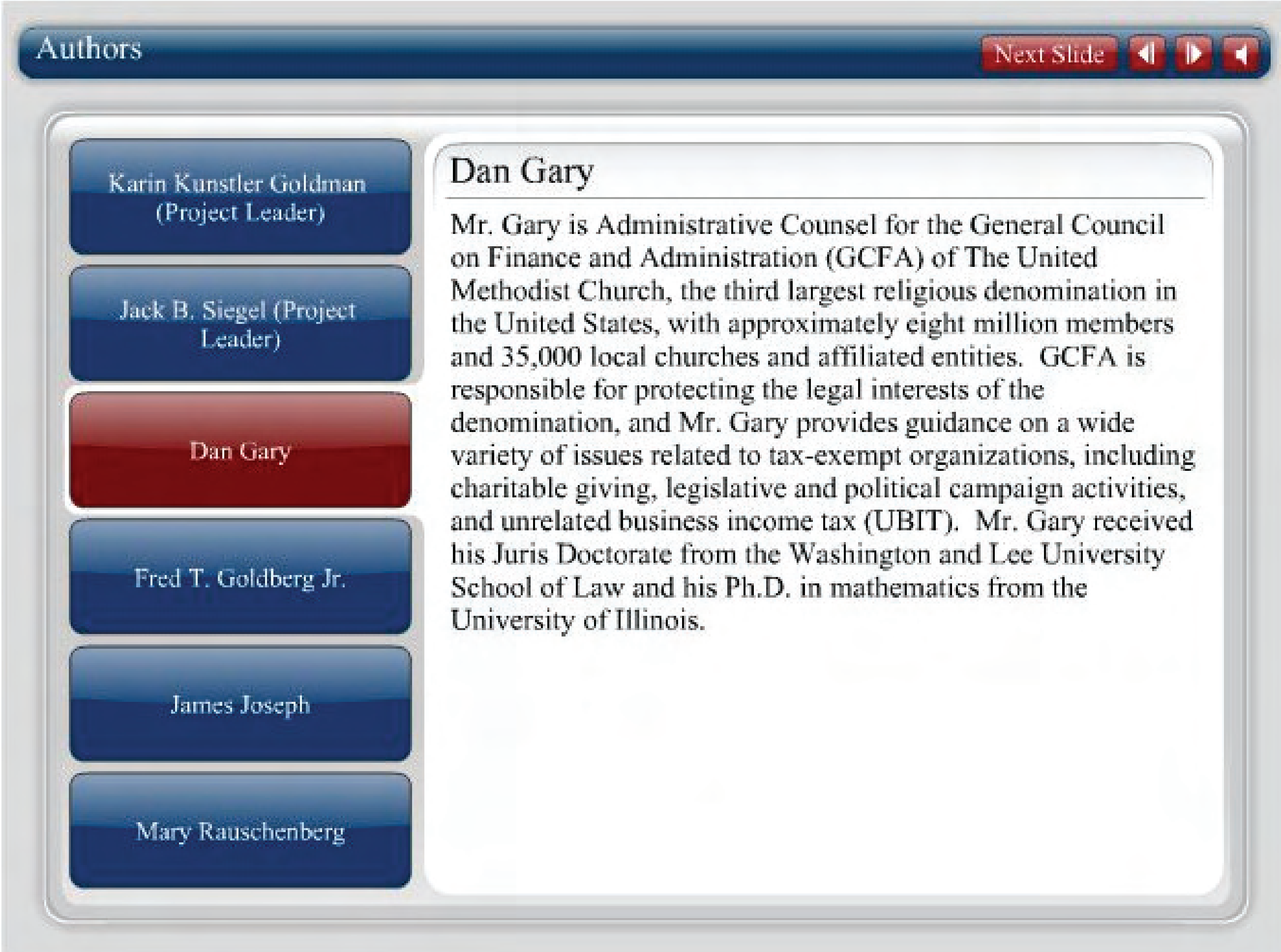


6) Interactive Diagram—Form 990

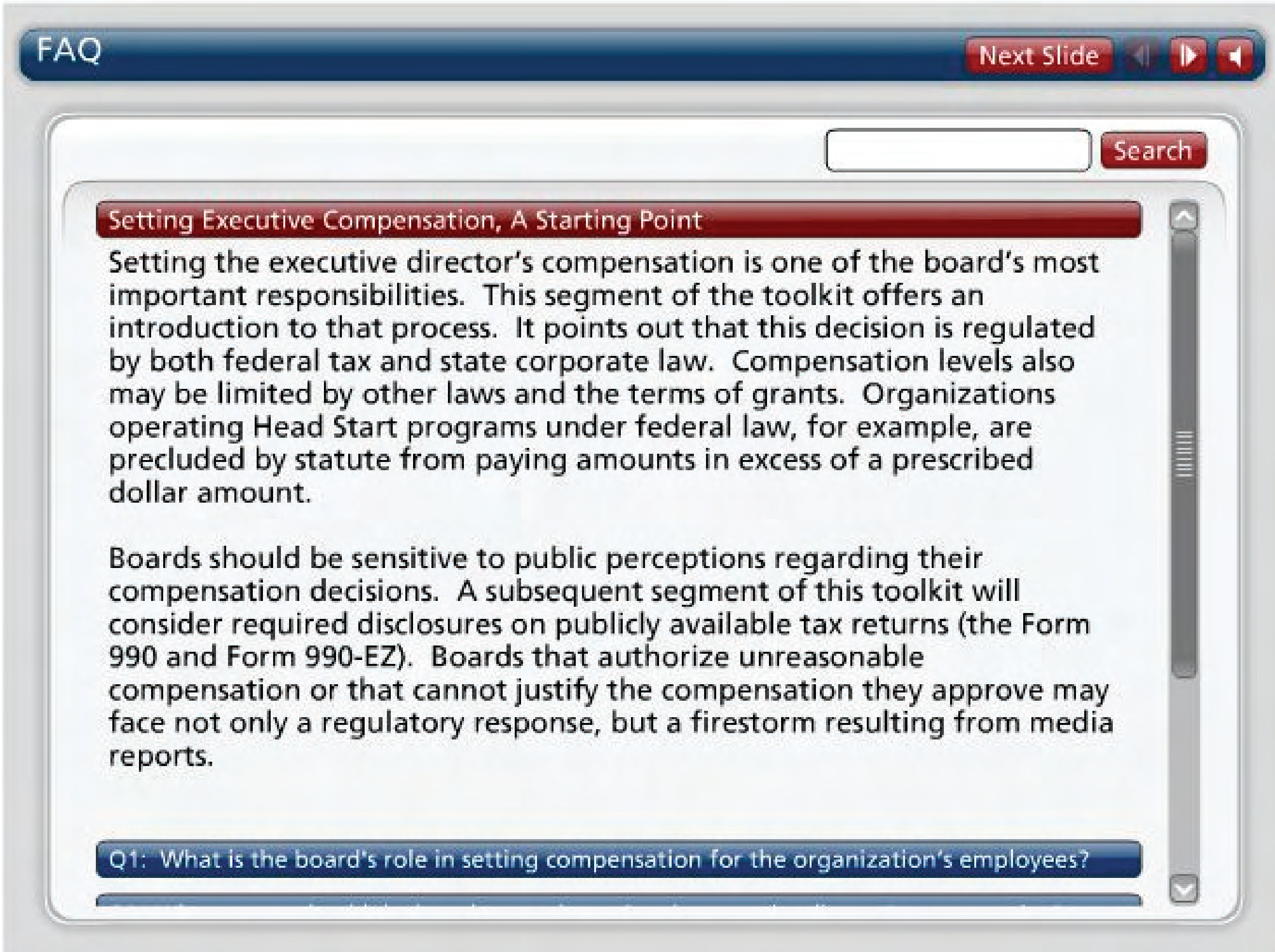


7) Interactive Diagram—Compensation Committee

8) Interactive Diagram—Authors



9) FAQ


FAQ
Next Slide
Search
Setting Executive Compensation, A Starting Point
Setting the executive director's compensation is one of the board's most important responsibilities. This segment of the toolkit offers an introduction to that process. It points out that this decision is regulated by both federal tax and state corporate law. Compensation levels also may be limited by other laws and the terms of grants. Organizations operating Head Start programs under federal law, for example, are precluded by statute from paying amounts in excess of a prescribed dollar amount.
Boards should be sensitive to public perceptions regarding their compensation decisions. A subsequent segment of this toolkit will consider required disclosures on publicly available tax returns (the Form 990 and Form 990-EZ). Boards that authorize unreasonable compensation or that cannot justify the compensation they approve may face not only a regulatory response, but a firestorm resulting from media reports.
Q1: What is the board's role in setting compensation for the organization's employees?

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Federal, State and Local Governments: Federal-State-Local Government Compliance Verification Checklist for Public Employers (Phase II)

Maryann Motza, Project Leader

Patricia Phillips

Paul Carlson

June 9, 2010

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I. EXECUTIVE SUMMARY

A. Overview of Report

The principal goal of the project undertaken during 2009-2010 by the Federal-State-Local Government (FSLG) Subcommittee of the Internal Revenue Service's (IRS) Advisory Committee on Tax Exempt and Government Entities (TE/GE) (ACT) was to pretest and further refine and improve the draft Compliance Verification Checklist that the FSLG Subcommittee prepared during 2008-2009 (see the FSLG Subcommittee report, included in the 2009 ACT Report, available at: http://www.irs.gov/retirement/index.html).

The Checklist is an adaption of the existing FSLG Compliance Check Form 4318 into a self-check form for public (state, and local government) employers [collectively referred to through the remainder of this report as "public employer(s)" unless otherwise noted] to enable them to verify their compliance with applicable Federal laws and regulations.

The ultimate intent of the project is to help public employers know what is expected of them so they can self-correct problems before the IRS initiates a compliance check, examination, or otherwise identifies a compliance problem within a state, or local governmental entity.

B. Principles

As noted in the 2009 ACT Report (the first year of this two-year project), the ACT adhered to the following principles while completing this project:

- The adaptation and enhancement of the FSLG Compliance Checklist for use by public employers and their representatives to verify their tax compliance will have an immediate, positive impact on taxpayers.

- The changes made to the existing internally-used FSLG Compliance Checklist and the addition of the revised form to the Web site will create a "win-win" situation for taxpayers and the IRS vis-à-vis encouraging—and facilitating—voluntary tax compliance. Further, both the U.S. Social Security Administration (SSA) and State Social Security Administrators (State Administrators) will also benefit from a compliance self-verification form such as is proposed. This is because both SSA and State Administrators have integral roles to play[1] in ensuring public employer (particularly state and local governments) compliance with FICA taxes; Social Security and Medicare coverage and benefits (both voluntary Section 218 Agreement and mandatory Social Security and Medicare coverage); Independent Contractor reporting, such as Form 1099 filings; worker

[1] See Chapters 1, 7, and 8, *Federal-State Reference Guide* (IRS Publication 963) for details on the roles and responsibilities of SSA and State Administrators vis-à-vis state and local governments' compliance with the United States Internal Revenue Code and United States Social Security Act and associated regulations and policies.

classification matters; public retirement system requirements; and other tax and coverage-related issues.

C. Recommendations

The ACT recommends that the IRS adapt the Final Recommended Compliance Verification Checklist (Appendix C) into a Web-based document that can be saved, printed, and shared by public employers, their legal and financial advisors. The Web-based version of the Checklist should be included on the IRS FSLG Employer Toolkit.

Once available on-line, FSLG should widely publicize the availability of the checklist, using the same network that the ACT/FSLG Subcommittee used during 2009-2010 to pretest the draft checklist. It is also recommended that Webinar technology be used to help promote the tool and enable people to learn how to use the checklist to: (1) determine their current compliance level; and (2) ensure they stay in compliance in the future.

II. Introduction and Justification for Project

The Office of Federal, State, and Local Governments (FSLG) supports the IRS and the Tax Exempt and Government Entities (TEGE) Division strategic goals of:

1. Enhancing Enforcement of the Tax Law;
2. Taxpayer Education and Outreach; and
3. Modernizing the IRS through its People, Processes and Technology.

In support of these goals, one of the major work plan areas during the 2008-2009 fiscal year for FSLG was to encourage voluntary compliance by government entities.[2] It is mutually advantageous to both the IRS and the taxpayers (including state and local "public" employers) for the IRS to promote and facilitate voluntary compliance by taxpayers.

The complexity of employment taxes, particularly for public employers who have numerous voluntary and mandatory exclusions and inclusions to apply on an employee-by-employee basis has been well documented.[3] For example, the Colorado State Social Security documented that state and local government employers have **a minimum of 500 possible compliance scenarios** for their employees solely in complying with the Federal Social Security and Medicare coverage and benefits and public pension system requirements.[4]

The National Taxpayer Advocate (NTA), Nina E. Olson, listed tax code complexity as the number one "most serious problems encountered by taxpayers" in her *National Taxpayer Advocate 2008 Annual Report to Congress.*[5] During her *2009 Annual Report to Congress,* Ms. Olson stated:

> "***Fundamental Tax Simplification Is Desperately Needed.***
>
> In several prior reports, I have designated the complexity of the tax code as the most serious problem facing taxpayers and the IRS like. The need for tax simplification is not highlighted as a separate discussion in this

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[2] *FY 2009 FSLG Work Plan*, October 1, 2008, http://www.irs.gov/pub/irs-tege/fslg_fy09_work_plan.pdf.

[3] See Advisory Committee on Tax Exempt and Government Entities (ACT) Report of Recommendations, Public Meeting, Washington, D.C., June 10, 2009, http://www.irs.gov/pub/irs-tege/tege_act_rpt8.pdf.

[4] Id., p. 3.

[5] *National Taxpayer Advocate -- 2008 Annual Report to Congress*, *December 31, 2008*, page 1, http://www.irs.gov/advocate/article/0,,id=202276,00.html.

year's report to avoid repetition, but the omission of a detailed discussion in no way suggests the lessening of its importance." [6]

As the 2009 ACT Report[7] stated:

"The laws and rules that impact public employers' Federal FICA tax obligations include numerous exemptions and exceptions to the laws that apply to the private sector. Further exacerbating the situation are the semantics associated with the laws which can create confusion and inadvertent noncompliance by those employers. For example:

- 'Voluntary' Social Security coverage through a Section 218 Agreement was once the only way state and local governments could elect Social Security coverage for their employees. However, since April 20, 1983, coverage under a Section 218 Agreement cannot be terminated unless the governmental entity is legally dissolved.[8]

- 'Mandatory' Social Security coverage[9] is not really mandatory for all state and local government employees. If a public employer has a qualifying FICA replacement retirement system for its employees, it is not required to pay the Old-Age, Survivor, Disability portion of Social Security. The Medicare-only portion, however, is required for anyone hired by the public employer after March 31, 1986.

- 'Mandatory' Medicare coverage is also not really mandatory for all state and local government employees (see above bullet point for employees who must pay Medicare).[10] It is actually illegal to pay Medicare tax for "Medicare exempt employees", i.e., those hired prior to April 1, 1986, who have been in continuous employment with the governmental entity since that time, unless a Medicare-only Section 218 Agreement is requested by the public employer and approved by the required number of employees in

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6 *National Taxpayer Advocate – 2009 Annual Report to Congress*, *December 31, 2009*, Volume One, Section One, page xi, http://www.irs.gov/advocate/article/0,,id=217850,00.html

7 ACT Report of Recommendations, June 10, 2009, http://www.irs.gov/pub/irs-tege/tege_act_rpt8.pdf.

8 Public Law 98-21, April 20, 1983, 97 Stat. 65.

9 Public Law 101-508, November 5, 1990, 104 Stat. 1388 (Omnibus Budget Reconciliation Act of 1990).

10 Public Law 99-272, April 7, 1986, 100 Stat. 82 (Consolidated Omnibus Budget Reconciliation Act of 1985).

a referendum election that is held by the State Social Security Administrator."[11]

All levels of government depend on one or more sources of income from the taxpayers, e.g., property taxes, user fees, sales taxes, income taxes, and so forth. Thus public employers actually have an increased awareness of the criticality of properly paying taxes in a timely manner.

The advantage of providing easy to understand information and tools to public employers has also been proven by the issuance of IRS Publication 963 (*Federal-State Reference Guide*). See the 2009 ACT Report for details on the value to the IRS and public sector employers of that reference guide because it explained their employment tax and public pension system obligations in a clear, concise terms.[12] The checklist is intended to provide public employers with another compliance tool.

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[11] See Chapter 5, *Federal-State Reference Guide*, Publication 963, for an explanation of Social Security and Medicare coverage requirements for public employers and employees, including when a referendum election must be conducted to obtain Section 218 coverage.

[12] ACT Report of Recommendations, June 10, 2009, http://www.irs.gov/pub/irs-tege/tege_act_rpt8.pdf.

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III. Background and Project History

During the 2008-2009, the ACT FSLG Subcommittee adapted the existing FSLG Form 4318, Compliance Check, into a “Compliance Verification Checklist for Public Employers” for state and local government employers and their legal and financial advisors to use as a self-checklist tool. During 2009-2010, the ACT FSLG Subcommittee pretested the draft Checklist with state and local governmental employers throughout the country. See Appendix A: Web site Posting of Exposure Draft and Evaluation Form, for the information that was included on the National Conference of State Social Security Administrators (NCSSSA) Web site, which hosted the pretest.[13]

The following high-level historical summary provides the necessary background to properly understand the current year’s project (i.e., Phase II of a two year project):

- The FSLG section of the IRS’s TE/GE Division uses **Form 4318, Compliance Check,** when conducting reviews of state and local governments’ compliance with all Federal laws and regulations that are applicable to public employers. It is only available to IRS specialists, not to the public.
- FSLG wants to increase voluntary compliance among public employers and one means to help achieve that goal is to enable those employers to conduct a “self-check” at any time, using the on-line **Government Entity Toolkit**.
- An on-line form that public employers can use to verify their compliance requirements will help the employers know what is expected of them and to self-correct problems before the IRS initiates a compliance check, examination, or otherwise identifies a compliance problem within an entity.
    - This approach is consistent with the Treasury Department and the IRS’s goal of improving compliance with the U.S. tax code, including focusing on increasing voluntary compliance as a means to reduce the tax gap.
- Initial work on the project was divided among the ACT/FSLG members, with each person analyzing and suggesting additions and changes to Form 4318, based on their areas of expertise. ACT members then did a comprehensive review of the entire draft form that is attached to the report.

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[13] NCSSSA officials were gracious enough to host the pretesting of the draft Compliance Verification Checklist because the Paperwork Reduction Act of 1995 requires that Federal agency information collections employ effective and efficient survey and statistical methodologies appropriate to the purpose for which the information is to be collected. It further directs the Office of Management and Budget (OMB) to develop and oversee the implementation of Government-wide policies, principles, standards, and guidelines concerning statistical collection procedures and methods. See http://www.whitehouse.gov/OMB/inforeg/pmc_survey_guidance_2006.pdf for details. That restriction prohibited the IRS from hosting the pretest.

- The ACT members reviewed existing documentation related to FSLG compliance checks and requirements, including Form 4318, FSLG's case selection criteria, other self-evaluation questionnaires used by TE/GE, IRS Publication 963 (*Federal-State Reference Guide*), the *SSA Handbook*, and other guidelines and resources. The ACT also examined examples of other Compliance Check forms, such as that which is available to Indian Tribal Governments.

- During the initial phases of the process, a conference call was held among the ACT members with Hans Venable, FSLG Specialist, who provided ACT with a clarification of the process used for Form 4318.

    - This conversation was particularly helpful and informative to the ACT members and provided a solid foundation for the necessary follow-up that is planned during 2009-2010 in order to finalize the self-verification form and process for public employers.

- ACT members also reviewed the *Retirement Plans Employment Tax Guide (Guide)* which was updated by the IRS and Treasury Counsel during 2008-2009. The guide was modified by the IRS and Treasury Counsel to permit its use by the public and has since been posted on the IRS Web site in the "Government Retirement Plan Toolkit" at http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html.

- Following the research period, the ACT members adapted the FSLG Compliance Check Form 4318, which is currently only available to FSLG staff, into a self-check, user-friendly format that can eventually be included in the FSLG Toolkit and accessible to public employers or their representatives.

- The project also involved ACT members enhancing or otherwise expanding the content of Form 4318 to include additional information, as necessary and appropriate.

IV. Evaluation (Pretesting) Process

During 2009-2010, the ACT/FSLG Subcommittee members took several steps to ensure a broad-based pretest of the draft Compliance Verification Checklist with stakeholders:

1. Reviewed the draft Compliance Verification Checklist that was included in the 2009 ACT Report and made additional edits, such as adding more clarifying language to some to the notes.

2. Created an evaluation form for distribution with the Exposure Draft of the Compliance Verification Checklist for use in obtaining feedback from stakeholders as to the perceived value and usability of the checklist as a compliance tool.

3. Arranged for the National Conference of State Social Security Administrators (NCSSSA) to host the pretest on its Web site "What's New" page, at: http://www.ncsssa.org/index.html.

4. Contacted numerous professional organizations who have public employer members, asking them to notify their members of the pretest and how to participate in evaluating the Exposure Draft.

5. ACT members contacted the national level expert (Mr. Ken Anderson) within the U.S. Social Security Administration (SSA) in the Baltimore, Maryland, headquarters office who review and approve the Social Security and Medicare benefits and coverage of public employees, to ensure those portions of the checklist are accurate and complete.

6. Improvements, enhancements, and other changes that were recommended during the pretesting and vetting process were incorporated into the final form.

The following information was included in the Exposure Draft (see Appendix A for the entire set of materials that were posted on NCSSSA's Web site for the pretesting process). This information was included in the Exposure Draft document to ensure anyone evaluating the checklist clearly understood its purpose and how the ACT would use the data obtained from the evaluation form that was posted on the NCSSSA Web site with the Exposure Draft:

> **Introduction and Instructions for Pretesters of the Compliance Verification Checklist**
>
> **This is an <u>*EXPOSURE DRAFT*</u> *of the* Compliance Verification Checklist for State and Local Governmental Entities. This draft Checklist was developed in cooperation with the U.S. Internal Revenue Service (IRS), Federal-State-Local Governments (FSLG) office, by the Advisory Committee on Tax Exempt and Government Entities (ACT), Federal-State-Local Government (FSLG) Subcommittee. The ACT/FSLG Subcommittee members are asking**

state and local government employers' payroll officials, human resources professionals, and their legal and financial advisors to "pretest" the draft Compliance Checklist.

We request that everyone who pretests the Compliance Checklist complete the online <u>Evaluation Form (NOT the actual Compliance Checklist</u>) at: http://www.surveymonkey.com/s/825RHY5. We know that your time is valuable, so the Evaluation Form is structured to take less than 4 minutes to complete. <u>Please complete the Evaluation Form no later than March 15, 2010.</u>

If you prefer to print and submit your responses in hardcopy, rather than online, you can return the completed Evaluation Form by either of the following means:

Fax: (303) 318-8069 (ATTN: Maryann Motza)

Mail: Maryann Motza
Colorado State Social Security Administrator
Colorado Dept. of Labor & Employment
633 17th Street, Suite 700
Denver, CO 80202

We will consider all comments and suggested edits, but cannot guarantee that all recommendations will be incorporated into the final product that will be sent to the IRS during the June 2010 public meeting. ***NO INDIVIDUAL RESPONSES RECEIVED DURING THE EVALUATION PROCESS WILL BE DOCUMENTED AND LISTED UNDER THE ORIGINATOR'S NAME/ENTITY NAME. ALL DATA WILL BE RECORDED ACCORDING TO A NUMBER WE WILL ASSIGN TO ALL EVALUATIONS WE RECEIVE. ONLY CUMULATIVE DATA WILL BE REPORTED IN THE JUNE 2010 ACT REPORT AND TO THE IRS.*** We value your comments, but need to ensure that we retain the primary goal of the project, i.e.:

"To adapt the existing FSLG Compliance Check Form 4318 into a self-check form for public (state and local government) employers to access in order to enable them to verify their compliance with applicable federal laws and regulations."

The final Compliance Verification Checklist and results of our evaluation will be reported in the June 2010 ACT Report, which will be available later that month on the IRS Web site at http://www.irs.gov/.

Further information about the ACT and the reason the FSLG Subcommittee has been working on this project over the past two years is explained below. If you have questions or need further information about the Checklist, the ACT/FSLG Subcommittee's evaluation process, or other information pertinent to this project, please email or call Maryann Motza, Project Leader, at MMotza@msn.com or (303) 318-8061. Thank you, in advance, for your help.

Current Versus Final Format After Pretesting Concludes

We recognize that the current draft Compliance Checklist format is not ideal, because of its length. Unfortunately, we do not have the resources to create a "Web-based form," which will ensure that detailed explanatory information is available to people completing the form, but does not require space on the form itself. This pretest version of the Compliance Checklist includes the detail explanatory information within the checklist itself, with each question. **The purpose of the information is to allow the person completing the form to "self-verify" whether or not the public employer has any compliance problems. Due to the complexity of the laws associated with this area, a particular public employer cannot simply answer "Yes" (or "No") to all of the questions and be assured that s/he is in compliance with the law.** ***Thus, we have included the explanatory notes in the body of the form (in italicized type).***

Once finalized, as part of the 2010 ACT report, it is recommended that the self-check form be formatted by the IRS Forms and Publications, or other appropriate division within the IRS, for on-line use by public employers and their legal and financial advisors. The IRS should make it as easy as possible for public employers to use the self-check guide, by permitting public employers to save the form on-line and return to it later, to print it, to submit it electronically to the FSLG officials within the IRS, who can then work with the public employer to provide more detailed analyses of the results of the compliance self-check." (Emphasis in original.)

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V. EVALUATION RESULTS

The response to the Exposure Draft of the Compliance Verification Checklist was overwhelming, both in terms of numbers of responses and in the assessment of the checklist's value to public employers as a compliance tool. See Appendix B, Evaluation Form and Results, for complete details, including graphs, charts, and tables of data that were generated by the surveymonkey.com on-line survey tool, which the ACT members used to collect and tabulate the evaluation forms. That data shows the following key findings:

1. **Total respondents to the survey: 157.** This is a significant response when compared to the responses the Governmental Accounting Standards Board (GASB) usually gets to its exposure drafts. GASB establishes standards for state and local governmental accounting and financial reporting. Prior to issuing such standards, GASB releases exposure drafts throughout the country for public comment. In the past 25 years, GASB has released over 100 exposure drafts pertaining to such standards and other due process documents. The average number of responses GASB received for the exposure drafts was typically much less than 100, with the average being 66 responses. The recent GASB standard for Other Post Employment Benefits (OPEB), a very important topic, only generated 36 responses. While we understand that a few national organizations may have submitted one consolidated response for their organization to GASB, the fact that our survey garnered 157 responses indicates that we were very successful in obtaining a strong sampling of public opinion.

2. **Diverse representation of responses.**[14] The types of governments that responded to the survey includes state and institutions of higher education (22 total, 12.8 percent of all responses); local governments (including county, municipal, K-12 school districts, special districts; total of 140, or 81.9 percent of all responses); and "other" (unspecified; total of 9, or 5.3 percent of all responses). Also, respondents represented a variety of different sized governments (based on number of employees), with the largest percentage of responses (63.5 percent, 106 total responses) coming from smaller-sized employers (i.e., under 1,000 employees).

3. **Perceived value of the checklist with helping identify compliance level with federal employment taxes (Question number 4). Overwhelmingly (138 out of 152 people who answered the question, or 90.8 percent) answering "yes."**

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[14] The percentages listed in the summary chart in Appendix B do not total 100 percent because some respondents selected more than one response. The survey tool calculates the response percent based on the response count divided by the total respondents who answered each question. To provide a clearer understanding of the type of government and approximate number of employees represented by the respondents, the percentage calculations reported in this narrative for questions 1 and 2 are based on the individual response count divided by the total response count for each of those questions. All other questions are reported using the surveymonkey.com calculation method.

4. **Clarity and understandability of the checklist (Question number 5).** A significant number of people answering this question (130 out of 149, or 87.2 percent) said "yes" to this question.

5. **Value of the explanatory notes in assisting in responding to the questions (Question number 6).** The vast majority of respondents (141 out of 150, or 94.0 percent) answered "yes" to this question.

6. **Amount of detail contained in the explanatory notes were considered "just the right amount of detail" by 106 out of 149 respondents (71.1 percent).** Those who considered the notes to be too detailed totaled 20 (13. 4 percent), while those who thought they were not detailed enough totaled 17 (11.4 percent).

7. **Value of the checklist for public employers to keep apprised of new federal requirements related to employment tax obligations.** Clearly the majority of respondents think the checklist can assist them in this regard, with 135 out of 154 respondents (87.7 percent) answering "yes" to this question.

8. **Additional comments and suggestions for improvement or changes to the checklist.** A large number of respondents to the survey 69 (44 percent) took the time to provide general comments, suggestions for improvement, or changes to the checklist. The ACT members reviewed all of the responses and incorporated changes into the final recommended checklist (included in this report as Appendix C) as follows:

    a. Added more forms (1099S, 1099G, and 1099INT) to the "Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns" portion of the checklist. (#56)

    b. Corrected the implementation date for the three percent withholding (to 1/1/2012). (# 56)

    c. Added a clarifying note as to why it is important to know the classification of employees who pay Medicare only and the number of people in each classification for question 1. B. in the Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees. (# 53)

    d. Added the option for more than one person to complete the checklist because multiple people within many governments would need to provide input to ensure the responses are complete and accurate. (# 9, #46, # 108, # 111)

    e. Changed "are you aware" questions to "do you know" instead. (# 68)

    f. Inserted a new column after "N/A" (not applicable) entitled, "Not Sure." (#69)

    g. Added a "reminder" note at the end of the checklist that says: "If this Compliance Verification Checklist indicates your organization may have one or more compliance issue(s), it is suggested that you contact your IRS

Federal-State-Local Government (FSLG) Specialist for assistance. The names and contact information for FSLG staff are available at http://www.irs.gov/govt/fslg/article/0,,id=96060,00.html." This was added because a respondent said "it would be nice to know what the correct answers should be so you know if you are reporting correctly or not." Because of the complexity of the issues and multitude of possible "correct" answers, the checklist cannot provide that information, but FSLG Specialists can assist each public employer in ensuring they are in compliance. (# 71)

h. Added a link to the Appendix of IRS Publication 963 (*Federal-State Reference Guide*) that contains Section 218 of the U.S. Social Security Act. (# 83)

i. Added more information and links and otherwise edited the explanatory notes for the section entitled, "Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns." (# 88)

The ACT members could not make some recommended changes, such as the following:

1. "The drop down boxes were password protected." (# 98) None of the proposed drop-down boxes existed in the draft checklist that was pretested. The draft included notes, where applicable, for drop-down boxes to be added after the checklist is converted into a Web-based form by the IRS (assuming they adopt it) and made available on-line.

2. One suggestion for a substantive content change (provided by respondent number 74; see question 9 in Appendix B) could not be addressed at this time. The question stated, in pertinent part: "Page 9 notes that beginning 2011 government entities will be required to withhold 3% from certain 1099 payments. Would be helpful to identify what the new requirements will be. The www.irs.gov/govt Web site was not helpful – there was no publication easily referencing 3% withholding requirement. So, I gave up." That information could not be added, because it has yet to be created by the IRS. **This points out the importance of continually reviewing and updating the checklist, if the IRS decides to adopt it, because new laws and regulations will affect the quality of the content, both of the checklist itself and the explanatory notes that make it a useful compliance tool for public employers.**

3. "Would be nice to have an abbreviated form for those of us not under Section 218." (# 102) Unfortunately, it is impossible to create multiple forms that can accommodate all of the myriad of possible compliance scenarios for public employers in this area (e.g., at least 500 possible scenarios exist).

4. "Had a little problem understanding some of the retirement plans as explained. How does PERA and TRA fit into those explanations? Maybe use those acronyms along with the 401(a), etc." (# 97; also several other respondents had similar comments.) In that each state (and many local governments nationwide) has many different public retirement plans, it would be difficult to ensure all such plans are included in

the checklist. **This reinforces the importance of encouraging people who complete the form (or have questions while completing it) to contact their FSLG Specialist for assistance.**

5. "Include steps or suggestions on resolving, correcting prior non-compliance issues." (# 84) **Because each situation is different and may require different steps to correct prior problems, this reinforces the importance of encouraging people who complete the form (or have questions while completing it) to contact their FSLG Specialist for assistance.**

6. "The live document should have the links open in new windows." (# 130) And, "It would be necessary to include availability to preview/pre-print the form prior to a person completing it." (# 9) These suggestions are beyond ACT's ability to accomplish. It is dependent upon the IRS adopting the checklist and converting into a web-based form that is made available on-line.

7. "Since in CA the state (CalPERS) holds the Section 218 agreement and is the State Social Security Administrator for all schools, the school districts have never seen the Section 218 agreement…" (# 119) And "O (*sic*, I) got a copy of my Section 218 agreement once, but it was EXTREMELY confusing…so I keep doing what was done by the person before me and hope it's right :(" **These comments reinforce the importance of encouraging people who complete the form (or have questions while completing it related to their state's Section 218 Agreement or its Modifications) to contact their State Social Security Administrator. Each State Administrator can—and should—provide all of their public employers copies of their Section 218 Agreement/Modification so they know which employee groups are subject to Section 218 and which are under mandatory Social Security because the Agreement/ Modification(s) included certain "optional exclusions" when executed. The State Administrator should also assist public employers in interpreting and otherwise understanding the contents of their particular 218 coverage requirements.**

The ACT members want to also highlight some of the general comments (pro and con) that were offered by respondents to the survey:

1. "In some circumstances it was hard to decide if the questions being asked were pertaining directly to the local gov't or State Administered Retirement plan of which the City belongs." (# 3)

2. "Having a check list is a great idea. This area is so confusing, even seasoned personnel have a hard time remembering it all. So, having an easy to use checklist is a great idea that will increase compliance." (# 5)

3. "I reviewed but didn't 'complete' the form. I felt this would be a very useful tool but it count (*sic*, could) take a significant amount of time and resources to compete (*sic*, complete) the first time through." (#6)

4. "The checklist is good. I think it could be more effective if more concise." (#8)

5. “Thank you for allowing targeted users the opportunity to ‘pretest’ the new form.” (# 9)

6. “Maybe giving us info where we can go for help on each question would be great.” (#12)

7. “I found the hyperlinks to the actual documents extremely beneficial.” (#13)

8. “It’s too busy and kind of overwhelming. Maybe a little less information and maybe point or give directions to a particular site.” (#17)

9. “This is an excellent tool for internal audit purposes. The explanatory notes were especially helpful. While some language was taken directly for (*sic*, from) regulations, the ‘plain language’ explanations were especially appreciated. More of this type of explanation (i.e., taxation of Election Workers) would be useful.” (# 19)

10. “This is an excellent process and should be of great help to the government employers. Page 11 has some spacing issues but other than that, I thought it was well written and very understandable and has just the right amount of information provided.” (# 25)

11. “The links providing (*sic*, provided) were a great addition.” (# 41)

12. “I think this will be a useful tool if it is kept up to date timely.” (# 52)

13. “It is a valuable tool for school districts. When I first started payroll, I had to dig and dig to find out the information that is laid out on this checklist.” (#58)

14. “The checklist will be very helpful for state and local governments and will fill the compliance gap.” (# 65)

15. “I like the links to be able to click on to do further research when necessary.” (#73)

16. “Don’t ask to have all modifications entered. There are too many.” (# 76)

17. “It is obvious that a significant amount of time and effort has been spent on this project. I applaud each of you who have worked so diligently to come up with a thorough compliance checklist specifically relevant to government entities. Thank you for asking our opinions of the draft product.” (#77)

18. “No improvement needed! It should help all public employers comply with federal regs.” (# 85)

19. “I found the checklist very helpful – I learned things I did not know by reading the explanatory notes.” (# 86)

20. “I really think this checklist is long over due.” (# 87)

21. “Excellent.” (# 93)

22. “Was pleased to find our school district is in compliance in all areas.” (#94)

23. “I think it is a valuable tool for us to be able to locate information quickly and in one place.” (#96)

24. “It is quite comprehensive and it gives you enough information to find any details needed.” (#99)

25. “Didn’t like.” (# 103)

26. “I really like the contact information sheet, and plan to use it to update my Section 218 database information. I also prepared a pared down version of the questions for NY entities. Based on their answers, I can then provide additional information and guidance that is relevant to them.” (#121)

27. “Please send me the weblinks that may help me bring a solution to give you more feedback.” (# 123)

28. “Feel like small town payroll person needs to be an expert on tax law. . . “ (#125)

29. “Provides good information and awareness of requirements” (#128)

30. “Checklist was easy to follow. Similar to audit programs I have performed in my career as a certified public accountant. I think this checklist will be very helpful for those who perform their job without any real understanding of the laws and regulations.” (#131)

31. “This is a great idea.” (#133)

32. “Loved the fact that you also put in the extra websites on where to go to get help – being a small government it’s hard trying to find the right facts sometimes!” (#140)

33. “I think this is an excellent idea. I know a lot of little cities are not aware of the requirements.” (#141)

34. “As a State, no way should we have to list ALL of the mods on #4.” (143)

35. “As a fiscal Officer for a small entity in which I must be knowledgeable and responsible for all areas, I am always looking for ways to keep myself up-to-date.” (# 147)

36. “It should be a priority to ensure that the checklist is sent to the payroll representative who deals with these matters and not someone who will disregard it or answer it without really knowing the issues.” (#149)

37. “I think the checklist should be used by trained IRS professionals to lead the government compliance employee through.” (#151)

38. “It’s about time you all came up with this, great job!!” (#152)

39. “Excellent tool.” (#154)

40. “I personally think the list is valuable and most accurate. If you do your payroll efficient (*sic*, efficiently), then there shloud (*sic*, should) not be a problem.” (#155)

41. “I thought the checklist was very helpful.” (#156)

Thus, the results clearly indicate that we have accomplished the goal of this project, i.e.:

> “To adapt the existing FSLG Compliance Check Form 4318 into a self-check form for public (state and local government) employers to access in order to enable them to verify their compliance with applicable federal laws and regulations.”

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VI. SPECIAL THANKS

The ACT/FSLG Subcommittee wants to specifically thank a number of people and organizations that provided invaluable assistance to us during this two-year project. The people and organizations are listed alphabetically:

- Mr. Ken Anderson, Social Insurance Specialist, U.S. Social Security Administration, Office of Income Security Programs, SSA//OISP//Office of Earnings and Program Integrity Policy (Baltimore, Maryland). Mr. Anderson reviewed the content of the Exposure Draft and validated its accuracy in terms of compliance with the U.S. Social Security Act.
- Ms. Loretta Brown, Executive Assistant, Finance Department, City of Virginia Beach, Virginia. Ms. Brown's assistance was invaluable to the Subcommittee during the evaluation phase of the project. She created the survey-monkey form, addressed issues about how to complete the form from end-users, monitored the survey responses, and provided the final survey results to the ACT members for analysis. In addition, Ms. Brown created the Power Point slides that the subcommittee is using during the public meeting, to provide the ACT Report to the Commissioner.
- Mr. Dean J. Conder, Deputy Colorado State Social Security Administrator, who provided invaluable assistance during both years of the project in helping proof-read and validate the contents of the Compliance Verification Checklist during all of its various iterations.
- Mr. James Driver, Program Manager, and Ms. Tammy Taylor, Web site Manager, Division of Local Government Services, Social Security Coverage and Reporting Branch, Commonwealth of Kentucky. Mr. Driver, as immediate Past-President of NCSSSA, allowed the ACT to use the NCSSSA Web site (which he and Ms. Taylor maintain for the organization) as the "host" for ACT to post the Exposure Draft of the Compliance Verification Checklist and the link to the surveymonkey.com evaluation form.
- Ms. Sunita Lough, former IRS/FSLG Director, who asked the ACT to adapt the IRS's internal Form 4318 into a self-check tool for public employers to use.
- Mr. Paul Marmolejo, current IRS/FSLG Director, and Mr. Stewart Rouleau, FSLG Specialist, who used the FSLG Newsletter e-list and Web site link (http://www.irs.gov/govt/fslg/index.html) to notify public employers of the pretesting of the Exposure Draft.
- Ms. Karen Park (State Social Security Coordinator, State of Oregon), Ms. Linda Yelverton (Social Security Program Director, State of Louisiana), and other State Social Security Administrators throughout the country who distributed information about the Exposure Draft to public employers in their states.

- Mr. Hans Venable, FSLG Specialist, who provided ACT with a clarification of the process used for Form 4318 (during 2008-2009).

Several professional organizations were also extremely helpful by providing outreach to their members announcing the evaluation of the Exposure Draft (during early calendar year 2010):

- American Payroll Association
- Government Finance Officers Association
- National Conference of State Social Security Administrators
- National Association of State Auditors, Comptrollers, and Treasurers
- National Association of State Retirement Administrators

VII. Conclusions (Lessons Learned) and Recommendations

Reflecting back on this two-year project, there are a number of conclusions ("lessons learned") that we want to share for future ACT projects and recommendations specific to this project:

1. The on-line survey tool that collected and tabulated the evaluations of the Exposure Draft (i.e., available at www.surveymonkey.com) is an efficient and effective means to obtain valuable feedback from ACT's stakeholders. The costs to use the tool are modest plus it is easy to use—both from the perspective of the end-user and the ACT Committee. The ACT members recommend use that on-line survey tool whenever ACT needs to survey stakeholders' opinions.

2. The data indicate that the majority of public employers who tested the draft compliance checklist consider the tool to be valuable. Thus, the ACT members recommend that the IRS adopt the revised checklist (included as Appendix C of this subcommittee's report) and implement it as a compliance tool for state and local governmental employers.

3. If the IRS adopts the checklist and implements the tool, its value will depend on the IRS consistently maintaining the tool and ensure it is kept up-to-date as new statutory and regulatory changes are made.

4. Before implementation, the tool needs to be turned into a web-based form by IRS. Such a design will "clean up" the content of the checklist by allowing the end-user to click on a link or view a "pop-up" to see the explanatory notes. The ACT/FSLG Subcommittee members were unable to test the tool in a web-based format, which should logically make the tool even more user-friendly. It is recommended that it be formatted by the IRS Forms and Publications, or other appropriate division within the IRS, for on-line use by public employers and their legal and financial advisors.

   The IRS should make it as easy as possible for public employers to use the self-check guide. Thus, the ACT recommends that the IRS make the checklist into an on-line form that can be saved and returned to by public employers without losing information they have already entered. It should also be printable. This approach will serve all types and sizes of employers. For example, many small public employers only have part-time staff who do their accounting and employment tax reporting. Depending on the person's level of knowledge and experience with the maze of laws that apply to public employers' tax compliance, they may need to contact their counterparts in other similar organizations or other officials within the government to ensure they accurately and completely prepare the "self-check" form.

   Also, most mid- to large-sized public employers have a division of responsibilities. Thus, the person completing the form may not have all information needed to answer all of the questions contained in the form; for example, the Payroll Office may need to go to the Accounts Payable Office for information about how 1099's are processed. Thus, the form should be designed to be shared between and among various officials within the same governmental entity, to ensure it is accurately completed by all appropriate officials.

It is also recommended that the form include easy-to-use features, such as:

A. Allow public employers to copy and insert information into the form on-line and print a final version.

B. Permit employers to "save" their work, in case they are unable to complete the form in one sitting.

C. Radio buttons for the "Yes", "No", "Not Applicable (N/A)", and "Not Sure" options for each question, to prevent multiple selections as answers.

D. Drop-down boxes with logical options and a "fill-in-the-blank" option where an additional entry can be typed, to address the likelihood that the available options will not be all-inclusive.

E. The ability to transmit the completed form electronically to an FSLG Specialist for review and follow-up; and other, similar, user-friendly, on-line techniques.

5. The ACT members recommend that they work with the FSLG Director to determine what and how the voluntary closing agreement process for correction of items indicated in the checklist should be handled, after the on-line form is finalized and approved.

6. The ACT also recommends that, after the on-line form is finalized and approved, that the IRS widely publicize the checklist. The publicity should include stakeholder organizations for public employers, to maximize the distribution of the form's availability as a compliance tool. The organizations that the ACT members networked with during the pretesting of the checklist would be logical starting points.

7. The ACT members recommend that the FSLG Director determine what and how the voluntary closing agreement process for correction of items indicated in the checklist should be handled, after the on-line form is finalized and approved.

8. The IRS/FSLG Director determine what and how the voluntary closing agreement process for correction of items indicated in the checklist should be handled, after the on-line form is finalized and approved.

9. The IRS should request an exception to the Office of Management and Budget (OMB) Guidance on Agency Survey and Statistical Information Collections, January 20, 2006, restriction on surveys being posted on the IRS Web site for the ACT. The Charter, which established the Advisory Committee on Tax

Exempt and Government Entities (ACT) pursuant to the provision of the Federal Advisory Committee Act, states, in pertinent part:

> "**Objective and Scope**. The ACT is established to provide an organized public forum for discussion of relevant employee plans, exempt organizations, tax-exempt bond, and federal, state, and local and Indian tribal government issues between officials of the Internal Revenue Service (IRS) and representatives of the employee plans, exempt organizations, tax-exempt bond, and federal, state, local and Indian tribal government communities; and to enable the IRS to receive regular input with respect tot the development and implementation of tax administration issues affecting those communities**.** The **ACT members will present in an organized and constructive fashion the interested public's observations about current or proposed Tax Exempt and Government Entities Division programs and procedures and will suggest improvements…**" (Emphasis added)

The ACT FSLG Subcommittee members acknowledge and respect the limitations imposed by the U.S. Congress for surveying members of the public. Those restrictions require the IRS to follow strict guidelines established by the OMB. The pragmatic impact of those restrictions, however, is to severely limit the ability of the ACT members to properly and thoroughly perform their responsibilities as outlined in the ACT Charter, thus defeating the purpose of the Committee's ability to "present in an organized and constructive fashion the interested public's observations about current or proposed Tax Exempt and Government Entities Division programs and procedures and will suggest improvements."

The ACT members recommend that the IRS/TE-GE address this restriction in the following ways:

A. Contact the IRS Taxpayer Advocacy Panel (TAP), another IRS Advisory Committee, to ascertain how it is permitted to solicit (i.e., "survey") the public. See the TAP Web site at: www.improveirs.org, especially on the following webpage: http://www.improveirs.org/comment/comment.shtml.

B. Work with OMB to obtain a special waiver or blanket approval for ACT members to solicit and receive public comments from our various stakeholder groups.

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VIII. APPENDICES

See the separately identified Appendices A, B, and C, as follows:

- Appendix A: Web site Posting of Exposure Draft and Evaluation Form
- Appendix B: Evaluation Form and Results
- Appendix C: Final Recommended Compliance Verification Checklist

Note Regarding Section 508 Issues Related to Appendix A and B:

Due to Section 508 issues, portions of Appendix A (Web site Posting of Exposure Draft and Evaluation Form) and all of Appendix B (Evaluation Form and Results), are not available on-line. To request a PDF copy of one or both of those Appendices, contact Maryann Motza at MMotza@msn.com or at (303) 318-8061.

Appendix A:

Website Posting of Exposure Draft and Evaluation Form (Excerpts)

Text for Websites to "Advertise" the Exposure Draft And Request Comments

In order to assist state and local government (public) employers and their legal and financial advisors in complying with federal employment tax laws and regulations, the IRS Advisory Committee on Tax Exempt and Governmental Entities ("ACT"), Federal-State-Local Government (FSLG) Subcommittee, has developed a compliance verification checklist for public employers that is now posted on the National Conference of State Social Security Administrators (NCSSSA) website at http://www.ncsssa.org/whatsnewcombo.html.

The intent of this project is to help public employers know what is expected of them so they can self-correct problems before the IRS initiates a compliance check, examination, or otherwise identifies a compliance problem within a Federal, state, or local governmental entity.

The ACT/FSLG Subcommittee members need your help in refining and improving the draft Checklist. To do so, the ACT/FSLG Subcommittee is asking state and local government employers' payroll officials, human resources professionals, and their legal and financial advisors to "pretest" a draft "Compliance Verification Checklist for State and Local Governmental Entities."

The draft Checklist, a cover memorandum from the ACT/FSLG Subcommittee members, and a brief evaluation form that we would like you to complete after reviewing the draft Checklist, are available at, respectively: http://www.ncsssa.org/whatsnewcombo.html and http://www.surveymonkey.com/s/825RHY5. There is no cost to you for completing the online Evaluation Form. We know that your time is valuable, so the Evaluation Form is structured to take less than 4 minutes to complete. ***The deadline for the ACT Committee to receive your feedback is March 15, 2010.*** Thank you, in advance, for your help perfecting this form.

ACT/FSLG Subcommittee members:
Paul Carlson
Maryann Motza
Patricia Phillips

To: State and Local Governmental Employers ("Public Employers")

From: Internal Revenue Service, Advisory Committee on Tax Exempt and Government Entities, Federal-State-Local Government (FSLG) Subcommittee

RE: Exposure Draft: Compliance Verification Checklist for State and Local Governmental Entities

Date: January 20, 2010

Public employers are subject to unique employment taxes (Social Security, Medicare, public pension systems, and fringe benefits) and regulations which are different from those for private sector employers. There are hidden issues that, if not addressed, could have serious long-term implications for public sector employees and employers.

Recent findings within some states indicate that lack of management of employment tax issues resulted in legal actions and impacts to employees which will take several years to resolve, and potentially result in costly settlement expenses and penalties for the public employers.

In order to assist public employers in complying with federal employment tax laws and regulations, the IRS Advisory Committee on Tax Exempt and Governmental Entities ("ACT") has developed a compliance verification checklist for public employers that is now posted on the National Conference of State Social Security Administrators (NCSSSA) website at http://www.ncsssa.org/whatsnewcombo.html.

The ACT will receive comments on this Exposure Draft until March 15, 2010; you may post your comments by responding to the online Evaluation Form at http://www.surveymonkey.com/s/825RHY5 or send a hardcopy of the completed Evaluation Form to Maryann Motza, ACT/FSLG Subcommittee Compliance Verification Checklist Project Leader, via the means listed on Page 2 of the Exposure Draft. We know that your time is valuable, so the Evaluation Form is structured to take less than 4 minutes to complete.

In addition to this Exposure Draft being posted for comments from public employers and their representatives, the ACT will also provide opportunities for public dialogue and input at various conferences and also solicit input from professional organizations, such as the National Conference of State Social Security Administrators (NCSSSA); the National Association of State Auditors, Comptrollers, and Treasurers (NASACT); the Government Finance Officers Association (GFOA); and the American Payroll Association (APA).

After input has been received and the Checklist edited, the FSLG Subcommittee of ACT will recommend that the Checklist become a permanent part of the FSLG On-Line Toolkit.

If there are any questions, you may send your email to Maryann Motza, FSLG Compliance Checklist Project Leader at: MMotza@msn.com.

Thank you, in advance, for your assistance in refining and improving this valuable compliance tool for state and local governments.

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

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Introduction and Instructions for Pretesters of the Compliance Verification Checklist

This is an *__EXPOSURE DRAFT__ of the* Compliance Verification Checklist for State and Local Governmental Entities. This draft Checklist was developed in cooperation with the U.S. Internal Revenue Service (IRS), Federal-State-Local Governments (FSLG) office, by the Advisory Committee on Tax Exempt and Government Entities (ACT), Federal-State-Local Government (FSLG) Subcommittee. The ACT/FSLG Subcommittee members are asking state and local government employers' payroll officials, human resources professionals, and their legal and financial advisors to "pretest" the draft Compliance Checklist.

We request that everyone who pretests the Compliance Checklist complete the online __Evaluation Form (NOT the actual Compliance Checklist)__ at: http://www.surveymonkey.com/s/825RHY5***. We know that your time is valuable, so the Evaluation Form is structured to take less than 4 minutes to complete.__Please complete the Evaluation Form no later than March 15, 2010.__***

If you prefer to print and submit your responses in hardcopy, rather than online, you can return the completed Evaluation Form by either of the following means:

Fax: (303) 318-8069 (ATTN: Maryann Motza)

Mail: Maryann Motza
Colorado State Social Security Administrator
Colorado Dept. of Labor & Employment
633 17th Street, Suite 700
Denver, CO 80202

We will consider all comments and suggested edits, but cannot guarantee that all recommendations will be incorporated into the final product that will be sent to the IRS during the June 2010 public meeting. ***NO INDIVIDUAL RESPONSES RECEIVED DURING THE EVALUATION PROCESS WILL BE DOCUMENTED AND LISTED UNDER THE ORIGINATOR'S NAME/ENTITY NAME. ALL DATA WILL BE RECORDED ACCORDING TO A NUMBER WE WILL ASSIGN TO ALL EVALUATIONS WE RECEIVE. ONLY CUMULATIVE DATA WILL BE REPORTED IN THE JUNE 2010 ACT REPORT AND TO THE IRS.*** We value your comments, but need to ensure that we retain the primary goal of the project, i.e.:

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> "To adapt the existing FSLG Compliance Check Form 4318 into a self-check form for public (state and local government) employers to access in order to enable them to verify their compliance with applicable federal laws and regulations."

The final Compliance Verification Checklist and results of our evaluation will be reported in the June 2010 ACT Report, which will be available later that month on the IRS website at: http://www.irs.gov/.

Further information about the ACT and the reason the FSLG Subcommittee has been working on this project over the past two years is explained below. If you have questions or need further information about the Checklist, the ACT/FSLG Subcommittee's evaluation process, or other information pertinent to this project, please email or call Maryann Motza, Project Leader, at: MMotza@msn.com or (303) 318-8061. Thank you, in advance, for your help.

Current Versus Final Format After Pretesting Concludes

We recognize that the current draft Compliance Checklist format is not ideal, because of its length. Unfortunately, we do not have the resources to create a "web-based form", which will ensure the detailed explanatory information is available to people completing the form, but does not require space on the form itself. This pretest version of the Compliance Checklist includes the detail explanatory information within the checklist itself, with each question. **The purpose of the information is to allow the person completing the form to "self-verify" whether or not the public employer has any compliance problems. Due to the complexity of the laws associated with this area, a particular public employer cannot simply answer "Yes" (or "No") to all of the questions and be assured that s/he is in compliance with the law.** ***Thus, we have included the explanatory notes in the body of the form (in italicized type).***

Once finalized, as part of the 2010 ACT report, it is recommended that the self-check form be formatted by the IRS Forms and Publications, or other appropriate division within the IRS, for on-line use by public employers and their legal and financial advisors. The IRS should make it as easy as possible for public employers to use the self-check guide, by permitting public employers to save the form on-line and return to it later, to print it, to submit it electronically to the FSLG officials within the IRS, who can then work with the public employer to provide more detailed analyses of the results of the compliance self-check.

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Form Being Pretested

Purpose of Compliance Verification Checklist

This Compliance Verification Checklist (also referred to as "checklist" or "self-check") is designed to allow state and local government entities (also referred to in this form as "public employers") to conduct a self-assessment of their level of compliance with certain federal tax laws, rules, and regulations. At the beginning of each section, there is a brief description of the basic legal requirements that apply to public employers for that category of requirements. Where necessary, due to the many nuances in the law that apply to some compliance subcategories, additional explanation of the requirements and resources are provided.

Public employers have unique legal requirements for compliance with the federal tax code (U.S. Internal Revenue Code (IRC)) and federal Social Security and Medicare coverage (U.S. Social Security Act). Public employers must be aware of numerous differences from the private sector that apply to them and their workers (both employees and independent contractors), especially related to employment tax, FICA, Social Security (Old-Age, Survivor, Disability Insurance) coverage, Medicare (Health Insurance) coverage, and public retirement system obligations.

Common Errors

During past **Compliance Checks and Examinations** of public employers that the IRS office of Federal State and Local Governments (FSLG) has conducted, a number of common errors have been identified:

- Amounts on Forms W-2, W-3, and 941 do not reconcile.
- Forms W-9 and W-4 are not being used or are not being updated when necessary.
- Public employers are unaware of the requirement to backup withhold if no Taxpayer Identification Number (TIN) is provided by a vendor prior to payment.
- Form 1099 problems:
  - The forms were not prepared at all.
  - The forms were prepared incorrectly, such as the amounts are in the wrong box, the names and TIN did not match, etc.
  - The forms were prepared, but not submitted to the IRS.
- Employment tax return filing and deposit problems:
  - Deposits were made, but no return was filed.
  - Deposits were made to an incorrect period.
- Unaware of electronic filing requirement and unaware of FIRE system (Filing Information Returns Electronically).
- Elected officials are treated as independent contractors, rather than as employees.
- Failure to pay and withhold Medicare-only tax on rehired annuitants.
- Election officials and workers treated as independent contractors, rather than as employees.

Due to the complexity of the law, however, other errors can occur, especially for smaller public employers. This Compliance Verification Checklist is designed to help public employers identify their issues and concerns and work with FSLG, Social Security Administration (SSA), and their State Social Security Administrator (depending on the issue) to correct the mistakes, so they become fully compliant with applicable federal laws and regulations. The IRS/FSLG Compliance program consists of two basic types of cases. [1]

For Assistance While Completing the Form

General resources that cover all aspects of this Compliance Verification Checklist can be accessed at the following websites:

- *Federal-State Reference Guide (Publication 963),* http://www.irs.gov/pub/irs-pdf/p963.pdf
- *Quick Reference Guide for Public Employers*, http://www.irs.gov/pub/irs-tege/public_employers_outreach_guide.pdf
- *IRS Federal, State and Local Governments Public Employer Tax Guide*: http://www.irs.gov/pub/irs-tege/public_employers_outreach_guide.pdf
- *Independent Contractor or Employee Brochure, http://www.irs.gov/pub/irs-pdf/p1779.pdf*
- FSLG website, which can be accessed at: http://www.irs.gov/govts.
- Federal, State & Local Government (FSLG) Toolkit, http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html
- *Retirement Plans for Government Employers*, **[insert link after this document is posted on the Retirement Toolkit website]**
- *Governmental Plans Information (IRS Employee Plans), http://www.irs.gov/retirement/article/0,,id=181779,00.html*

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[1] FSLG's compliance program relies on two types of cases: compliance checks and examinations.

There is no statutory or common law definition of the term "examination." However, an examination may be described as the systematic inspection of the books and records of a taxpayer for the purpose of making a determination of the correct tax liability.

A compliance check is a contact with the customer that involves a review of filed information and tax returns of the entity. It is a verification of recordkeeping and tax return and information return filing; it is not directly related to the determination of a tax liability. It is not an examination or audit.

A compliance check is different from an examination because:

- Books and records are not inspected, and
- There is no attempt to determine tax liability.

A compliance check is an alternative to an examination. It is less burdensome to the taxpayer and can generally be accomplished in one or two contacts with the taxpayer. It serves as an opportunity to educate the taxpayer and encourage compliance with regard to employment tax law and filing requirements.

- Correcting Governmental Plan Errors, http://www.irs.gov/retirement/article/0,,id=96907,00.html

- U.S. Social Security Administration Information for Federal, State, and Local Government Employers and Employees Regarding Social Security Benefits Reductions, http://www.ssa.gov/gpo-wep/

- *Employer's Supplemental Tax Guide* (Publication 15-A), http://www.irs.gov/pub/irs-pdf/p15a.pdf

- *Employer's Guide to Fringe Benefits* (Publication 15-B), http://www.irs.gov/pub/irs-pdf/p15b.pdf

- *Taxable Fringe Benefit Guide,* http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf

- IRS educational products for government employers: http://www.irs.gov/govt/fslg/content/0,,id=117706,00.html

- General Social Security Administration (SSA) information is available on SSA's homepage (www.ssa.gov) and more specific information pertinent to government employers and employees is available at: www.ssa.gov/slge.

Where to Go For Assistance and Further Information After Completing the Form

After completing the Compliance Verification Checklist, you are encouraged to contact your Federal, State & Local Government (FSLG) Specialist at the Internal Revenue Service (IRS). There is at least one FSLG Specialist assigned to every state. The FSLG Specialist can help you interpret the results of the self-check and ensure that you know what, if any, steps you need to take to be fully compliant with all applicable federal tax laws, rules, and regulations. The primary objective of FSLG is to ensure compliance with federal employment tax laws by governmental entities through the use of review and examination activities as well as through educational programs. The names and contact information for FSLG staff are available at: http://www.irs.gov/govt/fslg/article/0,,id=96060,00.html.

The FSLG Specialist may recommend that you contact your State Social Security Administrator for clarifications and information about a Section 218 Agreement, how to obtain Medicare-only coverage for Medicare-exempt employees, or other similar information about which the State Administrator has responsibility and knowledge. Each state's laws are unique in how they enacted the voluntary Social Security (and, later, Medicare) coverage agreements for state and local government employees. To learn more, you should contact the State Social Security Administrator for your state by going to: http://www.ncsssa.org/statessadminmenu.html.

The FSLG Specialist may also suggest that you contact the U.S. Social Security Administration (SSA) for further information about coverage and benefits under Social Security and Medicare, how an employee's or employee's spouse's Social Security benefits may be reduced (i.e., offset) by a public pension payment, and other issues that are unique to Social Security and Medicare benefits that are paid to government employees. FSLG works with the SSA to educate government entities about Section 218 Social Security Agreements. These voluntary agreements provide Social Security and/or Medicare coverage for state and local employees. While IRS is responsible for administering and enforcing the tax laws, SSA processes and interprets these agreements and related coverage issues. General SSA information is available at the Social Security Administration homepage (www.ssa.gov) and more specific information pertinent to government employers and employees is available at: www.ssa.gov/slge.

<table>
<tr><th colspan="7">Entity Identification and Contact Information</th></tr>
<tr><td>Entity (Taxpayer's) Name</td><td colspan="6"></td></tr>
<tr><td rowspan="3">Entity's Level and Type of Government (check only one box, then select the type of government from the appropriate drop-down box)</td><td colspan="2">Federal</td><td colspan="2">State</td><td colspan="2">Local</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="6">The final web-based form will have drop-down boxes for each of the above choices with options (e.g., Federal Department, State, county, municipality, etc.)</td></tr>
<tr><td>Entity (Taxpayer's) TIN (Tax Identification Number)</td><td colspan="6"></td></tr>
<tr><td rowspan="5">List any other TIN's associated with the entity, including name that is listed for the TIN</td><td colspan="6">Alpha-numeric fields, below, in the final form will allow for multiple entries</td></tr>
<tr><td colspan="3">Legal Name</td><td colspan="3">Assigned TIN or EIN</td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>Office Location (Address – Line 1)</td><td colspan="6">Alpha-numeric field</td></tr>
<tr><td>Office Location (Address – Line 2)</td><td colspan="6">Alpha-numeric field</td></tr>
<tr><td>City, State, ZIP Code</td><td colspan="6">Insert drop-down box with options</td></tr>
<tr><td colspan="7"></td></tr>
<tr><td>Name of Person Completing Questionnaire</td><td colspan="6"></td></tr>
<tr><td>Title of Person Completing Questionnaire</td><td colspan="6"></td></tr>
<tr><td>Telephone Number of Person Completing Questionnaire</td><td colspan="6"></td></tr>
<tr><td>Fax Number of Person Completing Questionnaire</td><td colspan="6"></td></tr>
<tr><td>Email of Person Completing Questionnaire</td><td colspan="6"></td></tr>
<tr><td colspan="7"></td></tr>
<tr><td>Entity Contact Name (if different from Name of Person Completing Questionnaire)</td><td colspan="6"></td></tr>
</table>

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Entity Identification and Contact Information	
Title of Contact Name (if different from Name of Person Completing Questionnaire)	
Telephone Number of Contact Name (if different from Name of Person Completing Questionnaire	
Fax Number of Contact Name (if different from Name of Person Completing Questionnaire	
Email of Contact Name (if different from Name of Person Completing Questionnaire	

Compliance Categories to be Reviewed in Completing this Checklist:

The remainder of this checklist consists of reviewing the following seven categories. The purpose of reviewing these areas is to have the person completing the checklist to identify areas in which s/he can improve compliance levels with federal employment tax issues.

- Worker Classification: Employee versus Independent Contractor.
- Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage).
- Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees.
- Retirement Plan Coverage as a Substitute for Social Security Coverage.
- Fringe Benefits.
- Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns.
- Social Security Benefits Offsets for Public Employees.

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EXPOSURE DRAFT FOR COMMENTS
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Worker Classification: Employee versus Independent Contractor

In general, an ***employee*** *is anyone who performs services subject to the will and control of the individual or entity paying for the services. Payments to employees for such services in the form of cash, property, services or other benefits are taxable wages, unless excluded by a specific provision of the law. Taxable wages are reported on Form W-2, Wage and Tax Statement. Forms W-2 and W-3 filing information is available on SSA's website at: http://www.socialsecurity.gov/employer/.*

For a full discussion of how to determine who is an employee, see Publication 963 and Publication 15-A. Additionally, Publication 1779 provides a good overview of this issue.

Independent contractors *include any person or business that performs services for you and is not subject to your will and control as an employee. Generally, any payment of $600 or more during a calendar year is reportable on Form 1099-MISC, Miscellaneous Income, by January 31 of the following year. For more information on information reporting, see the Instructions for Form 1099-MISC.*

Note: *Beginning in 2011, certain payments by governmental entities to vendors and independent contractors are subject to 3% withholding. For more information, see www.irs.gov/govt.*

Yes	No	N/A	
			1. For those entities without a Section 218 Agreement or for classes of workers who are not covered by a Section 218 Agreement, have you reviewed the facts and circumstances and made a determination under the common-law criteria that all workers are properly classified and treated accordingly? ***Notes:*** *State and local government employees were excluded from Social Security coverage from 1935 (the date of the original Social Security Act) until 1950 because of unresolved legal questions regarding the federal government's authority to tax state and local governments. Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide Social Security coverage to public employees. These arrangements are called "Section 218 Agreements" (also referred to as "voluntary coverage agreements") because they are authorized by Section 218 of the Act. In 1939, the Old-Age, Survivors, and Disability Income (OASDI) program was created, and the funding mechanism for the social security program was officially established in the Internal Revenue Code as the Federal Insurance Contributions Act (FICA). The IRS is responsible for the collection of this tax. See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf and IRS Publication 963*, Chapter 1, Social Security and Government Employers, and Chapter 5, Social Security and Medicare Coverage, for further information about Section 218 Agreements.* *(Explanation continued on next page)*

Worker Classification: Employee versus Independent Contractor			
Yes	**No**	**N/A**	
			There are three categories of factors (Behavioral, Financial and Relationship of the parties) that should be considered to determine whether the worker is an employee or independent contractor. Tax and penalties may apply if you misclassify a worker. See IRS Publication 1779, Independent Contractor or Employee, and IRS Publication 963, Federal-State Reference Guide, http://www.irs.gov/pub/irs-pdf/p1779.pdf and IRS Publication 963*, Chapter 4, for information about worker classification.*
			2. **Do you have any workers for which you are uncertain as to the proper classification -- independent contractor versus employee?** ***Note:*** *You can submit an SS-8 form (Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding) to the IRS to obtain a determination about whether or not a particular worker is an independent contractor or employee of the governmental entity?* ***Note:*** *Form SS-8 is available at: http://www.irs.gov/pub/irs-pdf/fss8.pdf.*

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Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)

*Public employers need to be aware of the rules that govern FICA (Social Security and Medicare coverage for their employees. Public employees may be subject to Social Security tax, either through mandatory withholding, or through the provisions of a Section 218 Agreement. They may be exempt from Social Security if they are covered by a qualifying public retirement system (see the compliance category section of this checklist entitled "*Retirement Plan Coverage as a Substitute for Social Security Coverage" *for details). Several legal issues must be considered to determine the correct Social Security and Medicare status of a worker.*

If the position is covered, either by an Agreement or under mandatory coverage, your worker is subject to Social Security up to the wage base (SSA adjusts the wage base annually; for the current base, go to: http://www.socialsecurity.gov/OACT/COLA/cbb.html) and Medicare tax. There is no wage base limit for Medicare tax. The employer pays matching amounts of these taxes.

A Section 218 Agreement is made between the Social Security Administration and a State (prepared by the state's Social Security Administrator)to provide coverage for a group of state or local government employees. ***A Section 218 Agreement covers positions, not individuals****. Since April 20, 1983, any public employer who had previously entered into a Section 218 Agreement to cover their employees must continue to cover employees under the Agreement, regardless of whether or not another qualifying public retirement plan is made available. Coverage under a Section 218 Agreement supersedes all other considerations.*

If a public employer wants to make a change and provide both a qualifying Social Security replacement plan and full Social Security coverage for its employees, a referendum election must be conducted by the State Social Security Administrator (or by the Social Security Administration, if the entity is an interstate instrumentality). An Interstate Instrumentality is an independent legal entity organized by two or more states to carry out one or more governmental functions. For purposes of a Section 218 Agreement, an interstate instrumentality has the status of a state. See Publication 963, Chapter 5, for details about the referendum process.

The referendum process can also be used to obtain Medicare-only coverage for Medicare exempt government employees (anyone hired prior to April 1, 1986, who has been in continuous employment with the same employer since that time). See the compliance category section of this checklist entitled "Medicare Coverage and Medicare Exempt Government Employment" and Chapter 5 in Publication 963 for further information.

Beginning July 2, 1991, if public employees are not covered for social security under a Section 218 Agreement and are not qualified participants in a public retirement system, they are mandatorily covered under social security. Mandatory social security coverage ceases if the employees subsequently become qualified participants in a public retirement system.

In addition to the reference materials noted earlier in this checklist, the FSLG website includes information entitled, "What State or Local Government Employers Should Know About Social Security and Medicare Coverage", which can assist employers in determining their Social Security and/or Medicare coverage and FICA requirements. That site is available at: http://www.irs.gov/govt/fslg/article/0,,id=182888,00.html.

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)			
Yes	**No**	**N/A**	
			1. **Does the entity have a voluntary Social Security (full Social Security and Medicare) coverage agreement, often referred to as a Section 218 Agreement?**
			2. **Are services performed by any of your employees mandatorily excluded from FICA (Social Security and Medicare) coverage?** ***Note:*** *Federal law requires the exclusion of the following services from voluntary (Section 218) coverage under the Social Security Act (Section 218(c)(6)):* • *Services performed by individuals hired to be relieved from unemployment.* • *Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government.* • *Services performed by an employee hired on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency.* • *Services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S.* • *Services in positions compensated solely by fees that are subject to SECA (Self-Employment Contributions Act), unless a Section 218 Agreement covers these services.* • *Services performed by a student enrolled and regularly attending classes at the school, college or university where they are working (to qualify, students must physically work on campus), unless a Section 218 Agreement covers student services.* • *Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law, unless a Section 218 Agreement covers election workers.* • *Services that would be excluded if performed for a private employer because it is not work defined as employment under Section 210(a) of the Social Security Act, unless a Section 218 Agreement covers certain agricultural services.* *See Chapter 5 of Publication 963, for details on what constitutes a mandatory exclusion under federal law.*

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)			
Yes	**No**	**N/A**	
			3. **If the entity does have a Section 218 Agreement, what classes of employees are included (or excluded) from the Agreement?** In the final form, an alpha-numeric field will allow for multiple entries
			4. **If the entity has a Section 218 Agreement, have any Modifications to the Agreement been adopted?**
			A. If "yes", list all Modification numbers, dates, and a description of what changes to the Section 218 Agreement were made by each Modification. In the final form, an alpha-numeric field will allow for multiple entries
			5. **Does the entity pay and withhold full FICA -- Social Security (Old-Age, Survivor, Disabilitiy Insurance) <u>and</u> Medicare (Health) Insurance – on all employees?**
			A. If "yes", is the entity paying full FICA based on a voluntary Section 218 Agreement? *(See Chapter* 5 of Publication 963 for details).
			6. **If the entity has no Section 218 Agreement, does the entity pay full FICA based on mandatory Social Security provisions contained in Omnibus Budget Reconciliation Act (OBRA) 1990** *(see Chapter 6 of Publication 963 for details).*
			7. **Does the entity have any of the following categories of workers?**
			A. Elected officials. ***Note:*** *A public official has authority to exercise the power of the government and does so as an agent and employee of the government. For this reason, the Supreme Court has held that public officials are employees. A public official performs a governmental duty exercised pursuant to a public law. A public office is a position created by law, holding a delegation of a portion of the sovereign powers of government to be exercised for the benefit of the public. Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1926).* (Explanation continued on next page)

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)			
Yes	**No**	**N/A**	
			For the same reason, elected officials are subject to a degree of control that typically makes them employees under the common law. Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall by the public or a superior official. In any event, elected officials are employees for income tax withholding purposes under Internal Revenue Code section 3401(c).
			B. Appointed officials. ***Note:*** *Very few appointed officials have sufficient independence such that they will not be considered common-law employees.*
			C. Part-time positions. ***Note:*** *After July 1, 1991, full-time, part-time, temporary and seasonal employees who are not participating in a qualifying retirement system made available through their employer* ***MUST be covered by Social Security and Medicare.*** *It is also possible for employees under a public retirement system to be covered for Social Security if a Section 218 Agreement covers them.*
			D. Fee-based positions. ***NOTE:*** *In general, if an individual performs services as an official of a governmental entity and the remuneration received is paid from governmental funds, the official is an employee and the wages are subject to Federal employment taxes. Examples of public officials include, but are not limited to, the President, a governor, mayor, county commissioner, judge, justice of the peace, sheriff, constable, registrar of deeds, building and plumbing inspectors, etc.* *An exception to this rule applies to a* ***fee-based public official****. A fee-based public official receives his/her remuneration in the form of fees* ***directly from the public (e.g., a notary public)*** *with whom he/she does business. However, if the fee service is covered by a Section 218 agreement, the services is covered as Employment, as discussed in Publication 15, Employer's Tax Guide (Circular E).*
			E. Does the entity have volunteer firefighters? ***Note:*** *Volunteer firefighters are considered employees and if they receive compensation, their remuneration is generally* (Explanation continued on next page)

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)			
Yes	**No**	**N/A**	
			subject to all withholding taxes. Beginning in 2008, and through 2010, qualified emergency response organizations may exclude certain amounts from income, social security and Medicare wages amounts paid to any firefighter. Additionally, if a firefighter's payment is reimbursement for out-of-pocket expenses actually incurred in the course of work, and the payment is accounted for according to the requirements of IRS Regulations regarding accountable plans, then the payment could be excludable from the rest of the firefighter's Form W-2. (See the section of the checklist entitled, "Fringe Benefits" for information about "accountable plans.") See Publication 963 for more information on this issue. See the IRS Quick Reference Guide for Public Employers, for more information.
			8. **Does the entity have any of the following categories of workers?**
			A. **Agricultural labor** (if their services would be excluded if performed for a private sector employer). ***Note:*** *Agricultural labor may continue to be excluded from Social Security and Medicare coverage even if they are not under a public retirement system. However, these services may be covered by a 218 Agreement and, therefore, subject to FICA.*
			B. **Student services** ***Note:*** *Students who are enrolled and regularly attending classes at the school where they are working are exempt from paying Social Security and Medicare taxes. However, these services may be covered by a 218 Agreement and, therefore, subject to FICA. Student services performed off campus are subject to FICA.* *Medical residents are generally common-law employees of the hospitals for which they work, and therefore are subject to Social Security and Medicare taxes (unless they are excepted by a Section 218 Agreement). However, IRC 3121(b)(10) provides an exception for students employed by a school, college, or university (SCU) who are enrolled and regularly attending classes at the SCU. For more information, see Regulation 31.3121(b)(10)-2 and Revenue Procedure 2005-11 at: http://www.irs.gov/irb/2005-02_IRB/ar16.html.* *In order for medical residents to meet this exception, several conditions must be met. For details, see Regulation 31.3121(b)(10)-2 and Revenue Procedure 2005-11: http://www.irs.gov/irb/2005-02_IRB/ar16.html.* (Explanation continued on next page)

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)			
Yes	**No**	**N/A**	
			Note: *Due to an 8th Circuit Court of Appeals decision in State of Minnesota v. Apfel, 151 F.3d 742 (8th Cir. 1998), public employers in the following states should contact their FSLG Specialist for additional information about FICA requirements applicable to their medical residents: Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota.*
			C. Services performed by election officials or election workers if they are paid less than the current dollar threshold. For the current threshold amount, go to: IRS Publication 963, Chapters 5 and 10. ***Note:*** *If an election worker earns $1,500 or more in a calendar year (effective January 1, 2010), all the worker's earnings, including the first $1,500 are subject to the FICA taxes. If it is anticipated that an election worker may earn $1,500 or more in a calendar year, a government employer may choose to begin withholding FICA taxes on the first dollar earned. If the worker then earns less than $1,500 in the calendar year, the worker would be entitled to a refund of the erroneously withheld FICA taxes. If the employer chooses not to begin withholding until after the worker earns $1,500, the employer would be liable for the total amount of FICA taxes due. The employer could recover the employee's share of the FICA from the employee by withholding from future earnings or by other arrangements with the employee.*
			D. Youth participants under the Workforce Investment Act (WIA) or American Recovery and Reinvestment Act (ARRA). ***Note:*** *For work experience activities that are considered as an element of training available to youth participants under the Workforce Investment Act (WIA) and/or the American Recovery and Reinvestment Act (ARRA), there should be no withholding and payment of federal, state, local taxes, including social security taxes. The intent of such programs is not to benefit the employer, but rather provide the WIA eligible youth with the opportunities for career exploration and skill development. In these cases, the formal relationship is between the WIA program and the employer that volunteers to provide the site of the work experience activity for the WIA program. (References: Workforce Investment Act, final rules, U.S. Department of Labor, Employment and Training Administration, 20CFR § 664.460 and § 664.470, http://www.doleta.gov/usworkforce/wia/policy.cfm -- Clarification from the U.S. Department of Labor, Employment and Training Administration on January 20, 2005, in response to an inquiry from the Virginia Employment Commission).*

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

<table>
<tr><td colspan="4">Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees</td></tr>
<tr><td colspan="4">If a state or local government employee was hired after March 31, 1986, it is mandatory that both the worker and public employer pay Medicare tax. These employees are considered to be “Medicare Qualified Government Employees” (MQGE). See Revenue Ruling 86-88 in the Appendix to Publication 963.

If the worker was hired prior to April 1, 1986, the employee is exempt from Medicare if he or she was a bona fide employee on that date and has been in continuous service since that time. Medicare coverage depends on whether the worker is currently covered by a public retirement system that meets Internal Revenue Service requirements. See the compliance category section of this checklist entitled “Retirement Plan Coverage as a Substitute for Social Security Coverage” and Chapter 5 of Publication 963 for details.

The referendum process can also be used to obtain Medicare-only coverage for Medicare exempt government employees (anyone hired prior to April 1, 1986, who has been in continuous employment with the same employer since that time). See the compliance category section of this checklist entitled “Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)” and Chapter 5 in Publication 963 for further information.

All state and local government employees who are covered by a Section 218 Agreement must pay both Social Security <u>and</u> Medicare.</td></tr>
<tr><td>Yes</td><td>No</td><td>N/A</td><td></td></tr>
<tr><td></td><td></td><td></td><td>1. Does the entity have any employees for whom you ONLY PAY Medicare?</td></tr>
<tr><td></td><td></td><td></td><td>A. If “yes”, are those employees also covered by a qualifying public retirement system plan (i.e., a substitute for Social Security coverage, based on OBRA 1990)? See the compliance category section of this checklist entitled “Retirement Plan Coverage as a Substitute for Social Security Coverage” and Chapter 5, Publication 963, for details.</td></tr>
<tr><td></td><td></td><td></td><td>B. If “yes”, are any of those employees covered by a Medicare-only Section 218 Agreement, because they were hired on or before April 1, 1986? If “yes’, please list the position classifications or categories of such employees.

In the final form, an alpha-numeric field will allow for multiple entries</td></tr>
<tr><td></td><td></td><td></td><td>2. Does the entity have any employees for whom it DOES NOT PAY Medicare?

(Subparts of question continue on the next page)</td></tr>
</table>

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees			
Yes	**No**	**N/A**	
			A. If "yes", were those employees hired on or before April 1, 1986, and have been in continuous employment with the entity since that time?
			B. **If "yes", please specify for which classification(s) of employees you DO NOT pay Medicare and how many employees are in each classification.** *See Chapter 1, Publication 963, for information about worker classification.* In the final form, an alpha-numeric field will allow for multiple entries
			3. Does the entity have any employees who have retired and started receiving an annuity payment from their public retirement system and were then hired back? If so, those employees are considered to be "rehired annuitants." ***Note:*** *A rehired annuitant is a retiree who is rehired by his or her employer or another employer that participates in the same retirement system as the former employer. A rehired annuitant is either drawing a retirement benefit from that retirement system, or has reached retirement age under the retirement system.*
			A. If "yes" (the entity does have rehired annuitants), do you pay Social Security (the Old Age, Survivor, Disability portion) on those employees? ***Note:*** *Rehired annuitants are excluded from mandatory Social Security coverage. However, if an employee is rehired to perform services in a state or local government position that is covered for Social Security under a Section 218 Agreement, services in that position are covered for Social Security. In addition, all retirees hired after March 31, 1986, are covered for Medicare.*
			B. If "yes", do you pay Medicare (the Health Insurance portion of FICA) on those employees and also withhold the required 1.45% from the employees' pay?

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

Retirement Plan Coverage as a Substitute for Social Security Coverage

Effective July 2, 1991*, Congress made Social Security coverage mandatory for state and local government employees who are neither covered by a Section 218 Agreement nor qualifying participants in a public retirement system. Under this provision, state or local governments can provide these mandatorily covered employees with membership in a public retirement system as an alternative to mandatory Social Security coverage. Employees may also be covered by both a public retirement system and Social Security under a Section 218 Agreement.*

A governmental retirement plan must meet certain minimum benefit or contribution standards to qualify as a public retirement system, and thereby serve as a "replacement" plan exempting the participants from mandatory Social Security coverage.

For more information about public retirement systems (Social Security replacement plans), go to the Retirement Plans for Government Employers, **[insert link after this document is posted on the Retirement Toolkit website]** *and Chapter 6 of the Federal-State Reference Guide, Publication 963.*

The IRS has introduced a governmental plan web page as part of an initiative to better serve its customers in the governmental plan community. This web page offers guidance, tools, educational materials, news, and other resources that the IRS hopes will be of particular interest and assistance to section 401(a), 403(b), and 457 governmental plans in maintaining compliance with the applicable federal tax-qualification requirements. Please check back frequently for updates to this page: http://www.irs.gov/retirement/article/0,,id=181779,00.html.

The Employee Plans Compliance Resolution System (EPCRS) offers a comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of sections 401(a), 403(a), 403(b), 408(k), or 408(p) of the Internal Revenue Code, but which have not met these requirements for a period of time. This system allows plan sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Audit Closing Agreement Program (Audit CAP). 457 Plans are not officially under this program yet; however, the IRS will accept submissions under the VCP program on a provisional basis outside of EPCRS based on the same criteria.

For more information concerning this correction program, see Correcting Plan Errors at: http://www.irs.gov/retirement/article/0,,id=96907,00.html.

Yes	No	N/A	
			1. **Does the entity have a public retirement system?**
			Note: *A public retirement system is not required to be a qualified plan within the meaning of the Employees' Retirement Income Security Act of 1974 (ERISA). The employee may be a member of any type of retirement system, including a nonqualified system (for example, a section 457(b) plan, discussed below), as long as the plan provides a minimum level of benefits, as specified by law, under that system.* *A public retirement system may take one of two forms: the* ***defined benefit retirement system****, which is based on a guaranteed minimum benefit, and the* ***defined contribution retirement system,*** *which is based on a minimum contribution relative to salary.* (Explanation continued on next page)

Retirement Plan Coverage as a Substitute for Social Security Coverage			
Yes	**No**	**N/A**	
			*In order for a **defined benefit retirement system** to be a qualified plan, benefits must be measured by and based on various factors such as years of service rendered by the employee, compensation earned by the employee and the age of the employee at retirement. The Service issued Revenue Procedure 91-40 to clarify the minimum retirement benefit tests, which must be met in the plan's formula. This Revenue Procedure can be found in the Appendix of Publication 963**,** Federal-State Reference Guide.* *In order for a **defined contribution retirement system** to qualify, the worker must be covered in a plan in which at least 7.5% of his/her income is placed into a retirement plan. This contribution can be any combination of employer and employee contributions, but must total a minimum of 7.5% of his pay, and cannot include any credited interest in the calculation. The plan may include any plan described in section 401(a), an annuity plan or contract under section 403(b) or a plan described in section 457(b) or (f) of the Internal Revenue Code.* *Any person working for a public employer after July 1, 1991, who is **not covered in a public retirement plan that meets the requirements** discussed above or the defined benefit system safe harbor rules of Revenue Procedure 91-40, **must be covered by Social Security and Medicare under the mandatory coverage provisions** of Section 210 of the Social Security Act.*
			2. Does the entity offer any of the following types of retirement plans? (Check all that apply)
			A. **Defined Benefit** *[IRC 414(j) & Rev. Proc. 91-40].*
			B. **Defined Contribution** *[IRC 401(a), 403(b), 457]*
			C. Deferred Compensation *[IRC 457(b)]*
			D. SEP IRA (Form 5305A-SEP, Salary Reduction Simplified Employee Pension —Individual Retirement Accounts Contribution Agreement, under Internal Revenue Code Section 408(k)).
			E. Other (describe): In the final form, an alpha-numeric field will allow for multiple entries

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

Retirement Plan Coverage as a Substitute for Social Security Coverage			
Yes	**No**	**N/A**	
			3. Is the retirement plan offered to all employees (i.e., universal availability)?
			4. Are all employees offered the right to make elective deferrals of wages?
			5. Are ALL employees covered under a retirement system, understanding that there may be a waiting period prior to participating?
			A. If "no", what categories of employees are NOT covered? (Specify all that apply) ***Note:*** *Those not covered by a qualifying public retirement plan (i.e., retirement plan "ineligibles") may be required to be covered by Social Security and Medicare under the mandatory Social Security provisions of OBRA 1990. See Publication 963, Chapters 5 and 13, for details.* In the final form, an alpha field will allow for multiple entries
			6. Has the entity received a Determination Letter [applies if the retirement plan is a qualified plan under IRC 401(a)] from the IRS?
			A. If "yes", when was the latest Letter received?

Fringe Benefits

Fringe benefits include any compensation other than wages. Examples of <u>taxable</u> fringe benefits are:

A. Personal use of an employer's cell phone, computer or vehicle.
B. Meals provided or reimbursed to an employee when they are not in overnight travel status.
C. Allowances for travel, vehicles or uniforms that do not meet the accountable plan rules.

The following taxes apply to taxable fringe benefits: Social Security, Medicare and Income Tax Withholding.
(Continued on next page)

Fringe Benefits			
Some fringe benefits are excluded from income based on provisions of the Internal Revenue Code. See the Taxable Fringe Benefit Guide on the IRS web site for more information: www.irs.gov/pub/irs-tege/fringe_bnft_flsg.pdf. For a more detailed discussion of fringe benefits, see Publication 15-B, Employer's Tax Guide to Fringe Benefits.			
Yes	**No**	**N/A**	
			1. Are you aware that generally all fringe benefits (cash and non-cash) paid to employees are:
			A. Taxable unless exempt by law? **Note:** *For a discussion of which fringe benefits are exempt, refer to Chapter 3 of Publication 963.*
			B. Reported on Form W-2?
			C. Subject to all applicable Federal employment taxes, e.g., Federal income taxes, Social Security, and Medicare (FICA)? *Note: Federal employment taxes also include the Federal Unemployment (FUTA) tax and self-employment tax, but public employers are not subject to those tax requirements. A description of all employment taxes is available at: http://www.irs.gov/businesses/small/article/0,,id=172179,00.html.*
			2. Does the entity have an "accountable plan" for reimbursement of expenses incurred by employees? ***Note:*** *In general, reimbursements or expenses paid by the employer on behalf of the employee are taxable unless they are for allowable excluded benefits or expenses, and the reimbursements are made under an accountable plan. For payments to be considered to be made under an accountable plan, the employee must:* *(a) Incur the expenses in the performance of work;* *(b) Adequately account for the expenses within a reasonable period of time, and* *(c) Return any amounts in excess of expenses within a reasonable period of time.* *If the accountable plan rules are met, no tax reporting is necessary. If they are not met, the reimbursements or advances are included in wages, and the employee may deduct allowable business expenses on his or her Form 1040.*

Fringe Benefits			
Yes	**No**	**N/A**	
			3. Does the entity allow the personal use of a government-owned vehicle? ***Note:*** *Unless it is excludable because it is infrequent and of little value (a de minimis benefit), the personal use of a government-owned vehicle is a taxable fringe benefit. Personal use includes the value of commuting to and from work in a government-owned vehicle, even if the vehicle is taken home for the convenience of the employer. The value of the fringe benefit must be included in wages and is subject to income and employment taxes.* *All of your employee's use of a **qualified nonpersonal use vehicle** qualifies as a working condition fringe. You can exclude the value of that use from employee income. A qualified nonpersonal use vehicle is any vehicle the employee is not likely to use more than minimally for personal purposes because of its design. Examples include, but are not limited to:* • *Clearly marked police, fire and public safety officer vehicles.* • *Unmarked vehicles used by law enforcement officers. The officer must be authorized to carry a firearm, execute search warrants and make arrests.* • *An ambulance or hearse used for its specific purpose.*
			4. Are taxable fringe benefits being reported as wages and taxes applied as required? ***Note:*** *You must report these wages on Form W-2 and Form 941.*

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns

INFORMATION REPORTING

Compensation to employees and the required withholding are reported on Form W-2 and on Form 941. The requirements and procedures for employee reporting are discussed in detail in Publication 15, Employer's Tax Guide (http://www.irs.gov/pub/irs-pdf/p15.pdf).

A variety of information returns are required to report various other types of payments. Any entity, including a governmental organization, conducting a trade or business, is required to file information returns for certain payments. In most cases, these payments are reported on Form 1099-MISC, Miscellaneous Income.

(Continued on next page)

EXPOSURE DRAFT FOR COMMENTS
Compliance Verification Checklist for State and Local Governmental Entities

The IRS Regulations state that every person engaged in a trade or business shall make an information return for each calendar year with respect to payments made by him to another person: salaries, wages, commissions for services rendered, interest, rents, royalties, annuities, pensions, and other gains, profits, and income ***aggregating $600 or more****. The returns used for this purpose are the forms in the 1099 series.*

The return with respect to certain payments of compensation to an employee is made on Forms W-2 and W-3; ***never use Form 1099-MISC to report payments for services by an employee, except in certain isolated instances, such as when an employee has a separate proprietorship doing business with the employer in a field unrelated to his/her regular work for the employer.****.*

NOTE: *Certain payments and recipients are exempt from the requirements, including:*

- *Payments to exempt organizations and governments*
- *Generally, payments to corporations BUT not attorneys' fees, medical and health care payments*
- *Payments of rent to real estate agents*

See the General Instructions for Forms 1099, 1098, 3921, 3922, 5498, and W-2G http://www.irs.gov/pub/irs-pdf/i1099gi.pdf for details.

Form 1096*,* ***Annual Summary and Transmittal of U.S. Information Returns*** *is used to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. For details, see:* ***http://www.irs.gov/pub/irs-pdf/f1096_08.pdf.*** *Do not use Form 1096 to transmit electronically. For electronic submissions, see Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically (http://www.irs.gov/pub/irs-pdf/p1220_07.pdf).*

Yes	No	N/A	
			1. **Employment Tax Filings:**
			A. Are all employment tax returns filed as required?
			B. Are all employment tax returns filed by the date required?
			C. Are all employment tax returns that were filed complete and accurate?
			D. Do Forms W-3, W-2, and 941 reconcile for the most recent calendar year?
			E. Were taxable fringe benefits included on Forms W-2 for each applicable employee?
			F. Are vehicles provided to employees?
			G. Is lodging provided by the employer?
			H. Is tuition reimbursement provided by the employer?
			I. Was Tip Income, if any, properly recorded on Form 941?

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns			
Yes	**No**	**N/A**	
			J. Does the entity provide for achievement awards or length of service awards?
			K. Does the entity provide Group Term Life Insurance?
			L. Does the entity provide for use of athletic or recreation facilities?
			M. Is any clothing provided by the employer?
			2. **Independent Contractor Reporting:**
			A. Does the entity make payments to independent contractors?
			B. Are forms W-9 on file for every vendor or independent contractor?
			C. Are all forms W-9 secured prior to initial payment? ***Note:*** *You should obtain vendor information before any payments are made. Use Form W-9 (http://www.irs.gov/pub/irs-pdf/fw9.pdf), Request for Taxpayer Identification Number and Certification, or a substitute, to collect the owner's name (if sole proprietor), legal business name, mailing address, taxpayer identification number.*
			D. Are all forms W-9 properly completed?
			E. Did the entity withhold federal income tax on miscellaneous income under the backup withholding rules, if applicable?
			F. Are Forms 1099 filed for payments to all vendors and independent contractors for payments in excess of $600 per year?
			G. Does the entity file Forms 1099s for payments for services or combination of products and services?
			H. Does the entity file Form 1099s for payments to individuals, partnerships, and certain corporations?
			I. Does the entity file Form 1099s for payments to attorneys, even if incorporated?
			J. Does the entity file Form 1099s for certain medical and health care payments, even if incorporated?

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns			
Yes	**No**	**N/A**	
			K. Did the organization receive CP2100 Notice (backup withholding) for prior years information returns that contained missing, incorrect, and /or currently not issued taxpayer identification numbers?
			L. Did the entity make payments of $10 or more for royalties?
			3. **<u>International Issues</u>:**
			A. Does the entity have control or signatory authority over any foreign bank accounts?
			B. Does the entity have employees working overseas?
			C. Does the entity conduct trade or business overseas?
			4. **<u>Policies</u>:**
			A. Does the entity have a cell phone policy?
			B. Does the entity have a travel reimbursement policy?
			C. Does the agency comply with the accountable plan rules?
			D. Do you offer reimbursement to your employees for taking educational classes?
			E. Does the entity have a spousal expense policy?
			5. **<u>Are you required to file any of the following federal tax returns?</u>**
			A. Form 941, Employers Quarterly Federal Tax Return
			B. Form 945, Annual Return of Withheld Federal Income Tax
			C. Form 990, Return of Exempt Organization
			D. Form 990T, Exempt Organization Business Income Tax Return
			E. Form 720, Quarterly Excise Tax Return
			F. Form 1042, Annual Withholding Return for U.S. Source Income of Foreign Persons

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns			
Yes	**No**	**N/A**	
			G. Form 1040-SS, U.S. Self-Employment Tax Return
			H. Form 1096, Annual Summary and Transmittal of U.S. Information Returns
			I. Form 1098E, Student Loan Interest Statement
			J. Form 1098T, Tuition Statement
			K. Form 1099 M, Statement for Recipients of Miscellaneous Income
			L. Form 1099 R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. and IRA Contribution Information
			M. Form 8300, Cash payments over $10,000 received in trade or business
			N. Form W-2, Wage and Tax Statement
			O. Form W-3, Transmittal of Wage and Tax Statements
			6. **Forms W-4, Employee's Withholding Allowance Certificate**
			A. Are Forms W-4 on file for every employee?
			B. Are all Forms W-4 secured prior to initial payment?
			C. Are all Forms W-4 properly completed?
			D. Are new Forms W-4 secured each year on all individuals claiming to be exempt from income tax withholding?
			7. **Forms W-5, Earned Income Credit Advance Payment Certificate**
			8. **Do you make any payments for which you knowingly do not have a correct Taxpayer Identification Number (TIN)?** Note: Special requirements apply to backup withholding requirements for government entities. When workers are (Explanation continued on next page)

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns			
Yes	**No**	**N/A**	
			independent contractors, the governmental entity may have information-reporting and backup withholding responsibilities, but is not required to withhold and pay employment taxes on behalf of the worker. *Government entities that make certain payments are required to withhold income tax of 28% from these payments if the payee is not exempt from backup withholding and fails to furnish correct taxpayer identification number (TIN). Backup withholding does not apply to wages or pension payments.* *For further information about backup withholding, see Publication 963: http://www.irs.gov/pub/irs-pdf/p963.pdf. Also, a more detailed compliance checklist for IRS backup withholding requirements is available at: http://www.irs.gov/pub/irs-pdf/p15.pdf (IRS Publication 15).*

Social Security Benefits Offsets for Public Employees

Note: The IRS has no jurisdiction over Social Security offset provisions discussed in this section. This section is included in the Checklist to ensure public employers know those compliance requirements, even though they are not tax issues. All questions related to this section of the Checklist should be addressed to the U.S. Social Security Administration.

*Some Federal employees and employees of State or local government agencies may be eligible for pensions that are based on earnings **not** covered by Social Security.*

*If you have employees who did not pay Social Security taxes on their government earnings **and** they are eligible for Social Security benefits, the formula used to figure the employee's Social Security benefit amount may be modified, giving the employee a lower Social Security benefit. Go to the Social Security Administration's website for details: http://www.ssa.gov/gpo-wep/. There are two types of pension offsets: Windfall Elimination Provision (WEP) and Government Pension Offset (GPO).*

1. *If an employee is eligible for Social Security benefits on his/her own record: The Windfall Elimination Provision (WEP) fact sheet explains the formula Social Security may use to modify your benefit amount. The WEP fact sheet is at: http://www.ssa.gov/pubs/10045.html.*

2. *If an employee is eligible for Social Security benefits on his/her spouse's record: The Government Pension Offset (GPO) fact sheet explains how an employee's pension may affect his/her benefit on his/her spouse's record. The GPO fact sheet is at: http://www.ssa.gov/pubs/10007.html*

   Note: Some government pensions *do not affect an employee's benefit on his/her spouse's record*. For details, go to SSA's website at: *http://www.ssa.gov/pubs/10007.html#when*.

Section 419(c) of Public Law 108-203, the Social Security Protection Act of 2004, requires State and local government employers to provide a statement to employees hired January 1, 2005, or later in a

Social Security Benefits Offsets for Public Employees			
job not covered under Social Security. The statement explains how a pension from that job could affect future Social Security benefits to which they may become entitled. ***Form SSA-1945, Statement Concerning Your Employment in a Job Not Covered by Social Security****, available on SSA's website at: http://www.socialsecurity.gov/form1945/SSA-1945.pdf, is the document that employers should use to meet the requirements of the law.* *Employers must:* • *Give the statement to the employee prior to the start of employment;* • *Get the employee's signature on the form; and* • *Submit a copy of the signed form to the pension paying agency.*			
Yes	**No**	**N/A**	
			1. Are you aware that some Federal employees and employees of State or local governments who are eligible for pension that are based on earnings not covered by Social Security and who are eligible for Social Security benefits may have their Social Security benefits modified?
			2. Are you aware that Federal law requires State and local government employers to provide a statement to employees hired on or after January 1, 2005, in a job not covered under Social Security?

Thank you for completing the Compliance Verification Checklist.

Appendix C:

Final Recommended
Compliance Verification Checklist

Compliance Verification Checklist for State and Local Governmental Entities

Introduction

Purpose of Compliance Verification Checklist

This Compliance Verification Checklist (also referred to as “checklist” or “self-check”) is a voluntary tool that is designed to allow state and local government entities (also referred to in this form as “public employers”) to conduct a self-assessment of their level of compliance with certain federal tax laws, rules, and regulations. At the beginning of each section, there is a brief description of the basic legal requirements that apply to public employers for that category of requirements. Where necessary, due to the many nuances in the law that apply to some compliance subcategories, additional explanation of the requirements and resources are provided.

Public employers have unique legal requirements for compliance with the federal tax code (U.S. Internal Revenue Code (IRC)) and federal Social Security and Medicare coverage (U.S. Social Security Act). Public employers must be aware of numerous differences from the private sector that apply to them and their workers (both employees and independent contractors), especially related to employment tax, FICA, Social Security (Old-Age, Survivor, Disability Insurance) coverage, Medicare (Health Insurance) coverage, and public retirement system obligations.

This checklist is designed to be completed by the persons responsible for withholding and paying employment taxes in your organization. If more than one person is responsible for those duties in your organization, then each person should complete his/her respective sections of the checklist. The checklist is designed to be saved and shared with others in your organization while it is being completed. When it is completed, you can save it to your computer and also print a copy for your files.

Common Errors

During past **Compliance Checks and Examinations** of public employers that the IRS office of Federal State and Local Governments (FSLG) has conducted, a number of common errors have been identified:

- Amounts on Forms W-2, W-3, and 941 do not reconcile.
- Forms W-9 and W-4 are not being used or are not being updated when necessary.
- Public employers are unaware of the requirement to backup withhold if no Taxpayer Identification Number (TIN) is provided by a vendor prior to payment.
- Form 1099 problems:
    - The forms were not prepared at all.
    - The forms were prepared incorrectly, such as the amounts are in the wrong box, the names and TIN did not match, etc.
    - The forms were prepared, but not submitted to the IRS.
- Employment tax return filing and deposit problems:
    - Deposits were made, but no return was filed.
    - Deposits were made to an incorrect period.
- Unaware of electronic filing requirement and unaware of FIRE system (Filing Information Returns Electronically).
- Elected officials are treated as independent contractors, rather than as employees.
- Failure to pay and withhold Medicare-only tax on rehired annuitants.
- Election officials and workers treated as independent contractors, rather than as employees.

Compliance Verification Checklist for State and Local Governmental Entities

Due to the complexity of the law, however, other errors can occur, especially for smaller public employers. This Compliance Verification Checklist is designed to help public employers identify their issues and concerns and work with FSLG, Social Security Administration (SSA), and their State Social Security Administrator (depending on the issue) to correct the mistakes, so they become fully compliant with applicable federal laws and regulations. The IRS/FSLG Compliance program consists of two basic types of cases. [1]

For Assistance While Completing the Form

General resources that cover all aspects of this Compliance Verification Checklist can be accessed at the following websites:

- *Federal-State Reference Guide (Publication 963),* http://www.irs.gov/pub/irs-pdf/p963.pdf
- *Quick Reference Guide for Public Employers*, http://www.irs.gov/pub/irs-tege/public_employers_outreach_guide.pdf
- *IRS Federal, State and Local Governments Public Employer Tax Guide*: http://www.irs.gov/pub/irs-tege/public_employers_outreach_guide.pdf
- *Independent Contractor or Employee Brochure, http://www.irs.gov/pub/irs-pdf/p1779.pdf*
- FSLG website, which can be accessed at: http://www.irs.gov/govts.
- Federal, State & Local Government (FSLG) Toolkit, http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html
- *Retirement Plans for Government Employers*, http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html

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[1] FSLG's compliance program relies on two types of cases: compliance checks and examinations.

There is no statutory or common law definition of the term "examination." However, an examination may be described as the systematic inspection of the books and records of a taxpayer for the purpose of making a determination of the correct tax liability.

A compliance check is a contact with the customer that involves a review of filed information and tax returns of the entity. It is a verification of recordkeeping and tax return and information return filing; it is not directly related to the determination of a tax liability. It is not an examination or audit.

A compliance check is different from an examination because:

- Books and records are not inspected, and
- There is no attempt to determine tax liability.

A compliance check is an alternative to an examination. It is less burdensome to the taxpayer and can generally be accomplished in one or two contacts with the taxpayer. It serves as an opportunity to educate the taxpayer and encourage compliance with regard to employment tax law and filing requirements.

Compliance Verification Checklist for State and Local Governmental Entities

- *Governmental Plans Information (IRS Employee Plans),* *http://www.irs.gov/retirement/article/0,,id=181779,00.html*

- Correcting Governmental Plan Errors, http://www.irs.gov/retirement/article/0,,id=96907,00.html

- U.S. Social Security Administration Information for Federal, State, and Local Government Employers and Employees Regarding Social Security Benefits Reductions, http://www.ssa.gov/gpo-wep/

- *Employer's Supplemental Tax Guide* (Publication 15-A)*,* http://www.irs.gov/pub/irs-pdf/p15a.pdf

- *Employer's Guide to Fringe Benefits* (Publication 15-B)*,* http://www.irs.gov/pub/irs-pdf/p15b.pdf

- *Taxable Fringe Benefit Guide,* http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf

- IRS educational products for government employers: http://www.irs.gov/govt/fslg/content/0,,id=117706,00.html

- General Social Security Administration (SSA) information is available on SSA's homepage (www.ssa.gov) and more specific information pertinent to government employers and employees is available at: www.ssa.gov/slge.

- National Conference of State Social Security Administrators (NCSSSA) website, including contact information for your state's Social Security Administrator who is responsibility for maintaining and administering the state's Section 218 Agreement and Modifications with the U.S. Social Security Administration: http://www.ncsssa.org/statessadminmenu.html .

Where to Go For Assistance and Further Information After Completing the Form

After completing the Compliance Verification Checklist, you are encouraged to contact your Federal, State & Local Government (FSLG) Specialist at the Internal Revenue Service (IRS). There is at least one FSLG Specialist assigned to every state. The FSLG Specialist can help you interpret the results of the self-check and ensure that you know what, if any, steps you need to take to be fully compliant with all applicable federal tax laws, rules, and regulations. The primary objective of FSLG is to ensure compliance with federal employment tax laws by governmental entities through the use of review and examination activities as well as through educational programs. The names and contact information for FSLG staff are available at: http://www.irs.gov/govt/fslg/article/0,,id=96060,00.html.

The FSLG Specialist may recommend that you contact your State Social Security Administrator for clarifications and information about a Section 218 Agreement or Modification, how to obtain Medicare-only coverage for Medicare-exempt employees, or other similar information about which the State Administrator has responsibility and knowledge. Each state's laws are unique in how they enacted the voluntary Social Security (and, later, Medicare) coverage agreements for state and local government employees. To learn more, you should contact the State Social Security Administrator for your state by going to: http://www.ncsssa.org/statessadminmenu.html.

Compliance Verification Checklist for State and Local Governmental Entities

The FSLG Specialist may also suggest that you contact the U.S. Social Security Administration (SSA) for further information about coverage and benefits under Social Security and Medicare, how an employee's or employee's spouse's Social Security benefits may be reduced (i.e., offset) by a public pension payment, and other issues that are unique to Social Security and Medicare benefits that are paid to government employees. FSLG works with the SSA to educate government entities about Section 218 Social Security Agreements. These voluntary agreements provide Social Security and/or Medicare coverage for state and local employees. While IRS is responsible for administering and enforcing the tax laws, SSA processes and interprets these agreements and related coverage issues. General SSA information is available at the Social Security Administration homepage (www.ssa.gov) and more specific information pertinent to government employers and employees is available at: www.ssa.gov/slge.

<table>
<tr><th colspan="7">Entity Identification and Contact Information</th></tr>
<tr><td>Entity (Taxpayer's) Name</td><td colspan="6">Alpha-numeric field</td></tr>
<tr><td rowspan="3">Entity's Level and Type of Government (check only one box, then select the type of government from the appropriate drop-down box)</td><td colspan="2">Federal</td><td colspan="2">State</td><td colspan="2">Local</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="6">The final web-based form will have drop-down boxes for each of the above choices with options (e.g., Federal Department, State, county, municipality, etc.)</td></tr>
<tr><td>Entity (Taxpayer's) TIN (Tax Identification Number)</td><td colspan="6"></td></tr>
<tr><td rowspan="5">List any other TIN's associated with the entity, including name that is listed for the TIN</td><td colspan="6">Alpha-numeric fields, below, in the final form will allow for multiple entries</td></tr>
<tr><td colspan="3">Legal Name</td><td colspan="3">Assigned TIN or EIN</td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>Office Location
(Address – Line 1)</td><td colspan="6">Alpha-numeric field</td></tr>
<tr><td>Office Location
(Address – Line 2)</td><td colspan="6">Alpha-numeric field</td></tr>
<tr><td>City, State, ZIP Code</td><td colspan="6">Insert drop-down box with options</td></tr>
<tr><td colspan="7"></td></tr>
<tr><td>Name of Person(s)
Completing Questionnaire</td><td colspan="6">Alpha-numeric field in the final form will allow for multiple entries</td></tr>
<tr><td>Section(s) of Questionnaire Completed by Each Person</td><td colspan="6">Insert drop-down box with options</td></tr>
<tr><td>Title of Person(s)
Completing Questionnaire</td><td colspan="6">Alpha-numeric field in the final form will allow for multiple entries</td></tr>
<tr><td>Telephone Number(s) of Person(s)
Completing Questionnaire</td><td colspan="6">Alpha-numeric field in the final form will allow for multiple entries</td></tr>
</table>

Compliance Verification Checklist for State and Local Governmental Entities

Entity Identification and Contact Information	
Fax Number(s) of Person(s) Completing Questionnaire	*Alpha-numeric field in the final form will allow for multiple entries*
Email(s) of Person(s) Completing Questionnaire	*Alpha-numeric field in the final form will allow for multiple entries*
Entity Primary Contact Name (if different from Name of Person Completing Questionnaire or if multiple people Complete the Questionnaire)	
Title of Primary Contact Name (if different from Name of Person Completing Questionnaire or if multiple people Complete the Questionnaire)	
Telephone Number of Contact Name (if different from Name of Person Completing Questionnaire or if multiple people Complete the Questionnaire)	
Fax Number of Contact Name (if different from Name of Person Completing Questionnaire or if multiple people Complete the Questionnaire	
Email of Contact Name (if different from Name of Person Completing Questionnaire or if multiple people Complete the Questionnaire)	

Compliance Categories to be Reviewed in Completing this Checklist:

The remainder of this checklist consists of reviewing the following seven categories. The purpose of reviewing these areas is to have the person completing the checklist to identify areas in which s/he can improve compliance levels with federal employment tax issues.

- Worker Classification: Employee versus Independent Contractor.
- Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage).
- Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees.
- Retirement Plan Coverage as a Substitute for Social Security Coverage.
- Fringe Benefits.
- Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns.
- Social Security Benefits Offsets for Public Employees.

Compliance Verification Checklist for State and Local Governmental Entities

Worker Classification: Employee versus Independent Contractor

In general, an ***employee*** *is anyone who performs services subject to the will and control of the individual or entity paying for the services. Payments to employees for such services in the form of cash, property, services or other benefits are taxable wages, unless excluded by a specific provision of the law. Taxable wages are reported on Form W-2, Wage and Tax Statement. Forms W-2 and W-3 filing information is available on SSA's website at: http://www.socialsecurity.gov/employer/.*

For a full discussion of how to determine who is an employee, see Publication 963 and Publication 15-A. Additionally, Publication 1779 provides a good overview of this issue.

Independent contractors *include any person or business that performs services for you and is not subject to your will and control as an employee. Generally, any payment of $600 or more during a calendar year is reportable on Form 1099-MISC, Miscellaneous Income, by January 31 of the following year. For more information on information reporting, see the Instructions for Form 1099-MISC.*

Note: *Beginning in 2012, certain payments by governmental entities to vendors and independent contractors are subject to 3% withholding. For more information, see www.irs.gov/govt.*

Yes	No	N/A	Not Sure	
				1. Are all of your workers properly classified as either an employee or an independent contractor? ***Notes:*** *There are three categories of factors (Behavioral, Financial and Relationship of the parties) that should be considered to determine whether the worker is an employee or independent contractor. Previously, this determination was made using the "20 common-law factors", but it has been replaced by the three categories of factors. See IRS Publication 963, Federal-State Reference Guide, Chapter 4, Determining Worker Status, for details: http://www.irs.gov/pub/irs-pdf/p963.pdf.* *It is critical for any entity paying compensation to know whether the workers are employees. When making a determination about worker status, the primary question is whether the worker is an employee or an independent contractor under the common-law standard. Generally,* ***when workers are employees, the government entity that employs them must withhold and pay employment taxes****. Employment.* When *workers are independent contractors*, the governmental entity may have information-reporting and backup withholding responsibilities, but is not required to withhold and pay employment taxes on behalf of the worker. *Tax and penalties may apply if you misclassify a worker. See IRS Publication 1779, Independent Contractor or Employee, and IRS Publication 963, Federal-State Reference Guide, [http://www.irs.gov/pub/irs-pdf/p1779.pdf and IRS Publication 963](http://www.irs.gov/pub/irs-pdf/p1779.pdf), Chapter 4, for information about worker classification. If a worker is* (Explanation continued on next page)

Compliance Verification Checklist for State and Local Governmental Entities

Worker Classification: Employee versus Independent Contractor				
Yes	**No**	**N/A**	**Not Sure**	
				determined to be an employee and if the government entity is covered under a Section 218 Agreement, then FICA (Federal Insurance Contributions Act – Old Age-Survivors-Disability Insurance and Medicare Insurance) must be withheld from the employee and matched by the employer.
				2. For those entities without a Section 218 Agreement or for classes of workers who are not covered by a Section 218 Agreement, have you reviewed the facts and circumstances and made a determination under the common-law criteria that all workers are properly classified and treated accordingly? ***Notes:*** *State and local government employees were excluded from Social Security coverage from 1935 (the date of the original Social Security Act) until 1950 because of unresolved legal questions regarding the federal government's authority to tax state and local governments. Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide Social Security coverage to public employees. These arrangements are called "Section 218 Agreements" (also referred to as "voluntary coverage agreements") because they are authorized by Section 218 of the Act. See the Appendix entitled, "Section 218 of Social Security Act" in IRS Pub. 963 for the full text of that Act. In 1939, the Old-Age, Survivors, and Disability Income (OASDI) program was created, and the funding mechanism for the social security program was officially established in the Internal Revenue Code as the Federal Insurance Contributions Act (FICA). The IRS is responsible for the collection of this tax. See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf *, Chapter 1, Social Security and Government Employers, and Chapter 5, Social Security and Medicare Coverage, for further information about Section 218 Agreements.*
				3.* Do you have any workers for which you are uncertain as to the proper classification -- independent contractor versus employee?** ***Note: *You can submit an SS-8 form (Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding) to the IRS to obtain a determination about whether or not a particular worker is an independent contractor or employee of the governmental entity?* ***Note:*** *Form SS-8 is available at: http://www.irs.gov/pub/irs-pdf/fss8.pdf.*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)

Public employers need to be aware of the rules that govern FICA (Social Security and Medicare coverage for their employees. Public employees may be subject to Social Security tax, either through mandatory withholding, or through the provisions of a Section 218 Agreement.

*They may be exempt from Social Security if they are covered by a qualifying public retirement system (see the compliance category section of this checklist entitled "*Retirement Plan Coverage as a Substitute for Social Security Coverage" *for details). Several legal issues must be considered to determine the correct Social Security and Medicare status of a worker.*

If the position is covered, either by an Agreement or under mandatory coverage, your worker is subject to Social Security up to the wage base (SSA adjusts the wage base annually; for the current base, go to: http://www.socialsecurity.gov/OACT/COLA/cbb.html) and Medicare tax. There is no wage base limit for Medicare tax. The employer pays matching amounts of these taxes.

A Section 218 Agreement is made between the Social Security Administration and a State (prepared by the state's Social Security Administrator) to provide coverage for a group of state or local government employees. The state administrator also prepares Section 218 modifications to include additional coverage groups, correct errors in other modifications, identify additional political subdivisions that join a covered retirement system, or obtain Medicare coverage for public employees whose employment relationship with a public employer has been continuous since March 31, 1986. The state administrator acts as a liaison between state and local government employers and federal agencies, including SSA and IRS. ***A Section 218 Agreement covers positions, not individuals****. Since April 20, 1983, any public employer who had previously entered into a Section 218 Agreement to cover their employees must continue to cover employees under the Agreement, regardless of whether or not another qualifying public retirement plan is made available. Coverage under a Section 218 Agreement supersedes all other considerations. See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf *, Chapter 1, Social Security and Government Employers, and Chapter 5, Social Security and Medicare Coverage, for further information about Section 218 Agreements.* To learn more, you should contact the State Social Security Administrator for your state by going to: http://www.ncsssa.org/statessadminmenu.html.

If a public employer wants to make a change and provide both a qualifying Social Security replacement plan and full Social Security coverage for its employees, a referendum election must be conducted by the State Social Security Administrator (or by the Social Security Administration, if the entity is an interstate instrumentality). An Interstate Instrumentality is an independent legal entity organized by two or more states to carry out one or more governmental functions. For purposes of a Section 218 Agreement, an interstate instrumentality has the status of a state. See Publication 963, Chapter 5, for details about the referendum process.

The referendum process can also be used to obtain Medicare-only coverage for Medicare exempt government employees (anyone hired prior to April 1, 1986, who has been in continuous employment with the same employer since that time). See the compliance category section of this checklist entitled "Medicare Coverage and Medicare Exempt Government Employment" and Chapter 5 in Publication 963 for further information.

Beginning July 2, 1991, if public employees are not covered for social security under a Section 218 Agreement and are not qualified participants in a public retirement system, they are mandatorily covered under social security. Mandatory social security coverage ceases if the employees subsequently become qualified participants in a public retirement system.

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
In addition to the reference materials noted earlier in this checklist, the FSLG website includes information entitled, "What State or Local Government Employers Should Know About Social Security and Medicare Coverage", which can assist employers in determining their Social Security and/or Medicare coverage and FICA requirements. That site is available at: http://www.irs.gov/govt/fslg/article/0,,id=182888,00.html.				
Yes	**No**	**N/A**	**Not Sure**	
				1. Does the entity have a voluntary Social Security (full Social Security and Medicare) coverage agreement, often referred to as a Section 218 Agreement or Modification to the State's Section 218 Agreement? **(If not, SKIP to question 5 in this section.)**
				2. Are services performed by any of your employees mandatorily excluded from FICA (Social Security and Medicare) coverage? ***Note:*** *Federal law requires the exclusion of the following services from voluntary (Section 218) coverage under the Social Security Act (Section 218(c)(6)):* • *Services performed by individuals hired to be relieved from unemployment.* • *Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government.* • *Services performed by an employee hired on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency.* • *Services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S.* • *Services in positions compensated solely by fees that are subject to SECA (Self-Employment Contributions Act), unless a Section 218 Agreement covers these services.* • *Services performed by a student enrolled and regularly attending classes at the school, college or university where they are working (to qualify, students must physically work on campus), unless a Section 218 Agreement covers student services.* • *Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law, unless a Section 218 Agreement covers election workers.* • *Services that would be excluded if performed for a private employer because it is not work defined as employment under Section 210(a) of the Social Security Act, unless a Section 218 Agreement covers certain agricultural services.* *See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf , *Chapter 5 of Publication 963, for details on what constitutes a mandatory exclusion under federal law.*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
Yes	No	N/A	Not Sure	
				3. What classes of employees are included (or excluded) from the 218 Agreement or Modification? In the final form, an alpha-numeric field will allow for multiple entries
				4. Have any Modifications to the 218 Agreement or the original Modification that put your entity under Section 218 coverage been adopted? **Note:** *The State Social Security Administrator in your state prepares Section 218 modifications to the state's agreement to include additional coverage groups, correct errors in other modifications, identify additional political subdivisions that join a covered retirement system, or obtain Medicare coverage for public employees whose employment relationship with a public employer has been continuous since March 31, 1986. The state administrator acts as a liaison between state and local government employers and federal agencies, including SSA and IRS.* ***A Section 218 Agreement or a Modification to the state's Section 218 Agreement covers positions, not individuals.*** *See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf *, Chapter 1, Social Security and Government Employers, and Chapter 5, Social Security and Medicare Coverage, for further information about Section 218 Agreements.* To learn more, you should contact the State Social Security Administrator for your state by going to: http://www.ncsssa.org/statessadminmenu.html.
				A. If "yes", list all Modification numbers, dates, and a description of what changes to the Section 218 Agreement were made by each Modification. In the final form, an alpha-numeric field will allow for multiple entries
				5. Does the entity pay and withhold full FICA -- Social Security (Old-Age, Survivor, Disabilitiy Insurance) and Medicare (Health) Insurance – on all employees?
				A. If "yes", is the entity paying full FICA based on a voluntary Section 218 Agreement? *(See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf *, See Chapter* 5, for details).
				6. If the entity has no Section 218 Agreement, does the entity pay full FICA based on mandatory Social Security provisions contained in Omnibus Budget Reconciliation Act (OBRA) 1990 *(See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf *, Chapter 6, for details).*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
Yes	**No**	**N/A**	**Not Sure**	
				7. Does the entity have any of the following categories of workers?
				A. Elected officials. ***Note:*** *A public official has authority to exercise the power of the government and does so as an agent and employee of the government. For this reason, the Supreme Court has held that public officials are employees. A public official performs a governmental duty exercised pursuant to a public law. A public office is a position created by law, holding a delegation of a portion of the sovereign powers of government to be exercised for the benefit of the public. Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1926).* *For the same reason, elected officials are subject to a degree of control that typically makes them employees under the common law. Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall by the public or a superior official. In any event, elected officials are employees for income tax withholding purposes under Internal Revenue Code section 3401(c).*
				B. Appointed officials. ***Note:*** *Very few appointed officials have sufficient independence such that they will not be considered common-law employees. See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf.
				C. Part-time positions. ***Note:*** *After July 1, 1991, full-time, part-time, temporary and seasonal employees who are not participating in a qualifying retirement system made available through their employer* ***MUST be covered by Social Security and Medicare.*** *It is also possible for employees under a public retirement system to be covered for Social Security if a Section 218 Agreement covers them. See IRS Publication 963, Federal-State Reference Guide,* http://www.irs.gov/pub/irs-pdf/p1779.pdf.
				D. Fee-based positions. ***NOTE:*** *In general, if an individual performs services as an official of a governmental entity and the remuneration received is paid from governmental funds, the official is an employee and the wages are subject to Federal employment taxes. Examples of*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
Yes	**No**	**N/A**	**Not Sure**	
				public officials include, but are not limited to, the President, a governor, mayor, county commissioner, judge, justice of the peace, sheriff, constable, registrar of deeds, building and plumbing inspectors, etc. *An exception to this rule applies to a **fee-based public official**. A fee-based public official receives his/her remuneration in the form of fees **directly from the public (e.g., a notary public)** with whom he/she does business. However, if the fee service is covered by a Section 218 agreement, the services is covered as Employment, as discussed in Publication 15, Employer's Tax Guide (Circular E).*
				E. Does the entity have volunteer firefighters? ***Note:*** *Volunteer firefighters are considered employees and if they receive compensation, their remuneration is generally subject to all withholding taxes. Beginning in 2008, and through 2010, qualified emergency response organizations may exclude certain amounts from income, social security and Medicare wages amounts paid to any firefighter. Additionally, if a firefighter's payment is reimbursement for out-of-pocket expenses actually incurred in the course of work, and the payment is accounted for according to the requirements of IRS Regulations regarding accountable plans, then the payment could be excludable from the rest of the firefighter's Form W-2. (See the section of the checklist entitled, "Fringe Benefits" for information about "accountable plans.") See Publication 963 for more information on this issue. See the IRS Quick Reference Guide for Public Employers, for more information.*
				8. Does the entity have any of the following categories of workers?
				A. Agricultural labor (if their services would be excluded if performed for a private sector employer). ***Note:*** *Agricultural labor may continue to be excluded from Social Security and Medicare coverage even if they are not under a public retirement system. However, these services may be covered by a 218 Agreement and, therefore, subject to FICA.*
				B. Student services ***Note:*** *Students who are enrolled and regularly attending classes at the school where they are working are exempt from paying Social Security and Medicare taxes. However, these services may be covered by a 218 Agreement and, therefore, subject to FICA. Student services performed off campus are subject to FICA.*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
Yes	**No**	**N/A**	**Not Sure**	
				Medical residents are generally common-law employees of the hospitals for which they work, and therefore are subject to Social Security and Medicare taxes (unless they are excepted by a Section 218 Agreement). However, IRC 3121(b)(10) provides an exception for students employed by a school, college, or university (SCU) who are enrolled and regularly attending classes at the SCU. For more information, see Regulation 31.3121(b)(10)-2 and Revenue Procedure 2005-11 at: http://www.irs.gov/irb/2005-02_IRB/ar16.html. *In order for medical residents to meet this exception, several conditions must be met. For details, see Regulation 31.3121(b)(10)-2 and Revenue Procedure 2005-11: http://www.irs.gov/irb/2005-02_IRB/ar16.html.* ***Note:** Due to an 8th Circuit Court of Appeals decision in State of Minnesota v. Apfel, 151 F.3d 742 (8th Cir. 1998), public employers in the following states should contact their FSLG Specialist for additional information about FICA requirements applicable to their medical residents: Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota.*
				C. Services performed by election officials or election workers if they are paid less than the current dollar threshold. For the current threshold amount, go to: IRS Publication 963, Chapters 5 and 10. ***Note:** If an election worker earns $1,500 or more in a calendar year (effective January 1, 2010), all the worker's earnings, including the first $1,500 are subject to the FICA taxes. If it is anticipated that an election worker may earn $1,500 or more in a calendar year, a government employer may choose to begin withholding FICA taxes on the first dollar earned. If the worker then earns less than $1,500 in the calendar year, the worker would be entitled to a refund of the erroneously withheld FICA taxes. If the employer chooses not to begin withholding until after the worker earns $1,500, the employer would be liable for the total amount of FICA taxes due. The employer could recover the employee's share of the FICA from the employee by withholding from future earnings or by other arrangements with the employee.*
				D. Youth participants under the Workforce Investment Act (WIA) or American Recovery and Reinvestment Act (ARRA). ***Note:** For work experience activities that are considered as an element of training available to youth participants under the Workforce Investment Act (WIA) and/or the American Recovery and Reinvestment Act (ARRA), there should be no withholding and*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)				
				payment of federal, state, local taxes, including social security taxes. The intent of such programs is not to benefit the employer, but rather provide the WIA eligible youth with the opportunities for career exploration and skill development. In these cases, the formal relationship is between the WIA program and the employer that volunteers to provide the site of the work experience activity for the WIA program. (References: Workforce Investment Act, final rules, U.S. Department of Labor, Employment and Training Administration, 20CFR § 664.460 and § 664.470, http://www.doleta.gov/usworkforce/wia/policy.cfm -- Clarification from the U.S. Department of Labor, Employment and Training Administration on January 20, 2005, in response to an inquiry from the Virginia Employment Commission).

Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees

If a state or local government employee was hired after March 31, 1986, it is mandatory that both the worker and public employer pay Medicare tax. These employees are considered to be "Medicare Qualified Government Employees" (MQGE). See Revenue Ruling 86-88 in the Appendix to Publication 963.

*If the worker was hired prior to April 1, 1986, the employee is exempt from Medicare if he or she was a bona fide employee on that date and has been in continuous service since that time. Medicare coverage depends on whether the worker is currently covered by a public retirement system that meets Internal Revenue Service requirements. See the compliance category section of this checklist entitled "*Retirement Plan Coverage as a Substitute for Social Security Coverage" and Chapter 5 of Publication 963 *for details.*

The referendum process can also be used to obtain Medicare-only coverage for Medicare exempt government employees (anyone hired prior to April 1, 1986, who has been in continuous employment with the same employer since that time). See the compliance category section of this checklist entitled "Social Security Coverage (Section 218 Agreement and Mandatory Social Security Coverage)" and Chapter 5 in Publication 963 for further information.

*All state and local government employees who are covered by a Section 218 Agreement must pay both Social Security **and** Medicare.*

Yes	No	N/A	Not Sure	
				1. Does the entity have any employees for whom you ONLY PAY Medicare?
				A. If "yes", are those employees also covered by a qualifying public retirement system plan (i.e., a substitute for Social Security coverage, based on OBRA 1990)? **Note:** *See the compliance category section of this checklist entitled "Retirement Plan Coverage as a Substitute for Social Security Coverage" and Chapter 5, Publication 963, for details.*

Compliance Verification Checklist for State and Local Governmental Entities

Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees				
Yes	**No**	**N/A**	**Not Sure**	
				B. If "yes", are any of those employees covered by a Medicare-only Section 218 Agreement, because they were hired on or before April 1, 1986? If "yes', please list the position classifications or categories of such employees. ***Note:*** *It is important to know the position classifications or categories of all such employees, because even if a Medicare-only Section 218 Agreement or Modification was entered into by a public employer, some positions or categories of positions may have been excluded from the referendum election that the State Social Security Administrator would have conducted for such coverage to have been chosen by the public employer and eligible employees. For example, some state laws prohibit police and firefighters from participating in Social Security and Medicare-only referendum elections. For details and further information, please contact your State Social Security Administrator at:* http://www.ncsssa.org/statessadminmenu.html. In the final form, an alpha-numeric field will allow for multiple entries
				2. Does the entity have any employees for whom it DOES NOT PAY Medicare?
				A. If "yes", were those employees hired on or before April 1, 1986, and have been in continuous employment with the entity since that time?
				B. If "yes", please specify for which classification(s) of employees you DO NOT pay Medicare and how many employees are in each classification. *See Chapter 1, Publication 963, for information about worker classification.* In the final form, an alpha-numeric field will allow for multiple entries
				3. Does the entity have any employees who have retired and started receiving an annuity payment from their public retirement system and were then hired back? If so, those employees are considered to be "rehired annuitants." ***Note:*** *A rehired annuitant is a retiree who is rehired by his or her employer or another employer that participates in the same retirement system as the former employer. A rehired annuitant is either drawing a retirement benefit from that retirement system, or has reached retirement age under the retirement system.*

Compliance Verification Checklist for State and Local Governmental Entities

Medicare Qualified Government Employees (MQGE) and Medicare Exempt Employees				
Yes	**No**	**N/A**	**Not Sure**	
				A. If "yes" (the entity does have rehired annuitants), do you pay Social Security (the Old Age, Survivor, Disability portion) on those employees? ***Note:*** *Rehired annuitants are excluded from mandatory Social Security coverage. However, if an employee is rehired to perform services in a state or local government position that is covered for Social Security under a Section 218 Agreement, services in that position are covered for Social Security. In addition, all retirees hired after March 31, 1986, are covered for Medicare.*
				B. If "yes", do you pay Medicare (the Health Insurance portion of FICA) on those employees and also withhold the required 1.45% from the employees' pay?

Retirement Plan Coverage as a Substitute for Social Security Coverage

Effective July 2, 1991*, Congress made Social Security coverage mandatory for state and local government employees who are neither covered by a Section 218 Agreement or Modification nor qualifying participants in a public retirement system. Under this provision, state or local governments can provide these mandatorily covered employees with membership in a public retirement system as an alternative to mandatory Social Security coverage. Employees may also be covered by both a public retirement system and Social Security under a Section 218 Agreement.*

A governmental retirement plan must meet certain minimum benefit or contribution standards to qualify as a public retirement system, and thereby serve as a "replacement" plan exempting the participants from mandatory Social Security coverage.

For more information about public retirement systems (Social Security replacement plans), go to the Retirement Plans for Government Employers, http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html and Chapter 6 of the Federal-State Reference Guide, Publication 963, http://www.irs.gov/pub/irs-pdf/p1779.pdf .

The IRS has introduced a governmental plan web page as part of an initiative to better serve its customers in the governmental plan community. This web page offers guidance, tools, educational materials, news, and other resources that the IRS hopes will be of particular interest and assistance to section 401(a), 403(b), and 457 governmental plans in maintaining compliance with the applicable federal tax-qualification requirements. Please check back frequently for updates to this page: http://www.irs.gov/retirement/article/0,,id=181779,00.html .

The Employee Plans Compliance Resolution System (EPCRS) offers a comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of sections 401(a), 403(a), 403(b), 408(k), or 408(p) of the Internal Revenue Code, but which have not met these requirements for a period of time. This system allows plan sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the

Compliance Verification Checklist for State and Local Governmental Entities

Retirement Plan Coverage as a Substitute for Social Security Coverage				
Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Audit Closing Agreement Program (Audit CAP). 457 Plans are not officially under this program yet; however, the IRS will accept submissions under the VCP program on a provisional basis outside of EPCRS based on the same criteria. *For more information concerning this correction program, see Correcting Plan Errors at: http://www.irs.gov/retirement/article/0,,id=96907,00.html.*				
Yes	**No**	**N/A**	**Not Sure**	
				1. **Does the entity have a public retirement system?** ***Note:*** *A public retirement system is not required to be a qualified plan within the meaning of the Employees' Retirement Income Security Act of 1974 (ERISA). The employee may be a member of any type of retirement system, including a nonqualified system (for example, a section 457(b) plan, discussed below), as long as the plan provides a minimum level of benefits, as specified by law, under that system. A public retirement system may take one of two forms: the* ***defined benefit retirement system****, which is based on a guaranteed minimum benefit, and the* ***defined contribution retirement system,*** *which is based on a minimum contribution relative to salary****.*** *In order for a* ***defined benefit retirement system*** *to be a qualified plan, benefits must be measured by and based on various factors such as years of service rendered by the employee, compensation earned by the employee and the age of the employee at retirement. The Service issued Revenue Procedure 91-40 to clarify the minimum retirement benefit tests, which must be met in the plan's formula. This Revenue Procedure can be found in the Appendix of Publication 963****,*** *Federal-State Reference Guide.* *In order for a defined contribution retirement system to qualify, the worker must be covered in a plan in which at least 7.5% of his/her income is placed into a retirement plan. This contribution can be any combination of employer and employee contributions, but must total a minimum of 7.5% of his pay, and cannot include any credited interest in the calculation. The plan may include any plan described in section 401(a), an annuity plan or contract under section 403(b) or a plan described in section 457(b) or (f) of the Internal Revenue Code.* *Any person working for a public employer after July 1, 1991, who is* ***not covered in a public retirement plan that meets the requirements*** *discussed above or the defined benefit system safe harbor rules of Revenue Procedure 91-40,* ***must be covered by Social Security and Medicare under the mandatory coverage provisions*** *of Section 210 of the Social Security Act.* *For more information about public retirement systems (Social Security replacement plans), go to the Retirement Plans for Government Employers, http://www.irs.gov/govt/fslg/article/0,,id=158481,00.html and Chapter 6 of the Federal-State Reference Guide, Publication 963,* http://www.irs.gov/pub/irs-pdf/p1779.pdf.

Compliance Verification Checklist for State and Local Governmental Entities

Retirement Plan Coverage as a Substitute for Social Security Coverage				
Yes	**No**	**N/A**	**Not Sure**	
				2. Does the entity offer any of the following types of retirement plans? (Check all that apply)
				A. Defined Benefit *[Internal Revenue Code 414(j) & Revenue Procedure 91-40].*
				B. Defined Contribution *[Internal Revenue Code 401(a), 403(b), 457]*
				C. Deferred Compensation *[Internal Revenue Code 457(b)]*
				D. SEP IRA (Form 5305A-SEP, Salary Reduction Simplified Employee Pension —Individual Retirement Accounts Contribution Agreement, under Internal Revenue Code Section 408(k)).
				E. Other (describe): In the final form, an alpha-numeric field will allow for multiple entries and unlimited space for detailed information to be provided.
				3. Is the retirement plan offered to all employees (i.e., universal availability)?
				4. Are all employees offered the right to make elective deferrals of wages?
				5. Are ALL employees covered under a retirement system, understanding that there may be a waiting period prior to participating?
				A. If "no", what categories of employees are NOT covered? (Specify all that apply) ***Note:*** *Those not covered by a qualifying public retirement plan (i.e., retirement plan "ineligibles") may be required to be covered by Social Security and Medicare under the mandatory Social Security provisions of OBRA 1990. See Publication 963, Chapters 5 and 13, for details.* In the final form, an alpha field will allow for multiple entries

Compliance Verification Checklist for State and Local Governmental Entities

Retirement Plan Coverage as a Substitute for Social Security Coverage				
Yes	**No**	**N/A**	**Not Sure**	
				6. Has the entity received a Determination Letter [applies if the retirement plan is a qualified plan under IRC 401(a)] from the IRS?
				A. If "yes", when was the latest Letter received?

Fringe Benefits

Fringe benefits include any compensation other than wages. Examples of taxable fringe benefits are:

A. Personal use of an employer's cell phone, computer or vehicle.
B. Meals provided or reimbursed to an employee when they are not in overnight travel status.
C. Allowances for travel, vehicles or uniforms that do not meet the accountable plan rules.

The following taxes apply to taxable fringe benefits: Social Security, Medicare and Income Tax Withholding.

Some fringe benefits are excluded from income based on provisions of the Internal Revenue Code. See the Taxable Fringe Benefit Guide on the IRS web site for more information: www.irs.gov/pub/irs-tege/fringe_bnft_flsg.pdf. For a more detailed discussion of fringe benefits, see Publication 15-B, Employer's Tax Guide to Fringe Benefits, at: http://www.irs.gov/pub/irs-pdf/p15b.pdf.

Yes	**No**	**N/A**	**Not Sure**	
				1. Do you know that generally all fringe benefits (cash and non-cash) paid to employees are:
				A. Taxable unless exempt by law? **Note:** *For a discussion of which fringe benefits are exempt, refer to Chapter 3 of Publication 963.*
				B. Reported on Form W-2?
				C. Subject to all applicable Federal employment taxes, e.g., Federal income taxes, Social Security, and Medicare (FICA)? *Note: Federal employment taxes also include the Federal Unemployment (FUTA) tax and self-employment tax, but public employers are not subject to those tax requirements. A description of all employment taxes is available at: http://www.irs.gov/businesses/small/article/0,,id=172179,00.html.*

Compliance Verification Checklist for State and Local Governmental Entities

Fringe Benefits				
Yes	**No**	**N/A**	**Not Sure**	
				2. Does the entity have an "accountable plan" for reimbursement of expenses incurred by employees? ***Note:*** *In general, reimbursements or expenses paid by the employer on behalf of the employee are taxable unless they are for allowable excluded benefits or expenses, and the reimbursements are made under an accountable plan. For payments to be considered to be made under an accountable plan, the employee must:* *(a) Incur the expenses in the performance of work;* *(b) Adequately account for the expenses within a reasonable period of time, and* *(c) Return any amounts in excess of expenses within a reasonable period of time.* *If the accountable plan rules are met, no tax reporting is necessary. If they are not met, the reimbursements or advances are included in wages, and the employee may deduct allowable business expenses on his or her Form 1040.*
				3. Does the entity allow the personal use of a government-owned vehicle? ***Note:*** *Unless it is excludable because it is infrequent and of little value (a de minimis benefit), the personal use of a government-owned vehicle is a taxable fringe benefit. Personal use includes the value of commuting to and from work in a government-owned vehicle, even if the vehicle is taken home for the convenience of the employer. The value of the fringe benefit must be included in wages and is subject to income and employment taxes.* *All of your employee's use of a **qualified nonpersonal use vehicle** qualifies as a working condition fringe. You can exclude the value of that use from employee income. A qualified nonpersonal use vehicle is any vehicle the employee is not likely to use more than minimally for personal purposes because of its design. Examples include, but are not limited to:* *Clearly marked police, fire and public safety officer vehicles.* • *Unmarked vehicles used by law enforcement officers. The officer must be authorized to carry a firearm, execute search warrants and make arrests.* • *An ambulance or hearse used for its specific purpose.*
				4. Are taxable fringe benefits being reported as wages and taxes applied as required? ***Note:*** *You must report these wages on Form W-2 and Form 941.*

Compliance Verification Checklist for State and Local Governmental Entities

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns

INFORMATION REPORTING

Compensation to employees and the required withholding are reported on Form W-2 and on Form 941. The requirements and procedures for employee reporting are discussed in detail in Publication 15, Employer's Tax Guide (http://www.irs.gov/pub/irs-pdf/p15.pdf).

A variety of information returns are required to report various other types of payments. Any entity, including a governmental organization, conducting a trade or business, is required to file information returns for certain payments. In most cases, these payments are reported on Form 1099-MISC, Miscellaneous Income.

*The IRS Regulations state that every person engaged in a trade or business shall make an information return for each calendar year with respect to payments made by him to another person: salaries, wages, commissions for services rendered, interest, rents, royalties, annuities, pensions, and other gains, profits, and income **aggregating $600 or more**. The returns used for this purpose are the forms in the 1099 series.*

*The return with respect to certain payments of compensation to an employee is made on Forms W-2 and W-3; **never use Form 1099-MISC to report payments for services by an employee, except in certain isolated instances, such as when an employee has a separate proprietorship doing business with the employer in a field unrelated to his/her regular work for the employer.**.*

NOTE: *Certain payments and recipients are exempt from the requirements, including:*

- *Payments to exempt organizations and governments*
- *Generally, payments to corporations BUT not attorneys' fees, medical and health care payments*
- *Payments of rent to real estate agents*

See the General Instructions for Forms 1099, 1098, 3921, 3922, 5498, and W-2G http://www.irs.gov/pub/irs-pdf/i1099gi.pdf for details. For instructions and copies of all IRS forms and instructions, go to: http://www.irs.gov/app/picklist/list/formsInstructions.html, and enter the appropriate form number.

For information about W-2 and W-4 filing requirements, go to the U.S. Social Security Administration's website at: http://www.socialsecurity.gov/employer/gen.htm.

***Form 1096**, **Annual Summary and Transmittal of U.S. Information Returns** is used to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. For details, see: **http://www.irs.gov/pub/irs-pdf/f1096_08.pdf.** Do not use Form 1096 to transmit electronically. For electronic submissions, see Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically (http://www.irs.gov/pub/irs-pdf/p1220_07.pdf).*

Yes	No	N/A	Not Sure	
				1. Employment Tax Filings:
				A. Are all employment tax returns filed as required?
				B. Are all employment tax returns filed by the date required?
				C. Are all employment tax returns that were filed complete and accurate?

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns				
Yes	**No**	**N/A**	**Not Sure**	
				D. Do Forms W-3, W-2, and 941 reconcile for the most recent calendar year? ***Note:*** *Each year, employers must send Copy A of Forms W-2 (Wage and Tax Statement) to the Social Security Administration (SSA) by the last day of February (or last day of March if you file electronically) to report the wages and taxes of your employees for the previous calendar year.* *In addition, you must give a W-2 to each employee by January 31 (for individual income tax purposes.) W-2s are sent to SSA along with a Form W-3 (Transmittal of Income and Tax Statements).* *Employers are required to file Form W-2 for wages paid to each employee from whom:* • *Income, social security, or Medicare taxes were withheld, or* • *Income tax would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on Form W-4, Employee's Withholding Allowance Certificate.* *The 2010 wage base is $106,800.* *For further information, go to the U.S. Social Security Administration's website at: http://www.socialsecurity.gov/employer/gen.htm.*
				E. Were taxable fringe benefits included on Forms W-2 for each applicable employee? ***Note:*** *See the section of this checklist entitled, "Fringe Benefits" for further information.*
				F. Are vehicles provided to employees?
				G. Is lodging provided by the employer?
				H. Is tuition reimbursement provided by the employer?
				I. Was tip Income, if any, properly recorded on Form 941?
				J. Does the entity provide for achievement awards or length of service awards?

Compliance Verification Checklist for State and Local Governmental Entities

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns				
Yes	**No**	**N/A**	**Not Sure**	
				K. Does the entity provide Group Term Life Insurance?
				L. Does the entity provide for use of athletic or recreation facilities?
				M. Is any clothing provided by the employer?
				2. <u>Independent Contractor Reporting</u>:
				A. Does the entity make payments to independent contractors?
				B. Are forms W-9 on file for every vendor or independent contractor?
				C. Are all forms W-9 secured prior to initial payment? ***Note:*** *You should obtain vendor information before any payments are made. Use Form W-9 (http://www.irs.gov/pub/irs-pdf/fw9.pdf), Request for Taxpayer Identification Number and Certification, or a substitute, to collect the owner's name (if sole proprietor), legal business name, mailing address, taxpayer identification number.*
				D. Are all forms W-9 properly completed?
				E. Did the entity withhold federal income tax on miscellaneous income under the backup withholding rules, if applicable?
				F. Are Forms 1099 filed for payments to all vendors (except for some legally exempt ones) and independent contractors for payments in excess of $600 per year?
				G. Does the entity file Forms 1099s for payments for services or combination of products and services?
				H. Does the entity file Form 1099s for payments to individuals, partnerships, and certain corporations?
				I. Does the entity file Form 1099s for payments to attorneys, even if incorporated?
				J. Does the entity file Form 1099s for certain medical and health care payments, even if incorporated?
				K. Did the organization receive CP2100 Notice (backup withholding) for prior years information returns that contained missing, incorrect, and /or currently not issued taxpayer identification numbers?

Compliance Verification Checklist for State and Local Governmental Entities

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns				
Yes	**No**	**N/A**	**Not Sure**	
				L. Did the entity make payments of $10 or more for royalties?
				3. <u>International Issues</u>:
				A. Does the entity have control or signatory authority over any foreign bank accounts?
				B. Does the entity have employees working overseas?
				C. Does the entity conduct trade or business overseas?
				4. <u>Policies</u>:
				A. Does the entity have a cell phone policy?
				B. Does the entity have a travel reimbursement policy?
				C. Does the agency comply with the accountable plan rules?
				D. Do you offer reimbursement to your employees for taking educational classes?
				E. Does the entity have a spousal expense policy?
				5. **<u>Are you required to file any of the following federal tax returns?</u>**
				A. Form 720, Quarterly Excise Tax Return
				B. Form 941, Employers Quarterly Federal Tax Return
				C. Form 945, Annual Return of Withheld Federal Income Tax
				D. Form 990, Return of Exempt Organization
				E. Form 990T, Exempt Organization Business Income Tax Return
				F. Form 1040-SS, U.S. Self-Employment Tax Return
				G. Form 1042, Annual Withholding Return for U.S. Source Income of Foreign Persons
				H. Form 1096, Annual Summary and Transmittal of U.S. Information Returns

Compliance Verification Checklist for State and Local Governmental Entities

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns				
Yes	**No**	**N/A**	**Not Sure**	
				I. Form 1098E, Student Loan Interest Statement
				J. Form 1098T, Tuition Statement
				K. Form 1099G, Certain Government Payments
				L. Form 1099-INT, Interest Income
				M. Form 1099 MISC, Statement for Recipients of Miscellaneous Income
				N. Form 1099 R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. and IRA Contribution Information
				O. Form 1099 S, Proceeds from Real Estate Transactions.
				P. Form 8300, Cash payments over $10,000 received in trade or business
				Q. Form W-2, Wage and Tax Statement
				R. Form W-3, Transmittal of Wage and Tax Statements
				6. Forms W-4, Employee's Withholding Allowance Certificate
				A. Are Forms W-4 on file for every employee?
				B. Are all Forms W-4 secured prior to initial payment?
				C. Are all Forms W-4 properly completed?
				D. Are new Forms W-4 secured each year on all individuals claiming to be exempt from income tax withholding?
				7. Forms W-5, Earned Income Credit Advance Payment Certificate
				8. Do you make any payments for which you knowingly do not have a correct Taxpayer Identification Number (TIN)? **Note:** Special requirements apply to backup withholding for government entities. When workers are *independent contractors, the governmental entity may have information-reporting and backup withholding responsibilities, but is not required to withhold and pay employment taxes on behalf of the worker.*

Compliance Verification Checklist for State and Local Governmental Entities

Other Tax Issues: Information Reporting, Vendor Payments, Back-up Withholding, and Timely Filing of Returns				
				Government entities that make certain payments are required to withhold income tax of 28% from these payments if the payee is not exempt from backup withholding and fails to furnish correct taxpayer identification number (TIN). Backup withholding does not apply to wages or pension payments. *For further information about backup withholding, see Publication 963: http://www.irs.gov/pub/irs-pdf/p963.pdf. Also, a more detailed compliance checklist for IRS backup withholding requirements is available at: http://www.irs.gov/pub/irs-pdf/p15.pdf (IRS Publication 15).*

Social Security Benefits Offsets for Public Employees

Note: The IRS has no jurisdiction over Social Security offset provisions discussed in this section. This section is included in the Checklist to ensure public employers know those compliance requirements, even though they are not tax issues. All questions related to this section of the Checklist should be addressed to the U.S. Social Security Administration.

Some Federal employees and employees of State or local government agencies may be eligible for pensions that are based on earnings not covered by Social Security.

If you have employees who did not pay Social Security taxes on their government earnings and they are eligible for Social Security benefits, the formula used to figure the employee's Social Security benefit amount may be modified, giving the employee a lower Social Security benefit. Go to the Social Security Administration's website for details: http://www.ssa.gov/gpo-wep/. There are two types of pension offsets: Windfall Elimination Provision (WEP) and Government Pension Offset (GPO).

1. *If an employee is eligible for Social Security benefits on his/her own record: The Windfall Elimination Provision (WEP) fact sheet explains the formula Social Security may use to modify your benefit amount. The WEP fact sheet is at: http://www.ssa.gov/pubs/10045.html.*

2. *If an employee is eligible for Social Security benefits on his/her spouse's record: The Government Pension Offset (GPO) fact sheet explains how an employee's pension may affect his/her benefit on his/her spouse's record. The GPO fact sheet is at: http://www.ssa.gov/pubs/10007.html.*

Note: Some government pensions do not affect an employee's benefit on his/her spouse's record. For details, go to SSA's website at: http://www.ssa.gov/pubs/10007.html#when.

*Section 419(c) of Public Law 108-203, the Social Security Protection Act of 2004, requires State and local government employers to provide a statement to employees hired January 1, 2005, or later in a job not covered under Social Security. The statement explains how a pension from that job could affect future Social Security benefits to which they may become entitled. **Form SSA-1945, Statement Concerning Your Employment in a Job Not Covered by Social Security**, available on SSA's website at: http://www.socialsecurity.gov/form1945/SSA-1945.pdf, is the document that employers should use to meet the requirements of the law. Employers must:*

- *Give the statement to the employee prior to the start of employment;*
- *Get the employee's signature on the form; and*
- *Submit a copy of the signed form to the pension paying agency.*

Compliance Verification Checklist for State and Local Governmental Entities

Social Security Benefits Offsets for Public Employees				
Yes	**No**	**N/A**	**Not Sure**	
				1. Do you know that some Federal employees and employees of State or local governments who are eligible for pension that are based on earnings not covered by Social Security and who are eligible for Social Security benefits may have their Social Security benefits modified?
				2. Do you know that Federal law requires State and local government employers to provide a statement to employees hired on or after January 1, 2005, in a job not covered under Social Security?
				3.* Have you completed and filed Form 131, EMPLOYER REPORT OF SPECIAL WAGE PAYMENTS?** ***Note: *Employees are sometime paid wages in a year subsequent to the year that the wages were earned. The most common types of payments are accumulated (for prior years) vacation pay or sick pay paid after retirement; deferred compensation; severance pay (when paid on account of retirement) and bonuses--paid pursuant to a prior agreement or contract.* *Wages which are earned in a year prior to the year they are paid usually do not affect benefits payable under the Social Security annual earnings test. However, for the Social Security Administration to pay benefits accurately, these prior year amounts must be reported to us. The above named individual has filed for Social Security benefits. To ensure that correct Social Security benefits are paid, please complete the information below and return this form to the Social Security Administration. (Please see reverse side for instructions for the completion of this form.) http://www.socialsecurity.gov/online/ssa-131.pdf*

Thank you for completing the Compliance Verification Checklist.

If this Compliance Verification Checklist indicates your organization may have one or more compliance issue(s), it is suggested that you contact your IRS Federal-State-Local Government (FSLG) Specialist for assistance.

The names and contact information for FSLG staff are available at: http://www.irs.gov/govt/fslg/article/0,,id=96060,00.html.

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Indian Tribal Governments: FICA Taxes in Indian Country and the Problem of Selective Incorporation in Administration of the Code

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June 9, 2010

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I. SUMMARY

In this report, the authors make a single recommendation. The authors recommend that the Internal Revenue Service ("Service") adopt a pre-filing program for tribal governments. Section 7121 of the Internal Revenue Code authorizes the Service to enter into specific matter closing agreements.[1] The Service interprets its Section 7121 authority to authorize the Service to enter into pre-filing agreements to resolve certain issues. Pre-filing relief "permits taxpayers to avoid costs, burdens and delays that are frequently incident to post-filing examination disputes between the taxpayers and the IRS."[2] The Service has, for example, exercised its authority to help resolve certain issues within the jurisdiction of the Large and Midsize Business Division. We recommend that the Service employ pre-filing agreements to resolve the specific issue of worker classification of tribal board, committee and commission members for FICA purposes.

We recognize that extending the pre-filing agreements to a new set of taxpayers entails risk. There is always tension between the policy of uniform enforcement of the Internal Revenue Code ("Code"), on the one hand, and exercising discretion to make adjustments in particular cases for particular taxpayers, on the other hand. There are also administrative burdens associated with making adjustments in particular cases. We anticipate that the Service may be reluctant to extend the pre-filing program to tribes. We make the case in this report that there are circumstances that do justify extending pre-filing agreements to tribes. The Service's enforcement of withholding tax on tribal officials is one such circumstance. We analyze the withholding tax treatment of tribal board, committee and commission members. These tribal officials make policy for tribal communities and play a key role in the political life of their tribes.

The Service's interpretation and enforcement of the withholding tax provisions of the Code to tribal public officials has been uneven. The Service's effort to fit tribal governments into the complex regulatory framework established by FICA presents unique difficulties. At times, the Service has treated tribal governments like state or local governments. At other times, the Service has treated tribal governments differently than state or local governments. Tribes do share some of the political characteristics of state and local governments. Like state and local governments, tribes hold elections and make policy through elected and appointed boards, committees and commissions. Tribal governments are, however, unlike state and local governments in important respects. Tribal governments derive their political powers from different sources and those powers have a different scope. As a result, it is often incorrect to treat tribes like state or local governments. Pre-filing agreements are one way to address the uncertainty in the administration and enforcement of the withholding tax provisions for tribal governments.

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[1] . 26 U.S.C.A. 7121.

[2]. Announcement 2005-42.

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II. INTRODUCTION

Widely considered to be the landmark social legislation of the 20th century, the Social Security Act of 1935[3] and the Federal Insurance Contribution Act (for convenience, we refer to both together as the "Act") imposed an unemployment compensation tax and a social security tax to combat the effects of the great depression of 1929. Title VIII of the Social Security Act imposed a tax on wages paid by employers to employees. The income and excise taxes imposed by Title VIII were enacted to defray the cost of providing social security insurance to the aged. Title II of the Act provided an "Old-Age Reserve Account" to provide defined benefits to workers over the age of 65. Title IX imposed an unemployment tax on employers measured by the amount of wages paid to employees. Employers were allowed to take a credit against the taxes due to the federal government for payment of a similarly-imposed state unemployment tax to states. Section 904 of Title IX provided that taxes paid into the "unemployment trust fund" would defray the cost of providing unemployment insurance to displaced workers. The Service collects both FICA and the unemployment tax. The Social Security Administration administers social security benefits. States and the federal government jointly administer unemployment insurance benefits. In this report, we focus on social security taxes and benefits to tribal governments.

The question arises whether the Social Security Act applies to tribal governments. The Act applies differently to governments than to private employers. Indian tribal governments can be both. Tribal governments engage in both commercial and governmental activities. On the commercial side, tribes engage in commercial activities as lessors, developers and proprietors. They provide security for workers, including establishing and maintaining retirements plans. In this report, we do not consider the circumstance in which a tribe pays wages in the course of carrying on commercial activities. On the governmental side, tribal governments make law for tribal members and non-members within their territorial jurisdiction. Tribal governments carry out a wide variety of political and communal functions through boards, commissions and committees. Board, committee and commission members often receive a fee or other payment for service on the board, committee or commission. We estimate that as many as 100,000 tribal members serve on boards, committees and commissions. The amounts and requirements for payments vary greatly from tribe to tribe. The applicability of federal withholding taxes on payments to board, committee and commission members is not clear. We consider here the special case of the applicability of withholding tax on payments made to board, committee and commission members.

The ACT project team began this project by considering the policy implications of Revenue Ruling 59-354[4]. Revenue Ruling 59-354 states that amounts paid to tribal council members for their services are not subject to FICA taxes or income tax

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[3]. Social Security Act of 1935, CH. 531 *codified at* 42 U.S.C.A. 301 et seq.

[4]. Rev. Rul. 59-354, 1959-2 C.B. 24

withholding (although they are includible in taxable income). Because amounts paid to tribal council members are not subject to FICA taxes, tribal council members are not eligible for social security benefits with respect to their tribal council service. We were curious to learn how tribal governments felt about this issue. We found that there is no consensus among tribes whether payments should be subject to FICA. Some tribes withhold FICA for tribal council members notwithstanding Revenue Ruling 59-354. Others do not. Still other tribes appear to be unaware of Revenue Ruling 59-354. In the course of questioning tribal correspondents about this issue, we were often asked whether tribal public officials, other than tribal council members, were also subject to Revenue Ruling 59-354 and related administrative guidance, and, more generally, whether fees and other payments made to tribally-appointed or elected board and committee members were subject to FICA taxes. We learned that there is deep uncertainty in Indian Country about this issue. As a result, we focused our inquiry on finding the sources of uncertainty about the applicability of FICA taxes to tribal public officials.

We found four sources of uncertainty. First, FICA taxes are complicated. FICA taxes are imposed on both employers and employees, at different rates and upon different wage bases. The withholding base differs from tax to tax. FICA applies in different ways depending on whether the employer is a government or a private employer. The Federal, State and Local Governments team reports that there are more than 500 different compliance scenarios for state and local government employers. Second, for those tribes that are aware of Revenue Ruling 59-354, the ruling itself causes uncertainty. Tribal administrators do not understand why tribal council members are not subject to FICA taxes, but other elected or appointed tribal officials might be. They do not understand why payments to council members are subject to income tax but not income tax withholding. Third, tribal members are told that whether a tribal official or other worker is an employee or an independent contractor is determined by applying the common law control test on a worker-by-worker basis. The difficulties inherent in the common law control test are well known and are not limited to Indian tribes. The classification of workers as either employees or independent contractors is a persistent source of conflict between the Service and taxpayers.

The fourth source of uncertainty was less obvious. In some ways, the fourth source of uncertainty is more important to the relationship between the Service and tribal governments because it impacts the administration of the Code as a whole. As pre-constitutional political bodies, tribal governments are distinctively different from state, local and foreign governments. Since its formation, the United States has made a commitment to protect tribes as separate sovereigns. One expression of that commitment is the federal decisional rule that federal statutes should not be interpreted to invade upon a tribe’s internal affairs. When Congress does not directly refer to tribes in legislation or legislative history, then tribes (and others) cannot tell whether tribes are subject to the particular legislative enactment. As a result, those charged with enforcement of congressional enactments are left to guess about how those enactments might apply to tribes. Some federal laws have been applied to tribes while others have not. The result is a crazy-quilt application of federal laws to tribes.

If a court or administrative decision maker decides that a federal enactment does apply to a tribal government, then the question arises how does the enactment apply? Generally, federal administrators and courts are left to decide on a case by case basis whether and how specific provisions of federal enactments should be applied to tribes and tribal members. Deciding how to fit tribes within a particular federal enactment is seldom clear because tribal governments do not fit neatly into the usual subjects of congressional legislation (e.g., federal, state, local, or foreign governments, citizens and non-citizens). We use the phrase "selective incorporation" in this report to refer to a decision, in this case by the Service, about whether and how provisions of the Internal Revenue Code should apply to tribes.

It may be tempting to conclude that questions about the general applicability of the Code raises abstract policy matters. The question whether a federal statute applies to a tribe, however, has a real-world impact. FICA's counterpart, the FUTA unemployment tax, demonstrates how questions about the applicability of silent statutes can have real world impacts on tribes. Prior to passage of Community Renewal Tax Relief Act of 2000, tribes were subject to conflicting treatment under FUTA.[5] FUTA imposed the unemployment tax on employers. FUTA allowed a credit against federal unemployment tax for amounts paid to qualifying state unemployment insurance programs. For many years, states and the Service were unclear whether tribes were either required or allowed to participate in the state unemployment insurance programs. States took different positions on whether tribes were required to contribute to the programs and whether their employees were entitled to unemployment insurance. In the late 1990's at least one state refused to extend insurance to qualified tribal member employees even though the tribe paid the state unemployment tax.[6] The state did not provide unemployment benefits because of uncertainty about the scope of its authority over tribal member employees. In response, the tribe stopped paying both state unemployment tax and FUTA. The Service demanded that the tribe pay FUTA to the United States. To resolve the conflict, Congress stepped in and passed special legislation forgiving back FUTA taxes and prospectively classifying tribes as states for purposes of administering FUTA.[7] There is no parallel legislation classifying tribal workers for purposes of FICA.

The specific issue of whether and how FICA applies to tribally-appointed or elected board, committee or commission members is especially important to tribes because it touches directly upon tribal self-government. A tribe's decision to classify an appointed or elected tribal member as an employee or independent contractor often is a politically sensitive issue. Classifying a board, committee or commission member as an employee often means that the member is entitled to other rights or benefits unrelated to taxation, as a consequence of tribal laws or traditions. How these rights and benefits

[5] . P.L 106-551, 106 Stat. 1003.

[6] . Cohen, Handbook of Federal Indian Law (2005), Sec. 8.02(c).

[7]. Cohen, Sec. 8.02(c), n. 107.

are allocated within the tribe involve difficult policy choices for the tribe and affect the availability of funds for delivery of tribal programs and services.

III. FICA TAXES: REGULATORY FRAMEWORK

A. Income and Employment Taxes

Employment taxes, defined here to include income tax, FICA tax, FUTA tax and SECA tax, are difficult to administer. For all but the most sophisticated taxpayers, it is easy to get it wrong. Reporting and paying income, FICA and FUTA taxes requires that employers understand the interplay of the three taxes. Section 61 of the Code imposes income tax on “all sources of income from whatever source derived.”[8] Section 3402 requires employers to withhold income tax from employee wages.[9] Section 3301 imposes FUTA tax upon “employers…with respect to having individuals in his employ.”[10] Section 3306 measures FUTA by all wages received including non-cash remuneration.[11]

Section 3101 imposes the FICA tax on “wages received…with respect to employment.”[12] The tax is imposed on both employers and employees. FICA tax is an income tax on the employee and an excise tax on the employer. Section 3121 defines taxable wages to include cash and various forms of non-cash remuneration.[13] Section 3102 requires employers to withhold the employee share of FICA tax in addition to paying the employer share.[14]

The price of getting it wrong can be high. As with other taxes, FICA tax assessments include interest and penalty amounts. Penalties may be assessed for failure to timely file returns, failure to timely file information returns or failure to timely deposit the tax. FICA tax, however, also imposes one of the most draconian penalties in the Code. The employee share of the tax is treated as trust money in the hands of the employer, and failure to remit the employee’s share of FICA tax subjects the individual responsible for payment to personal liability for non-payment.[15]

If a worker is an independent contractor rather than an employee, then the worker is subject to SECA tax. SECA imposes a tax on net earnings from a “trade or business.”[16] SECA tax is a companion tax to FICA tax. In contrast to FICA, SECA imposes a tax entirely on the self-employed worker. Workers who pay SECA tax are entitled to social security benefits in the same way that employees are entitled to social security benefits. Workers who are classified as employees are excluded from SECA tax.

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[8]. 26 U.S.C.A. 61

[9]. 26 U.S.C.A. 3402

[10]. 26 U.S.C.A. 3301

[11]. 26 U.S.C.A. 3306

[12]. 26 U.S.C.A. 3101

[13]. 26 U.S.C.A. 3121

[14]. 26 U.S.C.A. 3102

[15]. 26 U.S.C.A. 6672

[16]. 26 U.S.C.A. 1402

Although described as a tax, it is important to note that FICA taxes do not flow into the general fund of the federal treasury. Rather, the funds serve as a kind of "compulsory insurance" for the employee whose service give rise to the taxes, and the accumulation of service credits resulting from payments of the tax entitles the employee to retirement and similar benefits later in life. That means that tribes will not uniformly or necessarily seek to avoid paying and withholding these taxes. The question whether a tribe would seek to avoid FICA or to seek coverage, or whether a tribal worker would urge the tribe to avoid FICA or pay it with respect to the worker's service, varies from tribe to tribe and from worker to worker.

B. The Common Law Control Test

FICA applies to "employment" and "employees." FICA distinguishes between service providers who are employees and service providers who are independent contractors. Workers are classified for tax purposes under the well-known common law control test for distinguishing an employee from an independent contractor, usually described as the "control test" (the phrase we use in this report).

The control test evaluates the presence or absence of an employment relationship by examining the facts of each particular employment relationship. The Treasury Regulations summarize the factors to be considered in evaluating whether an employer-employees relation exists:

> Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct and control the manner in which the services are performed; it is sufficient if he has the right to do so.[17]

The Regulations explain further that "if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor."[18]

The Service considers 20 different factors to classify a worker, but they "are not the only ones that may be important."[19] There is no guidance on how to assign weight to particular factors in specific cases. The Service now bundles control test factors into three categories of "behavioral control, financial control, and the relationship of the parties." The IRS describes these categories as follows:

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[17]. Treas. Reg. § 31.3121(d)-1(c)(2).

[18] . Id.

[19]. (Rev. Rul. 87-41, 1987-1 C.B. 296); IRS Employment Tax Handbook, 104.6, § 5.8.1 (April 21, 1999).

1. Behavioral control – Facts that show whether there is a right to direct or control how the worker does the work.

2. Financial Control – Facts that show whether there is a right to direct or control the business part of the work include.

3. Relationship of the parties – Facts that illustrate how the business and worker perceive their relationship.[20]

Slight differences in facts or circumstances can result in different classifications of workers. Comparison of Revenue Rulings 65-188 and 75-243 illustrates how exceedingly fine factual distinctions can determine worker classifications.[21] Rulings 65-188 and 75-243 both involve the classification of interviewers for marketing research companies. The interviewers at issue in both rulings were selected by marketers from lists that the marketers maintained. Both interviewers were typically contacted by phone and both were free to refuse an assignment. Both were paid hourly and were reimbursed for costs. The work of both interviewers was subject to validation by the marketer after they completed their assignments. In Ruling 75-243, however, the interviewer could not hire assistants to help with the interviews, was required to make daily progress reports to the marketer, and was given somewhat more detailed written instructions than the reviewer in Ruling 65-188. Based on these differences, the Service ruled that the worker in Ruling 65-188 was an independent contractor but that the worker in Ruling 75-243 was an employee. In practice, proving (on audit) the factual detail necessary to defend a decision to classify a worker as an employee or independent contractor can be very expensive and frustrating for taxpayers.

The depth of the uncertainty inherent in worker classification is shown by Congress' enactment of "section 530 relief."[22] Recognizing the uncertainties inherent in worker classification cases, Congress and the Service have acted to minimize the effects of the control test. Congress has afforded some relief to employers with respect to worker classification cases. Section 530 of the Revenue Act of 1978, as amended, provides relief to a taxpayer if the taxpayer satisfies certain reporting and substantive consistency requirements. Section 530 was enacted by Congress "in reaction to the perceived inconsistent and arbitrary action of the Internal Revenue Service in reclassifying independent contractors as employees."[23] Section 530 has been described as "curative legislation of a remedial nature based on a standard of good faith reliance intended to provide interim relief for taxpayers involved in employment tax controversies."[24]

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[20]. Employment Tax Desk Guide for Indian Tribal Governments, IRS Pub. No. 4268. Publication No. 4268 is published on ITG's web page at <http://www.irs.ustreas.gov/pub/irs-pdf/p4268.pdf.

[21] . Rev. Rul. 65-188, 1965-2 C.B. 390; Rev. Rul. 75-243, 1975-1 C.B. 322.

[22] . Sec. 530, Revenue Act of 1978.

[23]. Apollo Drywall, Inc. v. United States, 1993 WL 13154093, 71 AFTR 2d ¶ 93-1689, *93-1692 (W.D. Mich. 1993).

[24]. Queensgate Dental Family Practice, Inc. v. United States, 1991 WL 260452, 68 AFTR 2d ¶ 91-5679 (M.D. Pa. 1991), aff'd, 970 F.2d 899 (3d Cir. 1992).

Originally passed as a temporary legislation, Section 530 is now permanent law. Unfortunately, over time, Section 530 relief has become nearly as complicated to administer as the control test itself.

IV. SELECTIVE INCORPORATION OF INDIAN TRIBES IN ADMINISTRATION OF THE CODE

A. The Applicability of Silent Federal Statutes to Indian Tribes

1. Applying General Federal Statutes To Indian Tribes

In principal, interpreting the scope of a federal statute should be straightforward. If a federal statute refers to a tribe, then apply the statute in accordance with its terms. If the federal statute does not refer to the tribes, then look at the legislative history for guidance on its scope and meaning. If the legislative history sheds light on the meaning of the statute, then use the legislative history as a guide to interpreting the statute. If there is no text or historical guidance on whether and how a federal enactment applies to tribes, then interpreting a general federal statute becomes more difficult. If there is no indication of congressional intent respecting tribes, then federal courts resort to legal presumptions. Federal courts do not always apply the same presumptions about the applicability of silent federal statutes to tribes.

Some courts have adopted the presumption that congressional silence means that Congress did not intend a general statute to apply to tribes. Courts adopting the presumption of non-application require evidence that Congress intended a federal statute to apply to tribes. In *Santa Clara Pueblo v. Martinez*,[25] for example, the United States Supreme Court held that the Indian Civil Rights Act of 1968 did not create a federal cause of action against an Indian tribe. The Supreme Court repeated the traditional interpretive rule that “a proper respect both for tribal sovereignty itself and for the plenary authority of Congress in this area cautions that we tread lightly in the absence of clear indications of legislative intent.”[26] Similarly, in *Donovan v. Navajo Forest Products Industries*[27], the tenth circuit held that the Occupational Safety and Health Act of 1970 (OSHA) did not apply to a tribally-owned sawmill. The Tenth Circuit held that imposing OSHA on the tribe would impair treaty-guaranteed right to self-government. The Court stated that “limitations on tribal self-government cannot be implied from a treaty or statute; they must be expressly stated or otherwise made clear from surrounding circumstances and legislative history.”[28]

Other courts have adopted the opposite presumption. Courts taking the opposite approach presume that congressional silence means that Congress intended a general statute to apply to tribes. Courts adopting the presumption of applicability require evidence that Congress intended that tribes should be excepted from the terms of a general statute. *Federal Power Commission v. Tuscarora Indian Nation*[29], is widely regarded as the decision that supports judicial employment of the presumption of

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[25].436 U.S. 49 (1978).

[26].436 U.S. at 60.

[27]. 692 F. 2d 709 (10th Cir. 1982).

[28]. 692 F. 2d at 714.

[29] .362 U.S. 99 (1960).

applicability of general statutes. In *Tuscarora*, the Supreme Court held that the Federal Power Act applied to Indian tribes stating that "a general statute in terms applying to all persons includes Indians and their property interests."[30] Following Tuscarora, the Ninth Circuit Court of Appeals in *United States v. Farris*[31], held that the Organized Crime Control Act of 1970 applied to tribal members in a case involving a reservation-based gaming operation.

Significantly, even those courts that adopt the presumption of applicability reason that there remains a protected zone within which a general federal statute will not apply to tribes. In the *Farris* decision, the Ninth Circuit acknowledged that a federal statute that impaired tribal treaty rights or "purely intramural" tribal affairs would not apply to the affected tribe unless there was evidence that congress specifically considered tribal interests.[32] The scope of "purely intramural affairs" is not well defined. It seems clear, however, that even courts adopting the presumption of applicability recognize that if the federal promise of tribal self-government is to have meaning, there must be a zone of tribal activity within which the presumption against applicability must still apply.

The Service has historically relied upon a different canon. The Service relies on the interpretive canon that tax exemptions may not be implied but must be express. Since the Code rarely mentions tribes, the canon almost always leads to the conclusion that tribes are subject to the Code. The interpretive rule that exemptions must be express does not necessarily lead to the conclusion that tribes are incorporated into the Code. The canon disfavoring implied tax exemptions conflicts with the canon favoring preservation of tribal autonomy. In the case *In re Cabazon*[33], the Service successfully argued before the bankruptcy appellate panel for the Ninth Circuit that tribes are not entitled to exemptions from federal taxation unless expressly exempted by the Code. In effect, the Service "trumped" the canon favoring tribes with the canon disapproving implied exemptions. The Supreme Court's more recent decision in *Chickasaw Nation v. United States*[34], however, casts doubt about whether one interpretive canon "trumps" the other. There, the Supreme Court considered a provision of the Indian Gaming Regulatory Act that provides "[t]he provisions of the Internal Revenue Code of 1986 (including sections 1441, 3402(q), 6041, and 6050I, and chapter 35 of such Code) concerning the reporting and withholding of taxes with respect to the winnings from gaming or wagering operations shall apply to Indian gaming operations conducted pursuant to this Act, or under a Tribal-State compact entered into under section 11(d)(3) that is in effect, in the same manner as such provisions apply to State gaming and wagering operations."[35] The question presented to the Court was whether the wagering

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30 .362 U.S. at 116.

31. 624 F. 2d 890 (9th Cir. 1980).

32. 624 F. 2d at 893.

33.57 B.R. 398 (BAP 9th Cir. 1986).

34. 534 U.S. 84 (2001).

35. 25 U.S.C.A.. 2719(d)(1).

excise and occupational taxes imposed by Chapter 35 of the Internal Revenue Code applied to tribes. Chapter 35 exempts states from the taxes imposed by Chapter 35. The tribes argued that the statute was ambiguous as to whether it imposed a tax on tribes. As such, the statute should be construed in favor of the tribes. The Supreme Court found that the statute was most naturally read to impose a tax on tribes. The Court nevertheless acknowledged the validity of both interpretive canons and declined to rule that one interpretive canon trumped the other. The Court observed that "[t]his Court's earlier cases are too individualized, involving too many different kinds of legal circumstances, to warrant any such assessment about the two canons' relative strength."[36]

2. The Case of Social Security Act of 1935

With the interpretive rules in mind, we turn to the Social Security Act. The text of the Social Security Act of 1935, including amendments, makes no reference to tribes. The Act creates a complicated interplay between the federal government and state and local governments. Title I appropriates monies for old-age assistance to states that have qualifying state assistance plans. Title III similarly makes grants to states for unemployment compensation. Title IV makes grants to states that have qualifying plans for aid to dependent children. Section 402 of Title IV describes the conditions that a state plan must meet to qualify for federal aid. Title VI makes grants to states for public health services. Title X makes grants to states that have qualifying plans for aid to the blind.

Available sources do not shed light on whether Congress intended the Act to apply to tribes. Passage of the Act was preceded by the formation of the Committee on Economic Security. President Roosevelt empanelled the Committee in June 1934 to make a comprehensive study of economic security in America. In January 1935, the Committee made its report to the President and Congress. The Committee report is replete with references to states:

> Education has been regarded in this Country as a responsibility of the state and local governments and should remain so. In the joint attack on economic security, which suggests federal participation, however, is most desirable.
>
> * * *
>
> Since the passage in 1920 of the Federal Vocational Rehabilitation Act, the [federal] government has been assisting the states in a service of individual preparation for and placement in employment of persons vocationally handicapped through industrial or public accident, disease or congenital causes.

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[36]. 534 U.S. at 95.

> * * *
>
> Public-work programs are most necessary in periods of severe depression, but may be needed in normal times, as well, to help meet the problems of stranded communities and overmanned or declining industries. To avoid the events of hastily planned emergency work, public employment should be planned in advance and coordinated with construction and development policies and the government and with state and local public-works projects.
>
> * * *
>
> We believe that states should administer unemployment compensation.[37]

The Committee report mentions state and local governments more than 100 times. The report does not mention tribes at all.

Given the detailed provisions respecting states, one might expect to find a decision to include or exclude tribes expressed in the congressional debates or in the Act itself, but neither is present. The lack of any mention of tribes in the extensive discussion of states is probative because of long standing jurisdictional conflicts between tribes and states. At the time of passage of the Act, federal legislators and executive administrators knew that states lacked jurisdiction over tribes and tribal members in Indian Country. In some states, for example, tribal members were not treated as state residents and were not allowed to vote in state and local elections.

The circumstances surrounding the passage of the Wheeler-Howard Act of 1934[38], a year before passage of the Social Security Act, offer some evidence that Congress made a distinction between tribal governments and other governments. Tribes were emerging from a fifty-year federal policy that sought the dissolution of tribal governments. When the Act was passed, federal Indian policy was changing from the policy of "allotment and assimilation" to a policy of tribal self-determination. The General Allotment Act of 1887 ("Dawes Act") authorized the allotment of parcels of reservation lands to tribal members.[39] The United States assumed guardianship over tribal members (called "wards") and their parcels. The Dawes Act provided that once an Indian ward was deemed "competent", the allotted parcel would pass to the tribal allottee in fee. The land and its owner would become subject to state civil and criminal jurisdiction. Tribal governments would dissolve and tribal members would be assimilated into the larger Anglo-American society.

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[37].(Report Of The Committee On Economic Security, Committee On Economic Security, http://ssa.gov/history/reports/ces/ces5.html).

[38] .Wheeler-Howard Act of 1934, Ch. 576, 48 Stat. 984.

[39] .General Allotment Act of 1887, Ch. 119, 24 Stat. 388. The Indian reorganization policy was followed by the so-called "termination era." Termination policy held sway from 1943-1961.

The Wheeler-Howard Act restored tribes as governments and implemented means to improve the social and economic status of tribal members. The Wheeler-Howard Act, which was passed shortly before the Social Security Act, stopped the allotment and alienation of tribal lands. Section 16 of the Wheeler-Howard Act authorized tribes to organize as governments and adopt constitutions to govern their political affairs. Section 17 of the Wheeler-Howard Act authorized tribes to form tribal-chartered corporations to conduct business. At the time of passage of the Social Security Act, the newly constituted tribal governments would not have had enough time to fulfill the promise of Section 17 to establish wage economies or become employers. Moreover, at the same time that it passed the Indian Reorganization Act, Congress passed the Johnson-O'Malley Act of 1934 to allow the Secretary of Interior to contract with state and local governments to provide "education, medical attention, agricultural assistance, and social welfare, including relief of distress, of Indians."[40] The express purpose of the Johnson-O'Malley Act was to provide for "social welfare" and "relief of distress." It is, therefore, possible to infer from the enactment of the Johnson-O'Malley Act that Congress intended that federal care for the tribes would come through direct appropriations from Congress and not through the Social Security Act.[41]

3. Administrative Interpretations of the Act

Administrative interpretations of the applicability of silent federal statutes display the same uncertainty that court decisions display. The Service has had difficulty reconciling the conflicting commands of federal law in interpreting the applicability of Code provisions to tribes. Administrative guidance shows that the Service does balance unflinchingly uniform enforcement of the Code with federal Indian law and policy and the former does not always "trump" the latter. In the case of FICA, the Service first took the position that tribes are subject to FICA in the 1940's.[42] The Service apparently first took the position that FICA applied to tribes in response to inconsistent views on the

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[40].Johnson-O'Malley Act of 1934, Ch. 147, 48 Stat. 596.

[41]. If one adopts the presumption that silence means that Congress does intend a general statute to apply to tribes, questions still remain. When is a statute one of "general application? Title VIII of the Social Security Act applies to "employers". The Act does not define the term employer as it is used in Section VIII. Is a statute that applies to "employers" a statute of general application? The Act, as originally adopted and subsequently amended, exempts several "employer" classes. The effect of these exemptions from FICA is to narrow the definition of employer for FICA purposes. If the answer to the question whether FICA is a statute of general application is "yes", do the exemptions from coverage change the answer? The legislative history of the Act shows that Congress identified the employers that would be subject to FICA. The House Committee on Ways And Means reported that it anticipated that 12,087,000 "owners, operators and self-employed" would be covered by Title VIII. The report does not say what percentage of the total number of all employers would be excluded from Title VIII coverage. The Committee reported, however, that about half of the total number of gainful workers would be excluded from Title VIII coverage. Given that half of the total number of gainful workers would be excluded, it is fair, if inexact, to conclude that the number of excluded employers would likewise be somewhat less than the total number of all employers. Does the fact that Congress had a specific numeric set of employers and employees in view change the answer?

[42]. General Counsel Memorandum 24990 (1946).

question. The Department of the Interior had taken conflicting positions on whether tribes and their employees are subject to FICA. In 1937, the Interior Solicitor opined that it was doubtful “that a general tax law should apply to Tribes unless the statue so indicated” and, therefore, that FICA did not apply.[43] A 1941 Interior memorandum reversed its earlier view and opined that tribes were subject to FICA. The 1941 memorandum did not note the contrary conclusion in a 1937 Interior opinion.[44] The Service’s opinion appears to have been aimed at resolving the uncertainty. The Service began to impose the provisions of FUTA and FICA on tribal governments during the 1940’s and 1950’s. Initially, tribes resisted imposition of FUTA and FICA. The Service and the Interior Department launched an educational campaign to advise tribes on the benefits of FUTA and FICA. The Service subsequently formally took the position that tribal governments are subject to FUTA and FICA.[45]

Removing the one source of uncertainty—whether tribes were subject to FICA at all—had the unintended consequence of adding others. In Revenue Ruling 59-354, the Service attempted to classify tribal officials for purposes of FICA. In Ruling 59-354, the Service concluded that amounts paid to tribal council members for services performed on tribal council are not subject to income tax or payroll tax withholding. Revenue Ruling 59-354 is significant because the ruling shows the difficulty of incorporating tribes into federal law without any clear congressional expression of intent. In reaching this conclusion, the Service observed that tribal council member duties were comparable to city council members. Ruling 59-354 is very short and the Service’s reasoning is open to several interpretations. The Service may have reasoned that tribal council members are not employees because there is insufficient control over them to make them so. If that is correct, then the Service’s reasoning would be analogous to the rule the board members of a corporation are like employees. Alternatively, the Service may have reasoned that council members are common law employees but should be treated as if they were state and local government employees and therefore exempt from FICA. The Service may also have reasoned that tribal council members should not be subject to withholding because withholding from council member pay would interfere with tribal self-government.

Adopting the interpretation that withholding from council member pay would interfere with tribal self-governance means that the Service does make choices about how and when the Code should apply to tribes. In fact, the Service has recognized that Code provisions do give way to the federal decisional rules protecting tribal self-government in particular cases. In General Counsel Memorandum 37357, Counsel allowed that the Service might imply exemptions where tribal policies are impacted.[46] In General Counsel Memorandum 37357, the question was posed whether union delegates were

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[43] .Op. Sol. Int., June 30, 1937 (M29156).

[44].Memo. Sol. Int., May 1, 1941.

[45] . Letter from IRS Acting Commissioner Stowe to Commissioner of Indian Affairs, November 8, 1957, (A-439974).

[46] . GCM 37357 (Dec. 21, 1997).

employees of the union for FICA tax purposes. The Office of General Counsel found that the delegates' duties were similar to the duties performed by board members of a corporation. In reviewing relevant authorities, including Ruling 59-354, General Counsel rejected the interpretation that tribal council members were common law employees. Acknowledging that there was no express exemption from FICA for amounts paid to tribal council members, Counsel interpreted Ruling 59-354 to "reflect not merely an interpretation of the term 'employee' as used in the employment tax provisions but also a concern with avoiding any position in conflict the federal government's policies with regard to Indians."

In Ruling 67-243[47], the Service reconsidered its earlier determination in Ruling 62-16[48] that income to a tribal member from an allotment was not exempt from income tax. The ruling was based on perceived hardship to tribal members. In Ruling 67-243, the Service modified Ruling 62-16 to allow for the exemption "in view of transactions by Indians regarded as unable to handle their own affairs to make intra-family transfers of allotments or to assist needy Indians in acquiring small amounts of land where the purchase money consisted of restricted funds." In Ruling 68-493[49], on the other hand, the Service ruled that a tribal member was not exempt from FICA withholding merely by reason of the tribal member's status as a ward of the United States.

These administrative rulings show that the Service recognizes that in appropriate circumstances uniform enforcement of the Code should give way to principals of federal Indian law. The Service's position is not surprising and it is not wrong. Even those courts that apply the presumption of applicability of silent federal statutes to tribes, like the *Farris* court, recognize that there are zones of activity that must remain beyond the reach of federal law. The Service's recognition that there are cases where federal Indian law may trump the Code is relevant in the special case under consideration here. Payments to tribal board, commission and committee members do impact the internal governance of tribes. Those payments, and tribes' decisions to classify those payments as wages or other remuneration, reflects a policy choice by tribes about how to carry out its day-today governmental affairs. Tribes' decisions about how those payments should be made are therefore entitled to deference in administration of the Code.

B. Application of FICA to Governments

1. Federal, State, Local, and Foreign Governments

Employment taxes apply to governmental employers differently than private employers. Employment taxes impose a host of specific rules governing the obligations of state and local governments. The Social Security Act originally exempted state and local governments from FICA tax. The exemption of state and local governments was based

[47].Rev. Rul. 67-243, 1967-2 C.B. 236.

[48] .Rev. Rul. 62-16, 1962-1 C.B. 7.

[49] .Rev. Rul. 68-493, 1968-1 C.B.

upon concerns that the federal government lacked constitutional power to impose the taxes on state and local governments. In 1950, Congress amended the Act to allow states to elect to provide coverage for public employees. Under so-called "Section 218" Agreements, states could elect FICA coverage for designated categories of employees.[50] States were defined to include "instrumentalities of a State… one or more political subdivisions of a State or… a State and one or more of its political subdivisions."[51] Before 1991, state and local government employees who were not covered by a Section 218 Agreement were excluded from social security coverage. After 1991, state and local government employees were included in social security unless they were either covered by a Section 218 Agreement or were members of a qualifying public retirement system. Every state has a Section 218 Agreement in place. Governmental instrumentalities have entered into 60 additional Section 218 Agreements.

Section 218 Agreements cover positions rather than individuals. Accordingly, if a position, such as a public officer, is covered by the agreement, then every individual who occupies that position is covered by the agreement. Coverage by a Section 218 Agreement takes precedence over worker classification. The control test does not apply to classify a worker if that worker is covered by a Section 218 Agreement. Participation in a qualified public retirement plan also takes precedence over worker classification.

Workers in federal government service are not subject to the common law control test. Section 3122 of FICA empowers federal agency heads to administratively determine whether a worker is subject to FICA. The agency head is not required to apply the common law control test in making the determination. Employees of foreign governments are likewise exempted from FICA.[52]

2. Tribal Governments

The Service does not treat Indian tribes as governments for purposes of FICA. In the *Cabazon* case, the Service successfully argued that tribes could not be treated as states because FICA does not expressly reference tribes in the definition of a "state."[53] As a result of that courtroom victory, the rules that govern the FICA obligations of states and local governments do not apply to tribes. Because tribes are not treated as states, tribes cannot elect coverage for specific classes of employees under a Section 218 plan. Tribes likewise cannot decide whether social security coverage should apply to tribal workers by adopting qualified tribal retirement plans. This is so even though many tribes have retirement plans.

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[50] . 42 U.S.C.A. 416.

[51]. 26 U.S.C. 3401.

[52] . 26 U.S.C.A. 3401(a)(5).

[53]. 57 B.R. at 401, n. 3.

The Service's position in *Cabazon* shows the problem of selective incorporation in administration of the Code. In *Cabazon*, the Service took the position that FICA applied to tribes even though there is little evidence that Congress ever considered the question whether tribes should be included in social security and, if so, how. The Service successfully asserted that the lack of any reference in the Act to tribes means that tribes should be subject to the Act. At the same time, the Service argued, equally successfully, that the lack of any reference to tribes in the definition of "states" or "local governments" means that tribes should not be treated like states or local governments. While the Service's argument that tribes cannot be treated as state or local governments may be faithful to the text of the Act, the irony is unmistakable: the Service argues, on the one hand, that no express reference or other evidence is required to subject the tribes to withholding tax provisions of the Code. The Service argues on the other hand that express reference in the withholding tax provisions to tribes is required to treat tribes as states or local governments. The decision to include tribes within the definition of taxpayers subject to withholding tax but exclude tribes from the definition of a state or local government for purposes of withholding tax is particularly unfortunate because, as we discuss in the next section, the decision to exclude tribes from the definition of state or local government makes administration of the Code still more difficult.

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V. THE SPECIAL CASE OF TRIBAL OFFICIALS

A. Tribal Boards, Committees and Commissions

Indian tribes carry out a wide variety of governmental functions through boards, committees and commissions. These boards, committees and commission are an integral component of tribal government and society. Boards, committees and commissions provide an avenue of direct democracy for tribal members wishing to participate in the tribal government. Because tribal governments must direct both governmental and commercial functions, their reliance on subordinate boards, committees and commissions for political governance is at least as great as a state or local government.

The Wheeler-Howard Act revitalized tribes as political and social bodies. The Act empowered tribes to adopt tribal constitutions as a way to conduct political affairs. The Department of Interior proposed that tribes consider unified governments with a single body of representatives clothed with comprehensive powers. The Wheeler-Howard Act did not require a single unified government and not all tribes adopted a constitution. While many tribes did not adopt constitutions under the Wheeler-Howard Act, virtually all tribes have developed diverse policymaking bodies. The Department of Interior suggested that each tribe should consider constituting standing committees, boards or commissions to deal with at least the following subjects:

1. Citizenship or Membership
2. Finance
3. Education
4. Internal Improvements
5. Judiciary
6. Claims

Many tribes have constituted these committees. Several examples illustrate the diversity of tribal boards, committees and commissions. The Oneida Nation, for example, has both elected and appointed board committees and commissions.

- Examples of Oneida boards committees and commissions are:
    1. Election Board
    2. Trust/Enrollment Committee
    3. Appeals Commission
    4. Gaming Commission

5. Land Commission
6. Land Claims Commission
7. Oneida Commission in Aging
8. Oneida Nations School Board

The Oneida Nation has authorized boards, committees and commissions to help administer Tribal Policy for various areas such as elections and the environment. The Oneida Business Committee appoints committee and commission members in accordance with a comprehensive policy governing boards committees and commissions. Board members of corporations chartered by the tribe are appointed in accordance with the corporate charter of the entity. Additional examples are:

- Oneida appointed board committees and commissions include:
  1. Oneida Personnel Commission
  2. Oneida Police Commission
  3. Oneida Land Commission
  4. Oneida Library Board
  5. Oneida School Board
  6. Oneida Paw-wow Committee
- Prairie Band Potawatomi has authorized the following clubs, boards, committees and councils:
  1. Ethics Commission
  2. Land Committee
  3. Peacemaker Circle
  4. Gaming Commission
  5. Prairie Band Potawatomi Athletic Commission
  6. Boys & Girls Club Board of Directors
  7. Charitable Contributions Committee
  8. Constitution Committee
  9. Education in Indian Education Committees

10. Elder Advisory Committee
11. Employee of the Month Committee
12. Energy Committee
13. Enrollment Review Committee
14. Head Start Policy Council
15. Promotions Committee
16. JA Co. Committees that Care
17. JA Co. Joint Economic Council
18. Natural Resources Council
19. PARR Advisory Committee
20. Prairie Band Potawatomi Inter-agency Coordinating Council
21. Personnel Advisory Committee
22. Plan Board Committee
23. Paw-wow Committee
24. Soldier Creek Watershed Partnership
25. Solid Waste Advisory Committee
26. Tribal Emergency Response Committee
27. Tribal Review Committee
28. Water Planning Committee
29. Workers Appeal Committee

- The Navajo Nation Council exercises the Navajo Nation's legislative power. The Council is constituted of 88 Council delegates. The Nation is further divided into 110 chapters, which are local political subdivisions of the Nation. Residents of each Navajo Chapter elect four chapter officials: Chapter President, Chapter Vice-president, Secretary and Grazing Officer. In addition to electing the 88 Council delegates, Navajo Nation elects 440 additional subordinate political officials to help govern the Nation's affairs.

Additional examples of tribal boards, committees and commissions are set forth in Appendix A.[54]

B. Application of FICA to Tribal Board, Committee and Commission Members

The specific issue of the correct withholding tax of tribal board, committee or commission reflects the larger uncertainty about to treat tribes for purposes of administering the Code. The Code does not prescribe the withholding tax treatment of tribal board, committee or commission members. The most natural classification of tribal board, committee or commission members for withholding tax purposes would be treatment as "public officials." By regulation, the Service describes public officials as the holders of "public offices."[55] The Service describes public office to include any elective office of the United States and it possessions, a state or its subdivisions, or a wholly owned instrumentality of one of the forgoing; the president, vice-president, a governor, a mayor, a member of a legislative body, a judge, justice of the peace, a county or city attorney, a marshal, registrar of deeds and a notary public; a court appointed commissioner, receiver or referee; appointed members of a pollution control district. The list of recognized public officials does not include tribal officials. The Service has, in one tax court case, successfully taken the position that a tribal judicial officer was not a public official for purposes of withholding tax.[56]

The benefit of being treated as a public official is that the classification of public officials is largely effected by statute. States avoid the uncertainties inherent in classifying public officials under the control test either by covering them in a Section 218 plan or a qualified state retirement plan. For those state or local officials not covered by either, section 3401 of the Code defines public officials as "employees" for purposes of income tax withholding.[57] Section 1402 excludes most payments to public officials from the definition of net income for purposes of SECA. Because the Service excludes tribes from treatment as a state or local government, tribes do not have those options. Tribes may not elect to be covered by a Section 218 plan or a qualified retirement plan. Tribal board, committee or commission members therefore cannot escape the worker classification issue for payments made to them in their capacities as board, committee or commission members.

The Code does not statutorily classify public officials for purposes of administering FICA. Those public officials, both state and tribal, who are neither covered by a Section 218 plan, nor a retirement plan, remain subject to the control test. The classification of public officials, for withholding tax purposes, presents its own unique set of difficulties.

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[54] . Descriptions of tribal boards, committees and commissions were drawn from tribally-sponsored Web sites.

[55] T. Reg. 1.1402(c)-2(b).

[56] . *Doxtator v. Commissioner*, T.C. Memo 2005-113, 2005 WL 1163978 (U.S. Tax Ct).

[57] .26 U.S.C. 3401 (c).

The control test does not easily apply to public officials. Our everyday intuition is that the "political" and the "commercial" are different spheres of activity. In one of the very few cases to apply the common law control test to a public official, the Indiana Court of Appeals held that an elected county treasurer was not an "employee" within the meaning of the Emergency Jobs and Employment Act of 1974.[58] The Emergency Jobs and Employment Act provided benefits to workers who qualified as "employees" under the control test. The treasurer's working conditions were prescribed by the county but the treasurer's official duties were prescribed by state law. The Court observed that the logic of applying the control test in the context of a public official was "unsatisfying."[59] The Indiana court observed that "the application of the common law control test is not without pitfalls" and held that "the requisite control is lacking in the present case. In the conventional sense the county treasurer is neither "hired" nor "fired."[60] Stated differently, a legislative body does not become an employer just because it creates a public office.

The Service has nonetheless adopted a "one size fits all" approach to the classification of public officials. In the "Federal-State Reference Guide"[61], for example, the Service instructs that "holders of public office are excepted from self-employment tax and are presumed to be employees receiving wages."[62] The Service further advises that "elected officials are subject to a degree of control that typically makes them employees under common law. Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall by the public or a superior official. Very few appointed officials have sufficient independence to be considered common law employees."[63]

Similarly, Chapter 2 of the Tax Desk Guide for Indian Tribal Governments provides this example:

> Ms. Fran is a tribal member but **not** a council member. Ms. Fran is on the Beautification Committee. She is required to attend the Ms. Indian Pageant Committee meeting and is paid $50. Ms. Fran is considered an employee and is subject to withholding of federal income taxes, FICA, and Medicare tax. Ms. Fran will also be issued a Form W-2.[64]

The basis for the Service's conclusion, that all or virtually all appointed and elected public officials are employees, is not clear. It is possible that the Service reasons that

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[58]. Harrell v. Review Board, 176 Ind. App. 326, 375 N.E, 2d 672 (Ind. App. 1978)

[59] .176 Ind. App. at 331.

[60] . Id.

[61]. IRS Publication No. 963 (2007)

[62]. Id. at 4-7.

[63]. Id. at 4-8.

[64] .Desk Guide, p. 13.

Section 3401 and 1402 can be interpreted to apply to FICA. Alternatively, it is possible that the Service reasons that application of the control test to public officials always leads to the result that public officials are employees. Both approaches awkwardly attempt to fit public officials into the existing withholding tax framework. We can find no authority for the proposition that the definitions employed in the income tax withholding and in SECA apply to FICA. There is no statutory connection between the three provisions of the Code. The Chief Counsel recently issued a Program Manager Technical Assistance ("PMTA") advising field staff that Section 3401 does not apply to classify tribal public officials for purposes of FICA.[65] The PMTA advised that the classification of tribal committee and board members must be determined by reference to the control test.

Reasoning that the control test almost always leads to the conclusion that public officials are employees is also doubtful. The fact that the public may choose not to re-elect or to recall an elected official, for example, does not lead to the conclusion that the elected official is an employee. As the Indiana court observed, an elected official is not "hired" nor "fired" in the conventional sense. Contractors and employers alike retain the power to discharge their employees or contractors. If the ability to fire (or recall) an elected or appointed official were all that was required to find an employer-employee relation, then the distinction between an employee and independent contractor would disappear.

The analysis is still more complicated when applied to tribal board, committee or commission members because the Service does not treat tribes as states or tribal board, committee or commission members as public officials. Yet, the Service has attempted to fit tribal public officials into the rules governing state and local public officials. In PLR 941006, the Service has held that payments to a tribal council member were exempt from both SECA and income tax withholding.[66] The basis for the ruling is not clear. The ruling appears to rely on Section 1402. The 1402 regulations exclude most payments to public officials from SECA tax. The analysis in Ruling 941006 is similar to Ruling 59-354. In both cases, the Service reasons that the tribal public officials can be treated like state and local government public officials. To make sense of the similar treatment, tribes must implicitly incorporate the rules governing state employees or public officials into the rules governing tribal members even though tribes are told that they cannot be treated like states or public officials.

Treating tribal public officials "as if" they were statutory employees disadvantages tribes. Only a few state or local public officials are subject to the control test. Most are covered by either a Section 218 agreement or qualified plan. In contrast, all tribal public officials are subject to the control test. The scope of the problem of worker classification of tribal public officials is significant. There are currently 562 federally-recognized tribal governments in the United States. The classification of tribal workers impacts all of the

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[65]. PMTA (2008).

[66]. PLR 941006.

federally-recognized tribes. Those tribal governments pay approximately 9 billion in wages annually. No currently available data indicates what portion of those wages constitutes payments to members of tribal boards, commissions or committees. While the exact figures are not known, it is likely that a significant percentage of all wages paid by tribal governments, both cash and non-cash, are paid to elected or appointed members of tribal boards, committees and commissions. Assuming, for illustrative purposes, that every tribe establishes seven (7) boards, committees or commissions, then the total number of boards, committees would equal 3892. Further assuming that each of those boards, committees and commissions has seven members, then the total number of individuals subject to the worker classification issue would equal 27,244. If each of the 562 federally-recognized tribes had 29 committees, as does the Prairie Band Potawatomi, and we assume each of the 29 board committees or commissions have seven members, then the total number of individuals potentially subject to the worker classification issue would equal 114,086 tribal members.

The selective incorporation of tribes into the Code leaves tribes to guess about the correct tax treatment of their board, committee and commission members. Tribes are told that they are excluded from the statutory treatment afforded to state and local governments. Tribal public officials are told they are subject to the common law control test. As a result, the Service's informal classification of tribal public officials "as if" they were statutory employees is confusing. Not surprisingly, ITG field staff report that there is "deep disagreement" between the Service and tribes about classification of tribal board, committee and commission members. Tribes receive the Service's current treatment of tribal board, committee or commission members as if they are public officers with some skepticism. Tribes have watched over the past half century as the Service has selectively incorporated tribes into FICA. Those decisions were not always based on clear authority or history. Review of the Service's decisions over time show that the Service seeks to establish its authority over tribes and then, once established, to deal in an ad hoc way with the specific difficulties that arise as a result of imposing tax statutes in the first instance. Acknowledging that there remain uncertainties in federal law, that those uncertainties have an impact on tribes and using its discretion to take more flexible approach may serve the Service better going forward.

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VI. RECOMMENDATION

The Service should adopt a pre-filing program for tribes for worker classification issues. Section 7121 of the code authorizes the Service to "enter into an agreement in writing with any person relating to the liability of such person…in respect of any internal revenue tax for any taxable period." The Service has interpreted Section 7121 to authorize the Service to enter into pre-filing agreements for certain issues. We recommend extending pre-filing agreements to tribal withholding tax for two reasons. First, tribes are unlike other governments or other taxpayers. Because of their unique, pre-constitutional governmental status, federal Indian law holds that other federal laws do not always apply to tribes. Even the most stringent test for determining whether a federal law applies to tribes excepts some activities from the operation of some federal laws. The Service has in the past itself recognized that administration of the Code should take account of matters of core tribal concern. The special case of the withholding tax treatment of members of tribal boards, committees and commissions presents a matter of core tribal concern. The withholding tax treatment of members of tribal board, committees and commissions is therefore a good case for exercising the Service's authority under 7121.

Second, the withholding tax treatment of tribal board, committee and commissions members is unclear. The lack of clarity of treatment is not the product of a lack of guidance. Rather, the lack of clarity flows from the intersection between the control test as applied to public officials and the unique status of tribes as governments. The control test does not provide clear or consistent outcomes when applied to public officials. Our intuition is that public officials are not like wage employees or independent contractors. Luckily, federal law fixes that problem for most public officials by defining them as employees or independent contractors or otherwise removing them from the uncertainties of the control test. Not so lucky, tribal public officials are not defined as employees or independent contractors for purposes of applying the control test. The status of members of tribal boards, committees or commissions remains unclear and therefore subject to varying interpretations through time. Pre-filing agreements would help resolve some of the uncertainties surrounding tribal public officials by injecting some flexibility into the determination of the worker classification of members of tribal boards, committees and commissions.

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Appendix A. Examples of Tribal Boards, Committees and Commissions

The St Regis Mohawk Tribe has boards committees and commission that are appointed. Appointive committees include:

1. Police Commission
2. Gaming Commission
3. Housing Authority
4. Membership
5. Election Commission Governance
6. Business Task Force
7. Lands and Estates
8. Tribal Ethics Office
9. Judicial Advisory Board

The Pechanga Band of Luiseno Indians has various Tribal Council committees:

1. The Caring for Culture and Environment Committee
2. Pechanga Cultural Committee
3. Pechanga Water Committee
4. Pechanga Enrollment Committee
5. Pechanga Development Corporation
6. Pechanga Gaming Commission

The Northern Cheyenne Tribe has the following boards, commissions and committees:

1. The Board of Health
2. The Tribal Housing Authority Board
3. The Elderly Commission
4. The Natural Resource Board
5. Utility Commission

6. Tribal Employment Rights Office
7. Cultural Commission
8. Credit Committee
9. Scholarship Committee

The Mashpee Wampanoag Tribe has the following committees:

1. Wampanoag Housing Department Housing Commission
2. Health Advisory Committee
3. Tribal Education Committee
4. Tribal Youth Committee
5. Judiciary Committee
6. Tribal Education Committee
7. Tribal Youth Committee
8. Judiciary Committee
9. Fish Wildlife and Natural Resources Committee

The Ketchikan Indian Community has the following boards and committees:

1. Executive Committee
2. Subsistent/Cultural Committee/Elders
3. Finance Committee
4. Housing Committee
5. Health Committee
6. Education Committee
7. Education/Land & Site Committee
8. Enrollment/Veterans Committee
9. Policy and Procedures Committee
10. Economic Development Committee

11. Personal/Grievance Committee

12. KIC Tribal Housing Authority

13. KIC Contract Health Appeals Committee

Gila River Indian Community has several standing committees appointed by the Tribal Council. Standing committees are responsible for the review of matters directly related to the welfare of the community and in specific areas. After review at the committee level, recommendations are made to the Tribal Council for final action. A special committee may be appointed for a specific purpose, and upon completion, the special committee is automatically dissolved. Gila River standing committees include:

1. Education Standing Committee

2. Health and Social Standing Committee

3. Cultural Resource Standing Committee

4. Legislative Standing Committee

5. Economic Development Standing Committee

6. Natural Resources Standing Committee

7. Government and Management and Standing Committee

The Fort Peck Tribe has the following committees:

1. Constitutional Reform Committee

2. Law and Justice Committee

3. Land Committee

4. Health and Education Committee

5. Oil and Gas Committee

6. Social Services Committee

7. Economic Development Committee

The Coquille Indian Tribe uses committees to assist the Tribal Council to assist in providing services to its members and receive advice on programs and/or projects the tribe is developing. Committees are created by the Tribal Council to act in an advisory capacity to identify needs of tribe and recommend courses of future action to resolve the needs. Committees work with Coquille Indian Tribes staff and some occasions outside organizations on matters related to the committees duties. Some committees work on a range of broad issues such as developing cultural projects and programs or providing feedback on the tribe's educational needs. Other committees have a narrow focus such as reviewing enrollment applications or helping plan the development of specific projects.

The Coquille Indian Tribe has the following committees:

1. CHC Safety Committee
2. Cemetery Committee
3. Culture Committee
4. Education Committee
5. Elders Committee
6. Election Board
7. Emergency Preparation and Disaster Mitigation Committee
8. Enrollment Committee
9. Fish & Wildlife Committee
10. Health Advisory Board
11. Political Committee
12. Realty Committee
13. Gaming Commission
14. Housing Authority

The Porch Band of Creek has created the following boards:

1. Muskogee Metal Works
2. Muskogee Inn Board
3. CIE Development Authority
4. Magnolia Branch
5. Perdido River Farms
6. PCI Gaming Authority

7. Gaming Commission
8. Election Board
9. Utility Authority
10. Housing Authority
11. Endowment Committee
12. Investment Committee
13. Environmental Committee
14. Recreation Authority
15. Education Advisory Committee
16. Calvin McGhee Cultural Authority
17. Ethics board
18. Enrollment Committee
19. TERO Commission
20. Housing Authority
21. Tribal Gaming Commission
22. Wellness and Activities Authority
23. Cultural Authority
24. Utilities Authority

The Constitution of the Cheyenne and Arapaho Tribes adopted in 1934, but not officially approved, provided for committees on health, legislation and resolutions, budget, audit and entertainment. The Constitution of the Seneca Indian Council of Oklahoma provides for a special grievance committee elected by the members of the tribe which investigates complaints against the tribal Council and calls general meetings of the tribe as needed.[67]

Federal law often requires the formation of a board or boards. Under the Indian Gaming Regulatory Act, for example, the tribe is the primary regulator of Indian Gaming. As such, most tribes have constituted separate Tribal Gaming Commissions to administer

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[67] See generally Wilkins, “On The Drafting Of Tribal Constitutions” (2006).

the regulatory function. The NIGC advises that effective regulatory oversight requires a functional separation between the operation of Tribal Gaming and the regulation of Tribal Gaming.

ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Indian Tribal Governments: Report on the Implementation of Tribal Economic Development Bonds Under the American Recovery and Reinvestment Act Of 2009

Wendy Pearson
Bobby Jo Kramer
Joe Lennihan

June 9, 2010

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Table of Contents

I. INTRODUCTION

A. Executive Summary

This report evaluates the prospects for the tribal economic development bond ("TEDB" or "TEDBs") provisions of the American Recovery and Reinvestment Act of 2009 ("ARRA" or "the Act"). ARRA liberalized the ability of tribal governments to issue tax exempt bonds. ARRA authorizes tribal governments, for the first time, to issue tax exempt bonds in the same manner as state and local governments. Prior to the passage of ARRA, tribal governments could issue tax exempt bonds only in very limited circumstances. ARRA, however, limits the amount of tribal tax exempt bonds that may be issued in the same manner as states to a total of $2 billion dollars. ARRA delegates to the Secretary of Treasury and the Secretary of Interior responsibility for determining how to allocate ARRA's $2 billion in tax exempt issuances among the various tribes. In addition, ARRA requires the Department of Treasury to report to Congress on the effect of ARRA's liberalization of the use of tribal tax exempt bonds within one year of passage of the Act. The Advisory Committee on Tax Exempt and Government Entities-Indian Tribal Governments subgroup ("ACT") intends this report to assist the Secretary of Treasury in reporting to Congress on the effect of the new tribal bond authority and in making recommendations regarding tax exempt tribal bonding authority going forward.

The ACT recommends that Treasury report to Congress that there is a demonstrable need for TEDBs. The volume of applications for TEDBs leaves little doubt that tribes wish to use tax exempt financing where possible. The full $2 billion was allocated in a remarkably short time, just over six months. The initial applications for TEDB allocations exceeded the available volume. The over-subscription should not come as a surprise. The depth and breadth of need for infrastructure and economic development in Indian country is longstanding and well documented.

In addition to reporting that there is a strong need for tax exempt financing in Indian country, the ACT suggests that a full report on the effectiveness of the TEDBs within the given time must necessarily be incomplete. The actual benefits to tribes of tax exempt bond provisions may not be known for several years. For the promise of ARRA to realize itself, more time will be needed to allow tribal tax exempt issuances to find their place in the national capital markets. Although ARRA legislates that tribal governments are to be placed upon an equal footing with states, there remain asymmetries between tribal governments and state governments that will affect TEDBs' marketability and feasibility and, consequently, their value to tribes as a financing vehicle. We describe some of those asymmetries in this report. We conclude that those asymmetries will take time to resolve themselves. Accordingly, we advocate for patience in evaluating the full benefits of the TEDBs. Whether TEDBs ever fulfill the purpose of facilitating lower cost borrowing, may also require changes in executive policy and, possibly, enactment of additional laws to truly put tribes on an equal footing with state and local governments.

As of the time of writing of this report, Treasury has not yet made its report to Congress. In light of the President's recent Executive Order 13175, which mandates the implementation of a Tribal Consultation Policy by all federal agencies, the committee responsible for implementing Treasury's consultation policy with Tribes has determined that direct input from the Tribes would be beneficial to informing and articulating Treasury's recommendation to Congress on the TEDBs program.[1] ACT unequivocally concurs with this recent decision to delay Treasury's report and recommendations to Congress in order to obtain input directly from the tribes. ACT further advocates for continuing consultation between Treasury and the tribes on all matters relating to the use and efficacy of TEDBs and tax exempt financing for tribes.

ACT also suggests that the Internal Revenue Service ("IRS" or "Service") will have to continue to provide guidance to the tribes on the use of 26 U.S.C. § 7871(c) financing for "essential governmental function" activities. It is too soon to determine whether ARRA's expansion of tax exempt financing *vis a vis* TEDBs will render superfluous the Section 7871(c) financing options or otherwise require further Congressional action to remedy the overly restrictive interpretation of "essential governmental function." Likewise, the Internal Revenue Service should work collaboratively with tribes to ensure compliance with the TEDB financing provisions and restrain from utilizing audits as a means of ensuring such compliance over the next several years.

B. Sources and Methods

ACT surveyed tribal governments and their representatives for their direct input on this report. ACT also sought input from tribal associations such as National Congress of American Indians (NCAI), the Native American Finance Officers Association (NAFOA), and National Intertribal Tax Alliance (NITA). ACT reviewed all comments sought and received by the IRS for purposes of determining the TEDB allocation methodology. ACT reviewed the text and history of ARRA and available literature describing historical problems with issuance of tribal tax-exempt issuances. ACT consulted with underwriters, banks, bond financing experts, current tribal bond holders and other industry representatives involved in tribal bond issuances. ACT would like to acknowledge the contribution of the work of prior Advisory Committee on Tax Exempt and Government Entities committee through their report dated June 9, 2004, "Tribal Advice and Guidance Policy," upon which portions of this report are based. Finally, we would also like to acknowledge the helpful assistance of Cliff Gannett, Director of Tax Exempt Bonds office of IRS and Christie Jacobs, Director of Indian Tribal Governments office of IRS.

[1] Federal Register, Part IV, The President, November 5, 2009-Tribal Consultation.

II. THE CREATION OF TEDBS UNDER THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

President Obama signed the American Recovery and Reinvestment of 2009 (“ARRA”) into law on February 17, 2009.[2] ARRA authorizes new means by which local governments can finance capital improvements. ARRA authorized bonds including Build America Bonds (“BABs”), bonds to finance rental housing construction or first-time home buyer loans, Qualified School Construction bonds, and Qualified Recovery Zone bonds, Clean Renewable Energy bonds, Qualified Energy Conservation bonds, among other tax incentives. Tribes will almost certainly benefit from many of these new types of bond financing options. Section 1402 of the Act, in addition, provides a new type of bond, the Tribal Economic Development Bond, targeted specifically for use by tribal governments. Section 1402 amends Section 7871 of the Internal Revenue Code (“Code” or “I.R.C.”) to allow tribal governments to issue tax exempt bonds on similar bases as state or local governments. ARRA does not displace tribes’ prior ability to issue bonds under Code Section 7871(c).

ARRA Section 1402 does place specific limitations on the uses of TEDBs. New Code Section 7871(f)(B) establishes a nationwide volume cap on issuances of the new bonds to $2 billion. The $2 billion cap is to be allocated between the tribal governments in such manner as the Secretary of Treasury and the Secretary of the Interior determine to be appropriate. Once the volume cap is reached, there can be no further issuances of tribal tax exempt bonds. The Act does not impose a time limit on the issuances of TEDBs. The Joint Committee on Taxation estimates that the tax cost of TEDBs is $30,000,000 over a four year period. The cost of TEDBs is a small fraction of the cost of many of the other ARRA bonds.[3]

Within the $2 billion allocation, there are further restrictions. Section 1402 prohibits tribal governments from using TEDBs to finance facilities or for purposes outside Indian reservations. Section 1402 also specifically prohibits the issuance of TEDBs for the construction or improvement of a building or part of a building in which a tribal government conducts class II or class III gaming, or for the construction or improvement of any other property that a tribe actually uses to conduct tribal gaming.

ARRA Section 1402 suggests that Congress was concerned about the possible effects of tribal economic development bond issuances. ARRA Section 1402 directs the Secretary of Treasury to make a study “of the effects” of Section 1402, “including the Secretary’s recommendations” regarding Section 1402. Congress’ aim in calling for a report is not clear. It is possible that Congress is simply interested in monitoring the benefits of TEDBs as part of a larger effort to monitor the benefits of ARRA. It is equally possible Congress’ enactment of ARRA Section 1402 indicates a specific shift in policy toward tribal tax exempt bonds. The ITG workgroup can find no similar reporting

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[2] Pub. L. No. 111-5, 123 Stat. 115 (2009).

[3] Joint Committee Print (JCS-1-10), “Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013,” January 11, 2010. The Print estimates that Build America Bonds will cost $12.5 Billion.

requirement in the provisions for the other new bonds created by ARRA. The TEDB reporting requirement therefore suggests a shift in policy. Congress has in the past not followed a uniform policy regarding the appropriate scope of tribal tax exempt issuances. Congress' uneven treatment of tribes has resulted in considerable criticism from within Indian country and elsewhere.[4] Accordingly, the tribes' optimism about the enactment of ARRA Section 1402 is tempered by the tribes' concerns about Congress' purpose in requiring a turnaround report on ARRA Section 1402 and Treasury recommendations about the future of tribal tax exempt financing.

[4] ACT Report, "*Tribal Advice and Guidance Policy,"* (June 9, 2004); Schroeder, "*Tribal Advocates Decry 'Unequal Treatment' for Tax-Exempt Projects"* The Bond Buyer (January 21, 2010); Clarkson *Tribal Bondage: Statutory Shackles and Regulatory Restraint On Tribal Economic Development,* 85 *N.C. L. Rev.* 1009 (2007).

III. HOW ARRA CHANGES PRIOR LAW CONCERNING TRIBAL TAX-EXEMPT ISSUANCES

To understand why tribes may express skepticism about ARRA Section 1402, it is helpful to understand prior federal policy toward tribal tax exempt bonds. The United States has recognized Indian tribes as separate sovereigns since the pre-constitutional era. Interest income on state bonds has been exempt from federal taxes since the original enactment of federal tax code in 1913. Surprisingly, prior to the 1960's, the question whether to exempt interest income on tribal bonds appears never to have been asked. The Service's first administrative attempt at defining the issue of tribal tax exempt bonding authority, or more particularly the issue of whether Indian tribal governments were to be treated the same as states for federal tax purposes, was Revenue Ruling 67-284.[5] Ruling 67-284 administratively determined that tribes were not taxable entities. A year later the IRS administratively determined that tribes could not be considered as state or local governments for purposes of exemption from federal taxation.[6] The question arises because Section 103 of the Internal Revenue Code excepts from gross income "interest on any state or local bond" (including the District of Columbia and possessions of the United States). Code Section 103 does not expressly mention Indian tribes. A recurrent question in federal Indian law is whether a federal statute that does not expressly reference Indian tribes should be interpreted to include tribes. Federal courts have not always answered the question in the same way. A related question arises whether federal statutes that apply specifically to "states" should be read to apply to Indian tribes. The answer to that question has also received different answers. The different answers reflect the deeper difficulty administrative agencies have in deciding whether and when federal laws should apply to tribal governments.

A. The Indian Tribal Government Tax Status Act of 1982 Allowed Limited Tax-Exempt Issuances

The Indian Tribal Governmental Tax Status Act of 1982 ("Tax Status Act") clarified tribal governments' ability to issue tax exempt bonds. (codified as 26 U.S.C. §7871).[7] The Tax Status Act attempted to clear up the growing uncertainty about whether tribes should receive the same treatment as state and local governments in the Code. The Tax Status Act legislation followed a split approach to answering that question. On the one hand, the Act allowed a deduction from federal income tax for taxes paid to Indian tribes, allowed taxpayer deductions for contributions to tribal governments from income, estate and gift tax purposes, and exempted tribal governments from liability for various federal excise taxes. The Act made permanent the rules treating Indian Tribal governments, or subdivisions thereof, as states.[8] "Indian Tribal government" means the

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[5] Revenue Ruling 67-284, 1967-2 C.B. 55.

[6] Revenue Ruling 68-231, 1968-1 C.B. 48.

[7] Title II of Pub. L. No. 97-473, 966 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 CB 510, 511, §1065 of the Tax Reform Act of 1984, 1984-3 (Vol. 1) Cumulative Bulletin 556.

[8] *See* Revenue Procedure 86-17 and Revenue Ruling 86-44.

governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions.[9] This definition is used to comprise the federally recognized list as determined by the Bureau of Indian Affairs.

On the other hand, the Tax Status Act also limited tribes' ability to use either tax exempt general obligation or private activity bonds. The Tax Status Act limited tribal use of tax exempt private activity bonds to certain manufacturing facilities. Even in that limited circumstance, tribes could issue private activity bonds only if, in addition to being qualified manufacturing facilities, 95% of the bond proceeds were used to finance property acquired, constructed or improved by the tribal government, the property was subject to depreciation, the property was on Indian lands held in trust by the United States for at least five years before the issuance of the manufacturing bond and would be held while the bonds were outstanding, and finally only if the manufacturing met certain, restrictive, employment tests.[10] Because of the restrictions heaped upon these tribal issuances, few tribes have ever issued manufacturing facility bonds.

The Tax Status Act limited the ability of tribal governments to issue governmental bonds by allowing tribal bonds to issue only for activities that could then be classified as "essential governmental functions." The Act itself did not define the term "essential governmental functions." A Congressional Conference Committee Report stated that "essential governmental functions" included projects like "schools, streets, and sewers."[11]

In 1984, the Service promulgated regulations to implement the Tax Status Act. Treasury Regulation §305.7871-1(d) defined "essential governmental function" as any function that is either eligible for funding under the Snyder Act or the Indian Self-Determination Act or an essential governmental function as defined in Section 115 of the Code when conducted by a state or political subdivision.[12] The Service's interpretation of the scope of tribal tax exempt bonds was broad. The Snyder Act and the Indian Self-Determination Act allow the federal government to provide funds for tribal self-governance and self determination. The Act includes providing "relief to Indians," "general support," and "industrial assistance and advancement." In effect, Treasury Regulation 305.7871-1(d) applied the essential governmental services test to tribal bond issuances in the same broad way that it applied the essential governmental services test to state and local government bond issuances.

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[9] 26 U.S.C. Sec. 7701(a)(40)

[10] 26 U.S.C. §7871 (C)(3)

[11] H.R. Rep. No. 97-984, at 16-17 (1982) (Conf. Rep.), as reprinted in 1982 U.S.C.C.A.N. 4598, 4602.

[12] Treas. Reg. §305.7871-1(d); 26 U.S.C. 115.

B. The 1987 Amendments To The Indian Tribal Government Tax Status Act Restricted The Scope Of Tax Exempt Issuances

Congress was not happy with the Service's interpretation of the scope of tribal tax exempt issuances. Some of the displeasure is reported to have arisen in response to negative press involving tribal bond issuances to acquire off-reservation industrial or commercial projects. The information was anecdotal and, quite possibly, simply incorrect.[13] In fact, between 1982 and 1988, tribes issued bonds for seven projects totaling $300 million dollars. Nonetheless, in response, Congress amended the 1982 Tax Act to further restrict the use of tribal tax exempt issuances.[14]

The Report of the House Committee clarifies its reasons for restricting the scope of tribal tax exempt issuances as follows:

> The committee is extremely concerned about recent reports of Indian tribal governments issuing tax-exempt bonds for what are substantively interests in commercial and industrial enterprise. . . . [W]ith respect to bonds issued by Indian tribal governments, the term essential governmental function does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by States and local governments with general taxing powers. For example, issuance of bonds to finance commercial or industrial facilities (e.g., private rental housing, cement factories, or mirror facilities) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception.[15]

As amended, Code Section 7871 provided that interest income on tribal bonds shall not be exempt from income tax unless substantially all of the proceeds are used in the exercise of the tribe's essential governmental function.[16] For purposes of I.R.C. § 7871 the term "essential governmental function" Congress added the definition of essential government functions to mean functions that are "customarily performed by State and local governments with general taxing powers."[17]

C. Administrative Interpretations of The Amended Indian Tribal Government Tax Status Act Restrict Tribal Tax Exempt Issuances

Since the 1987 amendments, the Service has issued little guidance defining "essential governmental functions" as reformulated by the 1987 amendments. The Service has

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[13] For a description of the seven projects, see Ellen April, *Tribal Bonds: Indian Sovereignty and the Tax Legislative Process*, 46 Admin. L. Rev. 333 (1994).

[14] Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 201 Stat. 1330-1, 1330-455 (1987) (codified at 26 U.S.C. § 7871(e))

[15] . H.R. Rep. No. 100-391, at 1139 (1987), as reprinted in 1987 U.S.C.C.A.N. 2313-1.

[16] 26 U.S.C. § 7871(b).

[17] 26 U.S.C. § 7871(e).

not been able to provide formal guidance in the form of regulations to help tribes identify which activities constitute an "essential governmental function" "customarily performed" by state and local governments. And, the Service's evaluation of projects for exempt financing, as set forth in the handful of private letter rulings are, of course, restricted to the affected taxpayer.

The first ruling occurred in November 2002. The Service issued Field Service Advice 20024712 ("FSA") to address an issue of whether the construction and operation of a golf course by an Indian tribe constitutes the exercise of an "essential governmental function" within the meaning of I.R.C. Section 7871(e). The FSA employs a subjective balancing test in which the nature and purpose of the activity is examined to determine whether the activity is more commercial or more governmental. If the activity is determined to be predominantly commercial, then the activity will not be an essential governmental function. The FSA concludes that construction and operation of a golf course does not involve an essential governmental function of a tribe. The FSA concludes that a golf course is not an essential governmental function even though there were more than 2645 publically owned golf courses developed by state or local governments using tax exempt financing at the time the FSA was issued.[18] This FSA set off a maelstrom in the tribal finance community, who did not see this as credible or effective guidance.

In late 2006, the IRS tried to tackle the problem of insufficient guidance for tribal finance bonds. The Service acknowledged that there were an increasing number of instances in which tribes raised questions about the application of I.R.C. § 7871(e). Anticipating additional questions, the IRS issued an Advance Notice of Proposed Rulemaking (ANPRM) and sought public input in advance of issuing proposed rules pertaining to tribal issuers and state and local governments issuing for the benefit of tribes.[19]

The ANPRM proposes that an activity would be considered an essential governmental function customarily performed by a state or local government when:

(1) there are numerous state and local governments with general taxing powers that have been conducting the activity and financing it with tax-exempt governmental bonds;

(2) state and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds for many years; and

[18] Ellen April, *Tribal Bonds: Indian Sovereignty and the Tax Legislative Process*, 46 Admin. L. Rev. 333 (1994)(describing the Las Vegas Paiute tribe's effort to obtain tax exempt financing for a golf course): Schroeder, *"Tribal Advocates Decry 'Unequal Treatment' for Tax-Exempt Projects"*, The Bond Buyer, (January 21, 2010)("the debate reached a boiling point in 2005 when the IRS mistakenly released a field service memo pertaining to a 2002 audit of a bond-financed golf course built by the Las Vegas Paiute tribe that suggested it might not be able to prevail if it were legally challenged over the issue").

[19] Announcement 2006-59, *2006-2 C.B. 388.*, REG. 118788-06, 71 Fed. Reg. 45474.

(3) the activity is not a commercial or industrial activity.

Published comments from tribes and the bond community appear to generally oppose the proposed regulation on numerous grounds, including among other things, the imposition of a commerciality prohibition and the lack of clearly identifiable safe harbors.[20] Regulations have not been proposed.

In the meanwhile, there have been a handful of IRS rulings from 2006 through 2009. The rulings apply, in whole or part, the proposed regulatory standard for evaluating tribal finance bonds. For example, the IRS ruled during this time that the construction and operation of hotels and a convention center was not an exercise of an essential governmental function based upon the failure of the project to satisfy the criteria of prevalence and duration among state and local governments.[21] Tribal proceeds from conduit financings were held also to be subject to the "essential government function" test in the same way as if the Tribe were the bond issuer.[22] At the same time, two financing projects were permitted. The IRS allowed for tax exempt financed construction and operation of a tribal museum, cultural center, government offices, emergency services building, all contiguous to a casino. [23] The IRS noted that these projects were not commercial or industrial in nature, even though infrastructure improvements to support these developments would also serve the casino. The IRS also permitted a taxpayer to finance an electric generating facility through tax exempt financing. A political subdivision of the Tribe was the borrower and the issuer of the bond was a county electric district created by the state. The electricity was to be provided to the reservation on a non-profit basis. The IRS held this was an activity that is conducted regularly by state and local governments and is not commercial in nature due to the non-profit aspect of the service. [24]

Unfortunately, these rulings do not provide clear guidance and the regulation effort appears stalled. Indeed, the effort to define and implement vague standards such as what is "customary" or "essentially governmental" in nature is fraught with difficulties and controversy. Lacking clear guidance, tribal governments have not used tax exempt financing authorized by Code Section 7871(c). Code Section 7871(c) has become a dead letter. Tribes have issued few bonds under 7871 (c).

D. ARRA Restores The Original Scope Of Tribal Tax Exempt Issuances

ARRA's addition of TEDBs to Code Section 7871 permits Indian tribal governments to finance a broader range of governmental projects than are permitted under the

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[20] See, *for e.g.,* 2007 TNT 28-24, NABL Comments on Proposed Rules on Tribal Finance Bonds; 2006 TNT 224-23, Tribe Seeks Delay in Action on Proposed Rules on Tribal Finance Bonds.

[21] TAM 200704019.

[22] Technical Advice Memorandum (TAM) 200603028; *see also,* TAM 200705027.

[23] PLR 200648024.

[24] PLR 20091101.

restrictive “essential governmental function” financing options.[25] Tribes can now finance projects (subject to the restrictions of I.R.C. § 7871(f)(3)(B)) such as hotels, convention centers, and golf courses, as well as projects involving certain qualified private activities, to the same extent and subject to the same limitations imposed on State and local governments. The tribes can also use the Bonds for refunding issues, to the same extent as State and local governments. This indeed represents an important expansion of the opportunity for tribes to obtain lower cost financing through the capital markets.

ARRA section 1402 does not change the limiting nature of I.R.C. Section 7871(e) or modify prior administrative interpretation of “essential governmental function.” This remains an important issue to resolve because ARRA allows only $2 Billion in tax-exempt TEDB financing. As we describe below, the economic development needs of Indian tribes exceed $2 Billion. Once the $2 billion allocation is exhausted, tribes will be able to issue tax exempt bonds only through Section 7871 (c). The lack of clarity over the permissible scope of tax-exempt issuances under Section 7871(c) effectively requires tribes to obtain a private letter ruling or other binding guidance before issuing tax exempt bonds. Obtaining guidance adds years to the life of a tribal project. ARRA does not remedy the dilemma faced by tribes and the IRS in deciding which projects will qualify as essential governmental functions. Accordingly, the recommendations set forth by ACT in 2004, calling for the withdrawal of FSA 200247012 and formal guidance on what constitutes “essential governmental function,” remains relevant.[26] As currently interpreted, Section 7871(c) provides little incentive for tribes to pursue tax exempt bond issues.

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[25] Notice 2009-51, Internal Revenue Bulletin 2009-28, July 13, 2009

[26] ACT Report, “*Tribal Advice and Guidance Policy*,”(June 9, 2004).

IV. IMPLEMENTATION OF TEDBS

The Department of Treasury, in consultation with the Secretary of Interior, was charged with the responsibility of determining how to allocate the $2 billion national volume cap for TEDBs among the Indian tribal governments.[27] The Service moved quickly to implement the TEDB allocation. Consistent with ARRA's purpose of quickly stimulating and improving national economic conditions, and due to the short time frame of one year for reporting to Congress on the efficacy of TEDBs, the Service's goal was to get TEDBs "on the street" as quickly as possible.

To determine an allocation methodology, the IRS sought input from all 562 federally recognized tribes. The IRS sent a letter to the Tribes requesting their input on methods for allocating the TEDB volume cap and received numerous responses before the end of March, 2009. As required by the statute, the IRS also coordinated with the Department of Interior requesting the agency's input on allocation methods. The Service then issued Notice 2009-51 on July 13, 2009. Notice 2009-51 identified the allocation methodology based on Tribal input, and set forth terms and instruction for applying for TEDB volume allocations.

A. IRS Notice 2009-51 Generated Overwhelming Applications for Allocation of Volume Cap

Notice 2009-51 solicited applications for allocations of the $2 billion bond authorization. The Notice provided related guidance on the following: (1) eligibility requirements that a project must meet to be considered for a volume cap allocation, (2) application requirements, deadlines, and forms for requests for volume cap allocations, (3) the method that the Internal Revenue Service and the Department of the Treasury will use to allocate the volume cap.

The deadlines in which to apply for allocations were administratively determined by the Service. A relatively short time frame was established, at least in part, in response to the comments of many Tribes that a more generous timetable for completion presents a risk that allocation may be handed out but then languish unconsummated on projects that cannot feasibly get funded. To receive an allocation from the first $1 billion of volume cap allocated ("First Tranche"), an application must have been filed with the IRS on or before August 15, 2009. Bonds from the First Tranche are required to be issued by December 31, 2010. To receive an allocation from the remaining volume cap ("Second Tranche"), an application must have been filed with the IRS on or before January 1, 2010. Bonds from the Second Tranche are required to be issued by December 31, 2011.

The application process required the Tribe to provide the following information:

1. Proof that the applicant is a federally recognized Indian tribe;

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[27] 26 U.S.C. §7871(f)(1).

2. Dollar amount of volume cap requested;

3. Project Description, including location, expected start dates for construction and completion, a statement that the project will not be used for gaming, and a description of regulatory approvals needed;

4. Plan of Financing, including a description of who is providing the financing, what the sources of repayment are, estimated date for issuing bonds, and a schedule for spending the proceeds;

5. Statement of readiness that the Tribe expects to issue the TEDBs within the applicable deadline;

6. Statement whether the Tribe consents to the IRS disclosing certain details of the project and the allocation received-consent is optional; and,

7. Attestation to the accuracy of the information in the application.

Substantial changes in the described project after an allocation is made are not permitted. Notice 2009-51 provides, however, that "insubstantial deviations" are permitted and the IRS will determine what constitutes insubstantial or substantial deviation based on the facts and circumstances. Generally, criteria applied in other tax exempt borrowing contexts will be used to make this determination. The IRS has indicated that, based on this restriction, Tribes cannot transfer their allocation to another Tribe.

The Service has administratively placed a time limit on the use of the allocation. Notice 2009-51 provides that bonds that are not issued by December 31, 2010 for the first tranche are forfeited. Bonds that are not issued by December 31, 2011 for the second tranche are forfeited. Forfeited allocations will be re-allocated by the Service. The Service has not determined how it will re-allocate forfeited allocations.

1. Allocation of the First Tranche

The first tranche of TEDB allocations was issued on September 15, 2009.[28] There were a total of 58 applicants requesting a total of approximately $1.3 Billion in the first tranche. The allocation totaled $999,999,999.86 and all 58 applicants received an allocation. The allocations were made on a pro rata basis, with the allocable pro rata amount being capped at $30 Million, and due to the pro rating process, those requesting the $30 million cap had their allocation pared down to $22.5 Million. The allocation of the first tranche was distributed among 44 tribes in 21 different states. Allocations were requested for a wide variety of projects. One common reason that tribes applied for allocations was to refund or replace existing debt.

[28] IR 2009-18.

2. Allocation of the Second Tranche

The second tranche of TEDB allocations was issued on February 11, 2010.[29] The second tranche was over-subscribed, with a total of 76 applicants requesting $3 Billion. The allocation totaled $1,004,513,017.38. In the second tranche, some tribes submitted multiple applications for multiple projects. Some Tribes who received an allocation in the first tranche requested another allocation in the second tranche. Tribes who received allocations in the first tranche were allowed to receive an additional allocation in the second tranche on equal footing with new applicants. As with the first tranche, the second tranche was allocated pro rata and individual applications for allocation were capped at $30 Million. A small number of tribes that applied for allocations out of the first and second tranches received aggregate allocations above $30 million. Any excess over $30 Million was reallocated among the Tribes who requested under $30 Million. The allocation of the second tranche was distributed among 66 tribes in 18 different states. The states with the greatest number of recipients were California, with 27, and Oklahoma, with 10 recipients.

Significantly, no Alaska Native Tribes submitted an application for a TEDB allocation. Informal surveys conducted by ITG found that many of the Alaska Native Tribes were wholly unaware of the opportunity or misunderstood the application process.

[29] IR 2010-20.

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V. Comparative Features State and Local Government Tax Exempt Financing

A. State And Local Tax Exempt Financing

1. Uses of State and Local Government Tax Exempt Issuances

State and local governments generally can use tax-exempt municipal *general obligation* bonds to finance an unspecified broad range of projects and activities. General obligation bonds are repaid from any of the issuer's available funds and secured by the general credit of the issuer. State and local governments can use tax-exempt municipal *private activity bonds* to finance certain specified types of projects and activities without regard to the level of private involvement. Private activity bonds are repaid from the revenues generated by the project being funded by the issuance and are secured by the project itself.

Tax exempt governmental general obligation bonds are issued for a broad range of activities. In addition to issuing bonds for "schools, streets and sewers," state and local governmental bonds have been issued for hotels, convention centers, stadiums, racetracks and golf courses. As indicated earlier, this governmental bonding authority exceeds that of tribes who are limited only to governmental bonds for "schools, streets and sewers."

State and local governments can issue tax exempt private activity bonds for the following: (1) airports, (2) docks and wharves, (3) mass commuting facilities, (4) facilities for the furnishing of water, (5) sewage facilities, (6) solid waste disposal facilities, (7) qualified low-income residential rental multifamily housing projects, (8) facilities for the local furnishing of electric energy or gas, (9) local district heating or cooling facilities, (10) qualified hazardous waste facilities, (11) high-speed intercity rail facilities, (12) environmental enhancements of hydroelectric generating facilities, (13) qualified public educational facilities, (14) qualified green buildings and sustainable design projects, (15) qualified highway or surface freight transfer facilities, (16) qualified mortgage bonds or qualified veterans mortgage bonds for certain single-family housing mortgage loans, (17) qualified small issue bonds for certain manufacturing facilities, (18) qualified student loan bonds, (19) qualified redevelopment bonds, and (20) qualified 501(c)(3) bonds for the exempt charitable and educational activities of § 501(c)(3) nonprofit organizations.[30]

State and local governments can issue private activity bonds for other purposes only if: (1) not more than 10 percent of the bond proceeds are used for private business use and (2) the debt service on no more than 10 percent of bond proceeds is payable or secured from payments or property used for private business use. In addition, special rules under I.R.C. §§ 141(b)(3) and 141(c) further limit the use of tax-exempt

[30] 26 U.S.C. § 141.

governmental bonds in certain circumstances involving disproportionate or unrelated private business use and private loans.

2. Markets for State and Local Government Tax Exempt Issuances

The market for municipal tax exempt issuances is estimated to be $350 billion per year.[31] Bonds issued by state and local governments (often called municipal bonds) are desirable because they are tax exempt and because they are considered by investors to be very secure. Investors in municipal bonds are generally thought to be more risk averse than investors in corporate bonds or equity securities. Virtually all initial municipal general obligation bonds issues can expect to receive investment grade ratings. (Aaa-Baa or AAA-BBB).

Defaults are uncommon. Moody's reported that the average default rate for both investment grade and speculative grade (Ba-Caa-C) municipal bonds for the period 1970-2000 was less than ½ of 1% of all issuances rated by the agency.[32] Between 1970 and 2000, only 18 municipal issuers that Moody's examined defaulted out of 28,099 issuers and 375, 818 issuer years for issuers that received an investment grade rating.[33] Similarly, Fitch's reported that the default rate on investment and speculative grade for issuances that Fitch's examined during the period 1987-1994 was just over 1/2 of 1%.[34]

The Moody's report also found that recovery rates on defaulted municipal bonds were higher than for corporate bonds. Recovery rates for the same 1970-2000 period were about one-third higher than recovery rates for corporate bond defaults. Several factors explain the security of municipal bond issuances. First, state and local governments pledge all revenue sources as collateral for the issuance. In most cases the stream of revenues will be known for a reasonably certain period. Municipalities have significant experience in forecasting revenues and expenses in deciding whether to issue a bond and in what amounts and what terms. Particularly in conduit financings, that experience gives comfort to both ratings agencies and investors. If for some reason, revenues are not sufficient to service the bond debt, the municipality can raise taxes or impose new taxes to make up the shortfall.

Second, for issuances other than general obligation bonds, the municipality or the conduit borrower can mortgage property to secure the debt. Third, there are well understood creditor remedies in the event of a default. If a municipality defaults on a general obligation bond, for example, bondholders may seek a writ to compel the responsible official to levy and pay over the required debt service. Similarly,

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[31] www-ac.notherntrust.com.

[32] Moody's Special Comments, November 2002.

[33] Washburn, Special Comment, "Moody's US Municipal Bond Rating Scale"(November 2002).

[34] Litvack, Special Report, "Municipal Default Rates Revisited" (June 2003).

municipalities are constrained by the Contracts Clause of the Constitution from taking action that would impair the bonds.[35] Finally, a municipality that cannot meet its debt service can seek bankruptcy protection under Chapter 9 of the federal Bankruptcy Code.[36] Municipalities cannot be liquidated under Chapter 9 so that Chapter 9 provides for repayment to bondholders over time.

Fourth, state laws restrict how much debt a municipality may incur, how a municipality may incur the debt, and for what purposes the municipality may incur the debt. Many states have constitutional, statutory and common law limitations on the amount of debt that a municipality may incur. Property tax revenues are the most common source of security and repayment of a general obligation bond. State constitutions and statutes restrict the amount of debt that may be secured by property tax revenues. Those restrictions are commonly expressed as a percentage of taxable property values. Similarly, state and local governments often require bond issues be considered in open meetings and many bond issues must be submitted to the local electorate for a vote. The requirement of public notice and participation removes objections at an early stage of the process leading to issuance.

State laws also regulate various aspects of issuances through “Blue Sky” laws and, in some cases, through judge-made rules that restrict the purposes for which bonds may be used.[37] Some states, for example, prohibit the issuance of bonds that would compete too directly with private industry.[38]

Finally, state and local governments can use tax-exempt bonds in “refunding issues,” as defined in § 1.150-1(d) of the Treasury Regulations, to refinance prior bonds, subject to certain restrictions, including a restriction under § 149(d) against not more than one “advance refunding issue,” as defined in Treasury Regulation § 1.150-1(d)(4), for tax-exempt governmental bonds, and a prohibition against any advance refunding issue for tax-exempt qualified private activity bonds.

3. Special Challenges for Alaska State And Local Government Tax Exempt Issuances

Unlike the lower 48 states, municipalities in the State of Alaska have experienced particular difficulties in issuing tax exempt bonds. This experience is important to the analysis of the efficacy of TEDBs for Alaska Native tribes because the tribes are located in the same far-flung regions as the municipalities and the difficulties brought on by a municipality’s remoteness and lack of familiarity to bond markets will apply in equal or greater force to the tribes.

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[35] Art. I, U.S. Const., Sec. 10.

[36] Chapter 9, Bankruptcy Reform Act of 1978, 11 U.S.C. § 901 *et. seq.*

[37] *See*, *e.g*, KSA Sec. 17-1252 to Sec. 17-1275 (Kansas blue sky laws).

[38] .*See, e.g., Churchill v. Bd. of Trustees*, 409 So. 2d 1382 (Ala. 1982)(oppression)

To combat the problems faced by municipalities in stimulating economic development through exempt financing, the Alaska legislature created the Alaska Municipal Bond Bank Authority in 1975.[39] The legislature set out the following reasons for creating the Bank Authority:

The legislature finds that

(1) the rapid growth of municipalities in the state and the incorporation of new municipalities has created a demand for capital improvements that can only be met by these municipalities borrowing money through the issuance of bonds or notes;

(2) many of these municipalities, although creditworthy, either have not issued bonds or notes or have little outstanding debt;

(3) the cost of borrowed money to these municipalities is or may be unnecessarily high due to lack of investor familiarity with the municipalities;

(4) other municipalities in the state pay unnecessarily high borrowing costs because of the distance of the state from capital markets or may find borrowing difficult or impossible because of temporary economic dislocation due to loss of employment or prospective loss of employment.

The Alaska Municipal Bond Authority, stated that the aid of its organization has been essential to municipalities in securing almost $1 billion in financing for public works projects for the following reasons: [40]

- Communities lack of familiarity with financial markets;
- Reduction in the cost of issuing bonds;
- Better terms on bonds issued by the Bond Bank;
- Bond pooling allows much larger issues than any one community can, creating economies of scale;
- Lower costs in contracting for professional services than less active individual communities can access; and
- The Bond Bank has a better credit rating than is available to most communities.

[39] AS Sec. 44.85.005

[40] Remarks of Mark Pfeffer, Chair, Alaska Municipal Bond Authority 2009 Annual Report

B. Tribal Governments

To assess the prospects for the new TEDBs, an understanding about how tribal governments are different from state and local governments is necessary. Because the rules governing tax exempt bonds are based upon long experience with state and local governments, evaluating the differences helps to show where the rules will work or not work for tribes. In addition, an understanding of the historic and somewhat capricious shifts in federal policy towards Indian tribal governments will explain how potential investors might view TEDBs in the short term.

1. Federal Policy Toward Tribal Governments

The federal policy toward Indian tribes has followed a wavering path. In the earliest days of the republic, the Colonial times to 1820, witnessed the birth of the United States and the establishment of relationships among Indian tribes, European nations, and the United States. The first Congressional acts concerning Indians were passed to regulate commerce between Indians and non-Indians and to manage land exchange issues.[41] From 1820 to 1887, the federal policy was westward removal of indigenous populations and the establishment of reservations. This was a time when the federal government dealt with the "Indian problem" by removing en masse virtually all tribal peoples further and further westward to established "reservations" in an effort to minimize contact between the expanding Anglo population and tribes.[42]

From 1887 to 1934, the federal government pursued a policy of allotment and assimilation. The federal policy of allotment and assimilation was championed by proponents of assimilation who believed that Indians would be treated in the most socially responsible and honorable manner by integrating them, not as members of a tribal community but as individuals, into mainstream non-Indian American society.[43] In 1887, Congress approved the General Allotment (Dawes) Act that, for the most part, divided reservation lands into separate parcels that were then allotted to individual Indian males.[44] The allotment policy, while viewed as the most socially responsible plan for dealing with the Indians, also conveniently served to open up vast surpluses of reservation lands for non-Indian settlement. Many Indian reservations that were allotted became (and often remain today) a checkerboard of lands owned by both non-Indians and Indians, with a concomitant hodge-podge of governmental jurisdiction often disputed by both parties.

The period of Indian Reorganization, from 1934 to1953 reversed the policy of allotment and assimilation. Based on the dismal failure of the allotment policy, which was well documented across the country, Congress attempted to reverse the devastating effects

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[41] Cohen, Handbook of Federal Indian Law, Sec. 1.03[1] (2005).

[42] Cohen, Handbook of Federal Indian Law, Sec. 1.03[4] (2005).

[43] Cohen, Handbook of Federal Indian Law, Sec. 1.04 (2005).

[44] General Allotment Act of 1887, Ch. 119, 24 Stat. 388.

of allotment. Congress placed reservation lands into trust status and enacted a system of federal oversight governing the alienation of these lands. Economic development and education became funding priorities, and tribes were allowed to adopt constitutions and corporations, many of which used federal or state governmental models.[45]

In 1953, the pendulum swung back as the federal government pursued a termination policy. Reorganization of the Indians into cohesive tribal communities was then abandoned in favor of termination. During this era (1953-1968), the federal government “terminated” its official legal recognition of 109 tribes and extinguished the Indian peoples’ status as wards of the government.[46] Congress also legislated state control over Indian country in several states by enacting Public Law 280 that provided for state civil and criminal jurisdiction over reservation territory.[47]

Self-Determination defines the current policy toward Indians. The civil rights movement of the 1960’s led to the re-examination by the federal government of the termination policy. In a 1970 special message to Congress, President Nixon called for a new federal policy of “self-determination” for Indian nations. “Self-determination” is a federal policy that attempts to promote equitable government-to-government relations between the federal government and Indian tribes, to encourage tribal self-government, and to support the development of tribal economies.[48]

The shifts in federal policy, whether implemented by Congress of the other branches, can de-stabilize the value and marketability of long-term investments. The past federal policies of allotment and assimilation and termination would almost certainly have a chilling effect on tribal borrowing. Clearly, a long-term investor would not invest in the debt of a government whose future was in doubt. The notion that federal policy toward tribes could have direct effect on tribal bonding is not fanciful. The termination era, for example, lasted only 15 years which is less time than the maturity of an average bond issue. A hypothetical investor in a tribal bond who bought the bond before 1953 could therefore have seen the investment go from valuable to worthless and back to valuable.

2. Organization of Tribal Governments

Today there are today 562 federally-recognized Indian tribes in the United States. Each tribe develops and maintains its own internal governmental structure. Since each tribe has its own unique history and customs, each tribal government possesses unique

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[45] Cohen, Handbook of Federal Indian Law, Sec. 1.05 (2005).

[46] Cohen, Handbook of Federal Indian law, Sec. 1.06 (2005).

[47] P.L. 83-280, 67 Stat. 588 (1953).

[48] Cohen, Handbook of federal Indian Law, Sec. 1.07 (2005); Special Message to the Congress on Indian Affairs issued by Richard M. Nixon, July 8, 1970, and American Indian Policy issued by Ronald Reagan, January 24, 1983; 19 Weekly Comp. Pres. Doc. 98

elements and forms of government. Tribes manage their resources commensurate with the needs of its members. Many of these original tribal governments still exist today.

Tribal governments have retained inherent governmental authority to raise revenues through taxation, gaming, natural resource development and energy projects, and other economic ventures. Like all governments, tribal governments use their revenues to provide essential governmental services and to promote economic development for their citizens, residents and visitors. They have also regained certain powers once lost, although on a somewhat limited basis. Powers such as criminal and civil jurisdiction over Indian and non-Indians were restricted or extinguished during historical eras limiting tribal sovereignty. Inherent governmental authority of tribes has been circumscribed by federal common law and regulation that have left tribal governments with authority as “quasi-sovereign” entities that co-exist with federal, state and local governments.

The primary reason for this predicament is the inherent assumption in federal law that all governments, including tribal governments, possess or can easily acquire the fundamental infrastructure needed to provide basic services to its citizens, residents and visitors. In reality, many tribal governments, still suffering from the impacts of historical federal policies, lack the ability to provide the most basic infrastructure that most U.S. citizens take for granted, such as passable roadways, affordable housing, and the plumbing, electricity and telephone services that come with a modern home.

3. Tribal Property

Land ownership, which varies from reservation to reservation, may include a matrix of land owned by the United States in trust for tribes (“tribal land”) and individual Indians and allotted land owned in fee by tribes, individual Indians, and non-Indians. Tribal lands that are held in trust by the federal government are, for the most part, communally held in each tribe. And, some allotted lands remain subject to trust restrictions. Situated among the tribal and allotted lands are federal lands, state owned lands, and privately owned lands. Thus, this hodge-podge of ownership raises jurisdictional issues that are not always easily sorted out for purposes of securing any financing.

Added to this problem are the federal restrictions on alienation of tribal and allotted lands. Trust land cannot be sold, taxed or encumbered without federal approval. Some allotted land is subject to the same restrictions on alienation.[49] Because tribal land cannot be encumbered without federal approval, tribal trust lands cannot be mortgaged to secure debt. Tribes can and do lease lands, however.[50] Leases of trust lands can be used as collateral to secure debt. However, leases also require federal approval and the grant of a lease can trigger federal review in cases where review might not otherwise be required. (Under the National Environmental Policy Act, for e.g., the BIA must prepare an environmental impact statement before approving a lease of tribal

[49] Cohen, Handbook of Federal Indian Law, Sec. 15.03 (2005).

[50] 25 U.S.C. §§ 415, 477

land). Most tribal personal property is not trust restricted and can be used as collateral to secure debt.

VI. ECONOMIC NEED IN INDIAN COUNTRY EXCEEDS AVAILABLE TAX-EXEMPT BOND CAPACITY

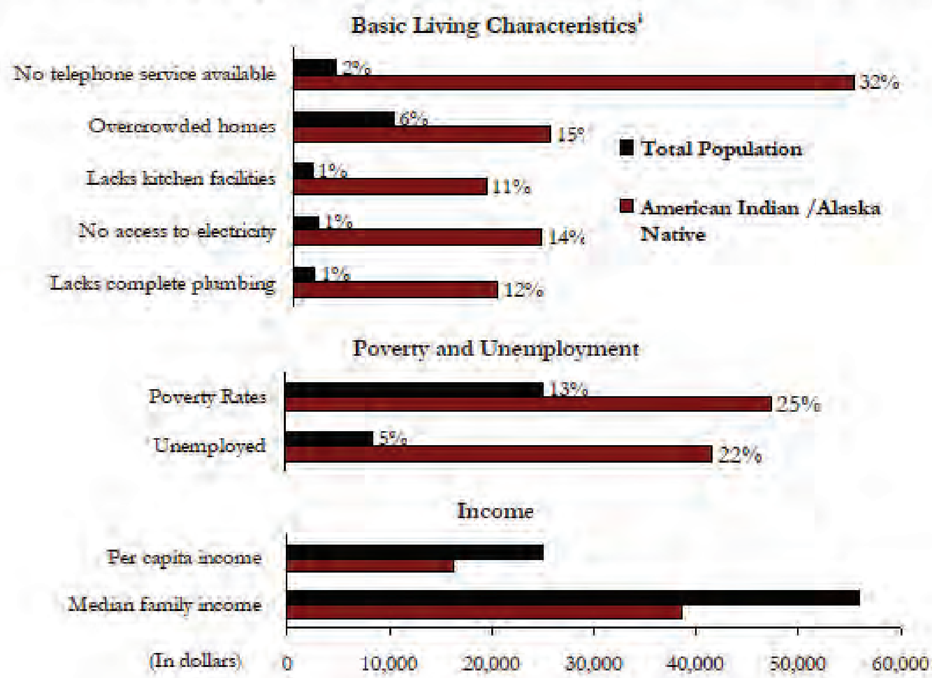
A. Prevailing Economic Conditions in the Lower 48 States Underscore Need

There is an abundance of evidence that tribes need the ability to obtain low cost financing to address infrastructure and economic development needs. American Indian reservations are extremely depressed with unemployment rates among the highest of the country. Most Indian tribes have an economy that is on par with underdeveloped countries. According to the U.S. Census Bureau, approximately 20% of American Indian households on reservations lack complete plumbing facilities, compared to 1% of all U.S. households. And about 1 in 5 American Indian reservation households disposed of sewage by means other than public sewer, septic tanks, or cesspool.

Tribes have had limited opportunities to invest in their own economies because often there has been no established resource base for community investment and development. Many reservations lack a developed physical infrastructure including utilities, transportation and other public services.

POPULATION STATISTICS

- Total American Indian/Alaska Native alone population: 2.48 million or 0.9% of the US population.
- Total AI/AN in combination with other races: 4.12 million or 1.5% of the US population.
- States with the highest proportion of AI/AN: Alaska (19%), Oklahoma (11%), New Mexico (10%).
- States with the largest populations of AI/AN: California, Oklahoma, Arizona, Texas, New Mexico.



DEMOGRAPHIC PROFILE OF INDIAN COUNTRY

Moreover, historical and social circumstances have created a climate in which Indian populations living within Indian territories generally have extremely low socio-economic factors, including low educational achievement, high unemployment, high poverty, and low per capita income. Overall, the lack of adequate infrastructure and low socioeconomic factors make business development on Indian reservations less attractive than off-reservation. Many tribal governments have been forced to rely on state and federal funds to mitigate these problems. But the funds are insufficient to address the myriad responsibilities facing tribal governments. Similarly, gaming does not provide sufficient funds to meet the needs of all tribal governments. A majority of all Indian tribes are without gaming of any kind.

For those tribes that have resources that may be exploited, the revenues often do not fully benefit the tribes. Many tribes receive below-market value for minerals and hydrocarbons. The revenues that tribes do receive often do not spur development of tribal economies. Because tribes do not have developed infrastructure, many have been unable to grow supporting businesses. One study finds that income multipliers from resource development on reservation generally equal 1.00.[51] A multiplier of 1 means that each dollar invested generates only one dollar of income for the tribe.

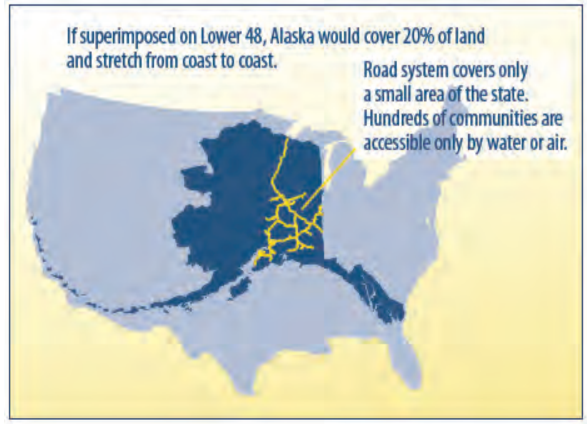
The American Recovery and Reinvestment Act contains more than $3 billion for federal investments in Indian country. The National Congress of American Indians (NCAI) established a clearinghouse of information on its website to detail the funding opportunities for tribes. NCAI recently published 'Investing in Tribal Governments *An Analysis of Impact and remaining Need Under the American Recover and Reinvestment Act,*' highlighting areas of tribal-specific appropriations, such as: Correctional Facilities; Indian Reservation roads; Native American Housing Block Grant; Indian Health Facilities; Indian Health Information Technology; School Construction; Water; Energy Efficiency; Community Development Financial Institutions Fund; and Tribal Economic Development Bonds. As NCAI notes, the Act provides much needed support for tribal projects, but the need is so great that additional consideration must be given to meet the desperate needs of America's Indigenous Peoples.[52]

[51] Kooros & Seip, "Self- Sufficiency Analysis", Presidential Commission on Indian Reservation Economies (1984), discussed in Ambler, *Breaking the Iron Bonds; Indian Control of Energy Development* (1990), p. 26, n.79 (a six tribe analysis revealed "the national multiplier was 2.82, the reservation multiplier was much lower --ranging from .99 to 1.19").

[52] National Congress of American Indians, *"Investing in Tribal Governments, An Analysis of Impact and Remaining Need Under the American Recovery and Reinvestment Act"*, (March 2010).

1. A Special Case: Alaskan Natives

The Alaska Native Claims Settlement Act illustrates the unusual economic and regulatory conditions that can hamper tribes' ability to raise capital. In 1971, Congress signed into law the Alaska Native Claims Settlement Act (ANCSA), which created 12 Regional Alaska Native for-profit corporations and more than 200 village corporations in place of giving reservation status to Alaska tribes. Additionally, the Thirteenth Regional Corporation was developed to allow Alaska Natives outside of Alaska the opportunity to enroll without the requirement of claiming a specific village and/or regional connection.



Source: Alaska's People and Economy, 1867-2009 Institute of Social and Economic Research, University of Alaska Anchorage

The purpose of ANCSA was to lay to rest controversial aboriginal claims to the majority of Alaska lands. The Act provided the ability of the Native corporations to select 44 million acres of land, the majority of which was to be owned by the village corporations, and the subsurface of those lands to be held by the regional corporations. Corporations also received approximately $1 billion divided amongst the regions and villages as 'start up' funds to organize and develop corporate management structures.

ANCSA created a complicated and controversial legal process by which to deal with aboriginal claims in the United States. Previously, Indian tribes in the Lower 48 states were removed from traditional lands onto reservations through war or treaty. The Interior Department has trust responsibility for reservation lands meaning any development, use and disbursement of the land has to go through an approval process—which can often be lengthy, and, as outlined in the *Cobell* litigation, often mismanaged. *Cobell v. Salazar* was a class action lawsuit whereby American Indians and Alaska Natives sought to hold the federal government responsible for the alleged mismanagement of Individual Indian Money Accounts held in trust by the government.[53] After 13 years of litigation, the federal government and plaintiffs have negotiated a settlement agreement—which in itself has generated controversy in the Indian community.

In the case of Alaska Natives, the United States bought the authority to govern Alaska from Russia for $7.2 million. In the transfer agreement, aboriginal rights were guaranteed—influenced perhaps by the Russian Orthodox Church which had embraced the Natives' 'need' for spiritual development and worked to protect human rights in Alaska.

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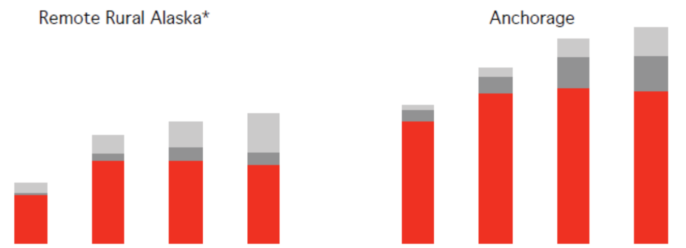
[53] *Cobell v. Salazar*, 573 F.3d 808 (D.C. Cir. 2009).

Sources of Income in Anchorage and Remote Rural Alaska, 1970-2000 income of all persons in 2000 dollars



	Remote Rural Alaska* 1970	1980	1990	2000	Anchorage 1970	1980	1990	2000
Transfers**	$1,508	$2,887	$4,027	$6,121	$647	$1,177	$3,036	$4,713
Dividends, interest & rent	$263	$996	$2,125	$2,250	$1,856	$2,832	$4,984	$5,832
Wages & Salaries	$8,110	$13,623	$13,603	$12,708	$19,900	$24,501	$25,355	$24,762

** Defined to be Wade Hampton, Bethel, Nome, Dillingham, and Yukon-Koyukuk census areas and the North Slope, Northwest Arctic, and Lake and Peninsula boroughs.*
*** Transfers include distributions from Alaska's Permanent Distribution Fund. (Goldsmith et al., 2004, 4-64)*

Native American Contracting Under Section 8(a) of the Small Business Act *Economic, Social and Cultural Impacts*

Since war with Alaska tribes was not an issue, the lack of need for a formal removal process encouraged the United States to benignly neglect addressing aboriginal rights in Alaska. The community of Metlakatla in Southeast Alaska spent many years petitioning the Bureau of Indian Affairs to support their application to become a reservation. Their fortitude and determination created the only tribe now acknowledged in Alaska with reservation status consistent with the terms of Indian tribes in the Lower 48 contiguous states.

The impetus for creating ANCSA is reported to have come from the oil industry, and the belief of the Nixon administration that North America's Indigenous Peoples should be treated with greater care than had been shown them in the past. Vast oil reserves had been discovered on the North Slope of Alaska's most remote regions and the oil companies wanted the ability to transport Alaskan oil to market. Many tribes in Alaska had been working to develop recognition of their aboriginal rights in the land and resources of the state. The threat of lengthy lawsuits drew national political interest in settling the issue so that the oil companies could build the Alaska Pipeline to transport Alaskan oil to oil refineries.

In December 1971, after years of effort by Members of the U.S. Congress and Alaska Native leadership, the Alaska Native Claims Settlement Act was enacted.[54] ANCSA made the development of the Trans-Alaska oil pipeline possible by addressing the status and claims of Alaska Natives.

[54] (P.L. 92-203); 85 Stat. 688.

The main question was what form should this settlement take? Should Alaska Natives be required to live on reservations as had been done in the rest of the United States, or should other options be considered—and what would those options be? The concept of interrelated economic development corporations at both the regional and village level was thought to be the best method for Alaska rather than the traditional reservation system. The Act did not preclude tribal organizations existence, but rather than putting lands under the ownership of tribes, it gave the land to the corporations. Village corporations would own the surface lands, and regional corporations would own the subsurface and share revenues from subsurface resource development with all the ANCSA corporations. The concept was that then both the regional corporation management and the village corporation management would have to interact and cooperate for the benefit of their mutual shareholders, most of whom would also be the aboriginal residents of the villages where the tribes had traditionally existed.

ANCSA and follow-on legislation allows Alaska Native Corporation's (ANCs) land status to be near that of trust lands of reservations in that it has many of the same protections. ANCSA allows the boundaries of the regional and village corporations to be considered reservation lands and for ANCSA corporations to be eligible for many federal programs as equal to that of the Alaska tribes.

Source: Alaska's People and Economy, 1867-2009 Institute of Social and Economic Research, University of Alaska Anchorage

Alaska Native business leaders have faced numerous challenges since the passage of ANCSA: 1) Lack of business development opportunities; 2) Costly transportation options limited by geographic distances and lack of connectivity to highway systems and urban centers; 3) Limited job opportunities or access to jobs in rural communities; and 4) High cost of living including lack of housing and sanitation. Following the passage of ANCSA, some of the regional and village corporations suffered disastrously from poor management and inadequate business leadership. Through the years, ANCs have developed the business acumen needed to survive in the greater economy of Alaska, the United States, and in some cases, internationally. Not only have many of these corporations survived in the business world, they have made great achievements in partnering with their tribal organizations in order to preserve Alaska Native Peoples culture, language and traditions while earning monetary benefit for their shareholders. Yet, these accomplishments are still not enough to alleviate the grossly endemic poverty of many of Alaska's remote, rural villages. Thousands of residents in small villages located throughout Western Alaska still live in poverty and Third World conditions.

By 1988, Alaska's per capita income levels fell 23 percentage points in comparison to the rest of the United States, and throughout the 1990's Alaska's slowed economy did little to enhance worker's wages in comparison to inflation. This recession was exacerbated by a decline in the price of Alaska crude oil and in Alaskan oil production.

Census Area	**Unemployment (as of 6/09)**	**Per Capita Income 2007**	**Population Below Poverty Level**
Wade Hampton	31.3%	$17,941	26.2%
Bethel Census	17.3%	$26,990	20.6%
American Indian & Alaska Native	22% *Harvard Project	$35,343	25.3
Alaska General	8.4%	$40,042	9.2%
U.S. General	9.5%	$38,615	13.2%
Source: U.S. Bureau of the Census and the Institute for Social and Economic Research, University of Alaska			

The Department of Interior recognizes 229 tribes in Alaska. Alaska Natives, at a total of 121,929 in 2008, make up about 17.9% of the 679,720 residents of Alaska.[55] Rural Alaska is characterized by over 280 isolated villages scattered across an area more than twice the size of Texas. Populations in these communities are predominately Alaska Native and range between 25 and 6,000 residents.

Transportation systems across the majority of Alaska are limited to small aircraft, boat and barge during the short summer months and limited inter-village travel by snow machine in the frozen winter months. The harvest of fish and game is a vital method used by these villages to maintain cultural connections between elders and youth to create a continuity of traditions that have served the people of this region for 8,000 years.

The Alaska Native non-profit Association of Village Council Presidents (AVCP) serves the Bethel Census Area and the Wade Hampton Census Area where there is no organized regional borough (county) due to lack of a tax base to support regional government services such as education, public safety and tax assessment and collection. Twelve such Native regional non-profit organizations like AVCP, provide health, public safety, housing, and social services across rural areas of Alaska. The

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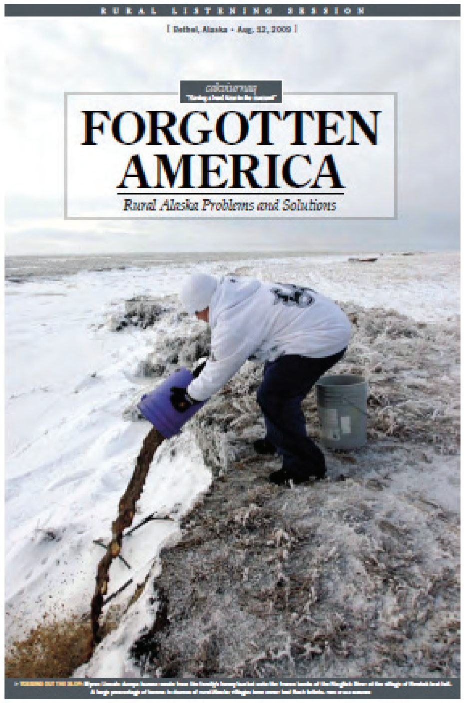
[55] Alaska Dept. of Labor "*Alaska Economic Trends"* (February 2010).

challenges faced by tribal leaders in the AVCP region closely reflect those shared by all Alaska Native and rural communities across the state.



Tossing out the slop:

Myron Lincoln dumps human waste from the family's honey bucket onto the frozen banks of the Ninglick River at the village of Newtok last fall.

A large percentage of homes in dozens of rural Alaska villages have never had flush toilets.

In AVCP's August 12, 2009 report "Forgotten America – Rural Alaska Problems and Solutions" states:

AVCP's Housing collects housing applications from residents from all of its member villages. Applicants complain of aging, sub-standard, and crowded home conditions, with some applicants having up to 11 people living in a small, one bedroom home. AVCP Housing has completed research that indicates that about 3,500 new homes are needed in the Y-K Delta [Yukon-Kuskokwim] with a cost of $250,000 to $300,000 each to build a 3 bedroom home in rural Alaska, the cost of meeting the housing need of the region's residents will cost between $800 million to $1 billion. At the rate of funding for housing projects in rural Alaska's Y-K Delta, around $10 million annually, it will take 105 years to build these 3,500 homes.

The *Forgotten America* report indicates that in the AVCP Region $248 million is required to fund sewer and water projects alone.

Total National 20-Year Need (in billions of January 2007 dollars)

System Size and Type	Need
Large Community Water Systems* (serving over 100,000 persons)	$116.3
Medium Community Water Systems* (serving 3,301-100,000 persons)	$145.1
Small Community Water Systems (serving 3,300 and fewer persons)	$59.4
Not-for-Profit Noncommunity Water Systems†	$4.1
Total State Need	**$324.9**
American Indian and Alaska Native Village Water Systems†	$2.9
Costs Associated with Proposed and Recently Promulgated Regulations	$7.0
Total National Need	**$334.8**

Note - numbers may not total due to rounding.
* "Large" and "medium" systems are defined differently for this Assessment than previous Assessments. See Appendix A in the DWINSA report for more information.
† Based on 1999 Assessment findings adjusted to 2007 dollars.

Source: EPA Drinking Water Infrastructure Needs Survey: American Indian and Alaska Native Village Water Systems

Regarding economic development activities in the AVCP region, the report highlights the region's geographic isolation and limited resources:

"The regional economy is extremely limited. 2006 census data lists 273 private businesses within the region. Most are located in Bethel. Villages have almost no businesses at all – there are no restaurants, no bed and breakfasts (tourists and visiting agency people stay at the school), no child care facilities, no DVD rental stores, and often even no grocery store.

Recommendation: Provide comprehensive and intensive assistance to develop new, small, village-based businesses and support existing businesses in order to provide needed services and employ local residents. Barriers to business development must be removed and home-based technology-oriented business development should be emphasized. Support should be provided for AVCP's flight school, new aircraft mechanic school, and the local vocational trades school. Additional funds for education should be provided as well as assistance to defray the high costs of transportation services." (AVCP report Forgotten America)

The challenges faced by Alaska Natives, highlighted in the AVCP report, are echoed by those listed by the U.S. Senate. In a recent letter to President-elect Barack Obama, Senator Tim Johnson, D-S.D. and 13 colleagues highlighted the unmet need of Indian Country for $50 billion in infrastructure development. Their funding requests included:

- $1.2 billion for Indian health facilities construction and support;
- $360 million for construction of tribal justice infrastructure and support;
- $568 million for construction of tribal schools and colleges;
- $50 million for housing construction, weatherization, and heating in Indian country;
- $80 million for Indian job training and business development;
- $600 million for water infrastructure development in Indian country;
- $4.4 million for energy development on Indian lands; and
- $50 million to address Indian land fractionation.

The senator noted, "Tribal infrastructure needs are significant and longstanding. The more than $50 billion unmet need in Indian reservation infrastructure poses both a danger to reservation residents and a barrier to investment and economic development of tribal communities.[56]

2. These Economic Conditions Require an Increase in the Availability of Low Cost Financing

The creation of productive economies and self-sustaining revenue sources is a primary goal of tribal governments. Cultivating robust economies serves to provide much needed economic opportunities for their citizens, promotes self-sufficiency, and provides revenue for essential services and true self-determination.[57] Governmental bonds and private activity bonds will be a vital financial tool for tribal governments because these bonds allow the government to secure capital for the building of infrastructure and institutional capacity building, which, in turn, encourages much-needed economic development within Indian country.

As this data illustrates, the need for low cost financing to foster economic growth far exceeds the tribes' current access to credit markets. The ARRA volume cap of $2 Billion for TEDBs is extraordinarily low and gives the tribes exempt financing opportunity that represents only a fraction of what they need. The $2 Billion volume cap represent less than 0.1% of the estimated $2.67 Trillion market as of December 31, 2008.[58] And, Code Section 7871(c) financing for "essential governmental functions" has proved to be elusive and, indeed, has served only to further stifle tribal economic growth and recovery. Accordingly, Congress should reconsider the $2 Billion cap on TEDBs and should consult with tribes to target a more appropriate exempt financing capacity.

[56] Johnson Urges President-Elect to Fund Tribal Initiatives, U.S. Senator Tim Johnson, (January 29, 2010).

[57] "The Nature and Components of Economic Development in Indian Country," *Stephen Cornell and Miriam Jorgensen,* The Harvard Project on American Indian Economic Development, Native Nations Institute for Leadership, Management & Policy.

[58] Securities Industry and Finance Markets Association, 2008 Report.

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VII. Barriers To Tribal Access To The Tax Exempt Bond Markets

There are presently numerous barriers to entry, or at least significant hurdles, into the credit markets that tribes face, which are not faced by state and local governments. These barriers will impact the viability of TEDB issuances, at least in the short term until the market becomes more familiar with tribal issuances. There are several concerns a potential bond investor will have that ACT's report highlights only briefly. We do not present an exhaustive list of impediments to tribal issuances. ACT recommends that Treasury's report to Congress fully examine these concerns in order to help craft necessary policy and regulatory changes which may be necessary to facilitate tribal tax exempt financing.

A. Collateral is Limited

1. Tribal Resources Are available As A Source Of Security For Tax Exempt Financing Only For Tribes That Have A Resource Base

Revenue bonds are available to tribes that have resources to collateralize an issuance. Revenue bonds will therefore be useful as a means of lowering borrowing costs for those tribes that have a resource base that can be pledged to secure the issuance. Some tribes have resources that can be used as a pledge. As described previously, many tribes do not. Less than 15% of all tribes have a sufficient resource base to secure tax-exempt issuances necessary to meet the tribe's infrastructure needs.[59] There is a strong public perception that all tribes have gaming and that gaming is a source of wealth for all tribes. That perception includes the more limited perception that tribes can pledge gaming revenues as a source of repayment of bonds or other financing. ARRA, of course, prohibits the use of tax exempt bonds for gaming facilities. More broadly, the perception that gaming provides a significant source of revenue to secure either taxable or tax exempt bonds is incorrect. Indian gaming is not economically viable for every tribe or, in some cases, not allowed at all. Of the 562 federally recognized tribes, 367 have Indian gaming. As of 2004, the fifteen largest gaming facilities accounted for 37% of total gaming revenues and the 55 largest Indian gaming facilities accounted for 70% of all Indian gaming revenues. Many tribes have casinos that are only marginally profitable.

Tribes can rely on various sources of revenue to secure bond issuances. To some extent whether a tribe can issue a general obligation bond secured by royalties, rents and other proprietary payments will depend on whether the tribe has adequate resources to secure the issuance or other borrowing. As with revenue bonds, some tribes will have the resources to pledge as security. Many will not.

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[59] Ambler, *Breaking the Iron Bonds: Indian Control of Energy Development,* p.29 (1990)(estimating that only 40 tribes out of 300 then-recognized tribes have significant energy resources).

2. Tribal Taxes Are A Limited Source of Security For Tax Exempt Financing

The principal source of collateral for general obligation bonds is tax revenues. State and local governments have imposed taxes since the beginning of the Republic and have used these taxes as a source of collateral to secure bond issuances. Tribes, on the other hand, have only recently begun to impose taxes. Tribes' authority to tax non-members was not known until 1982, when the United States Supreme Court decided *Merrion v. Jicarilla Apache Tribe.*[60] In *Merrion*, the Court held that the tribes retained inherent authority to tax activities within the tribes' territory. Three years later, the Supreme Court decided *Kerr-McGee* which reaffirms the Court's *Merrion* decision that Tribes retain authority impose taxes on both members and non-members.[61]

Tribes only began to consider taxes as a source of revenue in the wake of those two landmark decisions. As a result, tribes' experience with tax programs for the past 30 years is limited. Many tribes are still dealing with threshold issues of jurisdiction to tax. The Navajo Nation, for example, enacted its Possessory Interest Tax in 1978.[62] The Nation did not begin actively enforcing the Possessory Interest Tax until 1985, after the *Kerr-McGee* case was finally decided. Some tribes are still developing reliable long term revenue trends and ways to broaden their tax bases. Tribes are also wrestling with tax collections. Tribes do not have the same ability to collect unpaid taxes when the taxpayer leaves the taxing tribe's reservation. These issues will undoubtedly resolve themselves in time, but in the meantime, they circumscribe the practicality of general obligation bonds

There is a second difficulty with using tribal tax revenues as collateral bonds. Tribes' ability to impose taxes or raise tax rates is limited by state taxes that may be imposed on the same activity or taxpayer. Federal decisional law holds that states may generally tax the activities of non-Indians in Indian country even where the tribe imposes its own tax on the same activity.[63] The result is that tribes are limited in the taxes they may impose, since the activity may be subject to two taxes, thereby making the activity uncompetitive relative to the same activity conducted off-reservation. Tribes may not tax activities beyond reservation boundaries. One correspondent tribe located in a suburban area reports to the ACT that it cannot impose any taxes upon its own commercial retail development because the local property tax burden is so high that any additional taxes would make the development uncompetitive relative to other commercial developments in the local area. Unlike states that can adjust their rates to spur (or depress) economic development, tribes cannot control the taxes that a state or local government may impose. Thus, states can exercise some degree of control over

[60] 455. U.S. 130 (1982).

[61] 471 U.S. 195 (1985).

[62] Navajo Nation Council Resolution No. CJA-13-78.

[63] *Cotton Petroleum v. New Mexico*, 490 U.S. 163 (1989).

tribal taxing power and therefore, by extension, tribes ability to use tax revenues as collateral.

3. Federal Loan Guaranties Are Unavailable As Security For Tax Exempt Financing

Provisions in the Indian Financing Act prohibit federal guarantees as a source of security for tax exempt issuances.[64] Title II of the Act authorizes the Secretary of the Interior to guaranty or insure up to 90% of the unpaid principal and interest due on loans to Indian entities or individuals "[i]n order to provide access to private money sources which otherwise would not be available."[65] Section 1486 of the Code excludes from the guarantee loans the interest on which is not included in gross income for the purposes of Chapter 1 of the Internal Revenue Code.[66]

Similarly, the Code provides that a bond that otherwise meets the requirements or tax exemption will not be treated as a tax exempt bond if the payment of principal or interest is guaranteed by the federal government or any instrumentality of the government. Exceptions apply to guarantees by specified agencies of the federal government. The Code does not except guarantees by Interior from the rule against federal guarantees. Additional exceptions apply for investment of bond proceeds in Treasury securities or investments in debt service funds, reserve funds or during temporary initial periods. None of these exceptions would allow a federal guarantee of a tribal bond. Taken together, the Code and the Indian Financing Act exclude the act of guaranteeing a tax exempt issuance and, should such a guarantee ever be made, would result in the bond losing its tax exempt status.

B. Creditor Remedies Are Not Always Clear

The marketability of tribal bonds depends in part on the ability of bondholders to recover their investment in the event of default. For tribal issuers, remedies upon default present special considerations.

Tribes are not subject to creditors' remedies in the same way that bondholders can generally avail themselves of creditor remedies in non-Indian contexts. Federal and tribal law together determine what remedies creditors may employ to cure a default on a bond. There are two components that determine the creditworthiness of a bond issuance: The credit rating of the borrower and the likelihood of recovering the loan in the event of default. As discussed above, issues remain concerning ratings tribes can expect to receive for TEDBs. The assessment of creditor remedies presents separate

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[64] The Indian Financing Act of 1974, Pub. L. No. 93-262, Section 1, codified at 25 U.S.C. §§ 1451 et seq.

[65] 25 U.S.C. § 1481 ("The direct function of the Program is to help lenders reduce excessive risks on loans they make [, which] in turn helps borrowers secure conventional financing that might otherwise be unavailable")

[66] 25 U.S.C. § 1486; *see* 25 C.F.R. § 103.10(b)(3) ("A lender that does not include the interest on loans it makes in gross income...is not qualified to issue loans under the Program.").

considerations. While tribes can be incorporated into the national ratings scheme, they cannot easily be incorporated into default rating schemes.

Since tribes are likely to receive speculative grade ratings, they would ordinarily receive default recovery ratings as well. Because tribes do not always have the same remedies as state or local governments, credit ratings agencies are reluctant to assign default recovery ratings. At least one agency has indicated that it will not assign default recovery ratings to tribal issuances due to “uncertainties surrounding the exercise of creditor rights against a sovereign nation.” There are several sources of uncertainty. One source of uncertainty is whether a federal court would have jurisdiction over claims brought by bondholders and whether the Bankruptcy Code would apply. Another is whether a federal bankruptcy court could exercise jurisdiction over a tribal government as a debtor. There is also the question whether a tribal government could itself elect Chapter 9 bankruptcy.

C. The Securities Act of 1933 May Increase The Cost of TEDBs

The Securities Act of 1933 regulates the issuance of securities. Although ARRA amended the Internal Revenue Code to allow tax-exempt issuances, the securities laws were not similarly amended. Accordingly, there remain asymmetries between tribal and state or local governments in issuing bonds. The Securities Act exempts “transactions by an issuer not involving any public offering.”[67] The Securities Act exempts municipal debt from registration requirements but does not exempt a tribal government’s debt.[68] The Act does not treat tribes as states for purposes of the Securities Act. Tribes are therefore faced with a Hobson’s choice. Either they must bear the cost of registering the bonds or they must place tribal bonds in the private placement market. Issuers who issue into the private placement market generally receive inferior terms due to the illiquidity of their privately-placed bonds. Liquidity premiums range from 75 to 250 basis points and higher interest payments.[69] Alternatively, tribes can pay the registration costs. Given the $30 million cap on TEDB issuances, absorbing the cost of registration means a significant reduction in the benefits of using tax exempt financing.

D. TEDBs May Experience Lower Ratings

The benefits of tax exempt bonds depend in part on the rating assigned to a particular issuance. Bond ratings are the evaluation process which determines risk of default, ability to make interest and principal debt payments, and the general ability of the government to meet its debt and budget obligations. Higher ratings mean lower interest rates and a correspondingly lower cost of the borrowing. Lower rating means higher

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[67] 15 U.S.C. 77d, 77c (b).

[68] Securities Act of 1933, 15 U.S.C. 77c(a)(2).

[69] Clarkson, “Tribal Bonds: Statutory Shackles and Regulatory Restraints on Tribal Economic Development,” 85 *N.C. L. Rev.* 1009 (2007). Clarkson suggests that because tribes must register their bonds as securities under the 1933 Securities Act, their debt is less liquid than that of state and local governments who are exempted from such registration.

interest rates and higher cost of borrowing. Because I.R.C. §7871(c) has been the only authority for tribal governments to issue tax exempt bonds, tribes do not have extensive experience issuing tax exempt bonds. Accordingly, many tribes that have received allocations will be first-time issuers. As first-time issuers, tribes are likely to receive speculative grade ratings. First time issuers (whoever they may be) commonly receive speculative ratings because they lack history issuing bonds and complying with post issuance requirements. Because they are likely to receive speculative grade rating, the cost of the borrowing will be higher. The market for tribal TEDBs will be correspondingly smaller as the grade goes down because as there are limitations on the grade of issuance which institutional investors may buy.

There is a substantial body of research analyzing defaults of municipalities. As discussed above, there is ample data to support statistical and mathematically modeled data forecasting the likelihood of defaults, and, if so, the expected recovery in the event of default. The knowledge base regarding municipal bond performance over a long period of time provides ratings agencies with baseline against which to measure current municipal issuances. In contrast to the information available to measure the performance of municipal bonds, there is a paucity of data available about the performance of tribal bonds. Because of the lack of data, there is likely to be volatility in the market for tribal bonds. Investors and ratings agencies alike may over/under react to anecdotal data. The recently reported default of the Mashantucket Pequot tribe on some of its debt obligations, for example, may cause investors and ratings agencies to undervalue other tribal bonds, including bonds which have not yet been issued. [70]

Ratings on not *per se* required for a successful bond issuance, but they become significantly more important when there is little other information upon which an investor can make a determination of the credit worthiness of the issuer.

E. Lack of Information About TEDBS May Impair Investor Demand

1. No Tribally Created Bonding Regulations

States are regulated by reasonably well-developed rules that limit the circumstances in which bonds may be issued. Tribal governments, on the other hand, are not constrained by the same constitutional or statutory regimes that constrain states. The lack of a clear legal or regulatory framework defining how the issuer and investor will define and manage their relationship could have a chilling effect on potential investors and, at the very least, increase the cost of borrowing due to lack of information or certainty.[71]

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[70] Some institutional bond buyers are reporting that there is indeed a market dislocation due to the 2009 reported default by the Mashantucket Pequot tribe.

[71] Fitch Ratings, "Tribal Governments in the Bond Market," (2004). Legal covenants, tribal governance and tribal sovereignty affect ratings.

For instance, while the federal constitution constrains actions by States, the federal constitution does not by its own terms apply to tribal governments. The 1968 Indian Civil Rights Act, however, imposes some of the federal constitutional limitations on tribal governments although there is no federal jurisdiction to decide claims brought under the Indian Civil Rights Act. Claims brought under the Act must be brought in tribal courts. Judicial development of the "impairment of contracts" clause of the constitution may be interpreted differently in tribal courts.

On the matter of regulatory guidance or established legal parameters, these also are not well-developed or readily predicted. Tribal governments decide as a matter of policy whether and how the rules that limit states in issuing bonds should apply in Indian country. Rules that restrict states in issuing bonds, rules that protect bondholders and rules that protect taxpayers do not apply unless the tribal government elects to make them applicable. For instance, state law requirements for voter referenda to issue bonds, and related case law such as usurpation and oppression rules of open meetings acts would not apply unless adopted by the tribe. Similarly, state constitutional limits on debt issuances do not apply to tribal governments.

Finally, investors have been historically concerned about whether tribes will waive their sovereignty in favor of creditor rights. This creates uncertainty in the capital market because investors must be assured of the debtor's willingness to pay. Tribes have been given little opportunity, to date, to prove to the capital markets their willingness to pay. And, so again, time is needed to educate the market.

2. Lack of Debt Performance History

In addition, due to the chilling effect that Section 7871(c) has had on tribes' ability to issue tax exempt financing for their economic development needs, only a handful of tribes' have experience and success in issuing exempt debt. In fact, there were only two successful issuances (not TEDBs) in 2009. Accordingly, there is a paucity of information available to the capital market and potential investors about tribes as debtors. In addition to the effect of this information paucity or "asymmetry" on bond ratings discussed previously, the lack of knowledge and information will either discourage tribal issuances or increase the cost of the issuances.[72] It will take time to educate both the investors and the tribes on their exempt debt issuance opportunities. To this end, some have suggested a Tribal Financial Information Clearinghouse.[73]

F. Other Barriers To Issuance of TEDBs

The short time-frame created by Notice 2009-51 will no doubt have a dilatory effect on the ability of tribes to issue their allocation of volume cap. Applications for the allocation of the first tranche were due only six months after the passage of ARRA. Tribes had

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[72] Clarkson, "Information Asymmetry and Information Sharing" Government Information Quarterly 24 (2007).

[73] *Id.*; www.tribalfinance.org.

only one month to apply for the first tranche and 5 and a half months to apply for allocation of the second tranche. There was some misunderstanding in the community as to the application process for TEDBs. In Alaska, there was no information. Some tribes thought an application for allocation resulted in an immediate encumbrance. Many tribes were not aware of the application process. The application for allocations required tribes to describe specific projects and a plan of financing for the project. Providing the required information was challenging. Many tribes had projects identified as part of business plan, but they were not far enough along in the planning process to make their projects shovel- ready in time for the application deadlines.[74]

The administrative cap on allocations is relatively small and may limit the projects that tribes would choose to undertake using TEDBs. Correspondents report that tribes and others often borrow amounts less than $8-12 million through stand-alone or syndicated commercial loans. The transaction costs of borrowing are greater for smaller issuances relative to the total amount of the loan. Smaller bond issuances are not highly liquid and are more expensive to trade in the secondary market.[75] The range of debt that TEDBs will best serve is therefore small.

Issuance of TEDBs will be impacted by the other available financing mechanisms. In addition to TEDBs, tribes have access to new financing options such as BABs, qualified School Construction loans, Clean Renewable Energy bonds, Recovery Zone bonds and so on. These additional options may cause tribes to choose these financing vehicles over TEDBS in the short term. Indeed, the BABs have proved to be very popular. Many TEDBs will be issued as BABs. Because BAB's are easier to market – they will displace the demand for TEDBs somewhat.[76] Tribes may opt to issue Build America Bonds to finance "essential governmental functions" or finance projects which have received an allocation of TEBD volume cap pursuant to Section 7871(f)(1).[77] Tribes are working on ways to combine their financing options among all of these new opportunities. In fact, combining the financing of projects with taxable, tax exempt and/or tax credit options will be in many cases a necessity given the relatively small TEDBs allocations. Again, however, it will take time to make these determinations which is especially difficult in a volatile and uncertain credit market.

Finally, the general credit market conditions since passage of ARRA most certainly will impact the marketability of TEDBs. Discussion of the national economy and credit market conditions are beyond the scope of this report. However, ACT suggests that the

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[74] At the time this report was prepared, only three (3) tribes had successfully issued a TEDB.

[75] Harris and Piwowar, "Secondary trading Cost In the Municipal Bond Market", Univ. Southern Calif. Seminar Presentation, May 18, 2004, p.2, ("more than one million municipal securities exist, but very few trade with any regularity in the secondary market"..."small trades are substantially more expensive than large trades").

[76] It has been reported that BAB issuances for 2010 will total $100 billion. (www.-ac.notherntrust.com).

[77] The IRS ruled recently that tribes are permitted to issue their TEDB allocation as a BAB. Chief Counsel Advice AM 2009-014, October 26, 2009.

efficacy of TEDBs cannot be fully evaluated without factoring in the impact of general market conditions.

VIII. RECOMMENDATIONS

1. There is a demonstrated need for TEDBs. The well known and persistent economic conditions prevailing in Indian country throughout the United States bear witness to the need for assistance. There would be nothing remarkable about extending the same subsidies that the United States offers to state and local governments to Indian tribes. The over-subscription of tribal governments of the $2 billion allocation of TEDBs indicates the strength of the need for low cost financing for infrastructure in Indian country. Therefore, ACT recommends that TEDBs be made a permanent addition to tax exempt financing opportunities for tribes.

2. ARRA does not impose a time limit on the use of TEDBs. The ACT anticipates that some recipients of allocations may forfeit them. To accommodate that possibility, ACT recommends to the Service that the Service afford tribes ample opportunity to make complete use of the $2 billion allocation. The Service proceeded on an expedited basis in calling for applications for allocations. The Service's decision was understandable given the economic conditions prevailing at the time that ARRA was passed and the short turnaround time for a report to Congress on the efficacy of TEDBs. As we have argued in this report, however, there are obstacles to immediate and full implementation of TEDBs. Many of these obstacles are longstanding and will take time to work through.

3. Neither Treasury nor the Service should be required to determine how TEDBs should be allocated. As our report indicates, there will be forfeited allocations for a multitude of reasons. Thus, a determination will have to be made as to how to reallocate the forfeited volume cap. The ACT concludes that the difficult question about how to allocate TEDBs should only be made by Congress in consultation with tribes. As the President's Executive Order 13175 indicates, tribes and the U.S. government have a government to government relationship which must be respected, particularly with regard to issues directly affecting tribal governments. Delegation of the decision-making authority for allocating TEDBs to Treasury or the IRS contravenes the President's mandate. For purposes of the ARRA Section 1402 report to Congress, we invite the Service to note our objection to Congress' delegation to the Service the responsibility for judging the proper allocation of tax exempt financing.

4. We recommend that Treasury's report to Congress include information about the need of tribal governments for infrastructure and development relative to state and local governmental subdivisions. Billions of dollars in capital needs go unmet each year in Indian Country for infrastructure, housing, community facilities and enterprise development.

5. ACT recommends an increase in the TEDBs volume cap. We recommend that Treasury explore, in consultation with the tribes, the proper amount or elimination of the volume cap for TEDBs. Given the significant unmet need for exempt financing, the $2 Billion volume cap is impractical.

6. We recommend that Treasury develop a consultation policy to hear from tribes on problems and solutions to using the TEDBs (and other bonds which tribes can issue under ARRA). Consultation focused on this issue will assist Treasury going forward and will help Treasury to understand the unique circumstances in which tribes must operate. Some of those have been described in this report.

7. ACT suggests that Treasury's report to Congress consider the following:

   A. That BIA loan guarantees be made available for TEDBs.

   B. That the Securities Act, be amended to include tribes as governmental issuers to allow tribes broader access to the credit markets.

   C. Address the ongoing affect of the "essential governmental function" test of Code Section 7871 and whether and to what extent the TEDBs answer the policy concern of placing tribes and state and local governments on the same footing for purposes of tax exempt financing opportunities.

8. Because of the Tribes' experience with the 7871(c) bonds, some tribes remain wary of issuing bonds for fear of audit and open ended rules for issuing TEDBs. Accordingly, ACT suggests that the Service focus on proactive guidance and compliance checks, in an effort to work collaboratively with tribes to ensure successful issuances. We recommend continuing outreach for the next two to three years. The total number of TEDBs that will be issued will be a manageable number. The Service can provide localized assistance to issuing tribes. Careful stewardship by the Service ought to reduce or eliminate the need for audits and will improve the tribes' view on the utility of issuing bonds.

ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Tax Exempt Bonds: Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds

Michael Bailey
David Cholst
George T. Magnatta

June 9, 2010

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EXECUTIVE SUMMARY

This project makes specific recommendations with respect to the voluntary closing agreement program (*"VCAP"*) and the streamlined voluntary closing agreement program (*"SVCAP"*) for tax-exempt bonds and tax-advantaged bonds in the Internal Revenue Manual (*"IRM"*). The project recommends additions and changes to the IRM to make VCAP and SVCAP more inclusive, more flexible and less costly to administer. The project also recommends additions to SVCAP for certain violations specific to Build America Bonds, Recovery Zone Economic Development Bonds and direct pay versions of qualified tax credit bonds (*"Direct Pay Bonds"*) all of which provide for direct payments to the issuer of the bonds under Section 6431 of the Internal Revenue Code of 1986 (the *"Code"*).

Issuers of tax-exempt, tax credit and direct pay bonds may use VCAP and SVCAP to voluntarily correct violations that are not discovered through the Internal Revenue Service's (*"IRS"*) examination program. The use of VCAP and SVCAP by issuers should be encouraged. To that end, specific recommendations have been made to, among other things, (i) provide clear assurances that VCAP and SVCAP closing agreements will be more favorable than closing agreements used to resolve examinations, (ii) relax eligibility requirements that seem unnecessary and could dissuade issuers from using VCAP and SVCAP, (iii) provide procedures that permit self-correction of violations with minimal required IRS action, and (iv) allow for special procedures in the case of *de minimis* violations. Taken together, these changes should serve to promote the use of VCAP and SVCAP while making the program more administratively efficient.

Additionally, specific guidance is needed regarding how to remediate possible violations of statutory requirements relating to Direct Pay Bonds. Lack of such guidance may be a deterrent to the issuance of these bonds. Certain remediation rules that are currently available for tax-exempt bonds are not well suited to apply to Direct Pay Bonds. Particularly, unlike in the case of tax-exempt bonds, the tax subsidy for non-qualified Direct Pay Bonds may be removed without the need for redemption of the bonds. The proposal contains remediation provisions based on downsizing the amount of payments made on a Direct Pay Bond issue to ensure that credits are only paid for qualified bonds, allowing the issuer to confirm that the remainder of the issue qualifies for receipt of future credits. Issuers would alert the IRS to a re-sizing of the Direct Pay Bond issue by filing a "Direct Pay Reduction." The project puts forward specific additions to the IRM to address expenditure violations, issue price premium violations and private activity violations. In certain circumstances, if credits have been improperly paid, the issuer would be required to either repay the amounts improperly received in a lump sum at the time of the settlement agreement or agree to a reduction in its future subsidy payments.

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I. GENERAL PRINCIPLES FOR VCAP

Issuers of tax-exempt, tax credit and build America bonds may use the voluntary closing agreement program established under Notice 2008-31 (*"VCAP"*) to voluntarily correct violations that are not discovered through the IRS' examination program. TEB has accepted the principle that VCAP settlements should be proportional to the violation but has not set forth specific principles regarding proportionality. IRM 4.81.6.5 sets forth the bases for entering into closing agreements to resolve issues raised in examination, which bases include taxpayer exposure, the amount of income tax liability of a conduit borrower as a result of the application of Section 150(b) and arbitrage benefit received. In general, the IRS should clearly state the principal that the bases of closing agreements under VCAP should be more favorable and flexible than the bases of closing agreements to resolve examinations.

In that light, the ACT believes that the IRS should clearly state the principle that, in general, the bases of VCAP settlements should focus on benefit received by the issuer or conduit borrower, rather than tax exposure. In addition, the ACT believes that voluntary compliance is best encouraged through the use of a clear statement that VCAP settlements should not put the issuer in a worse position than it would have been had the issuer taken actions permitted under applicable rules that if timely taken would operate to eliminate or minimize the size of the violation. For example, rules that should be considered are the remedial action rules under Treas. Reg. Section 1.141-12 and the allocation rules under Treas. Reg. Sections 1.141-6 and 1.148-6. As such, an issuer that voluntarily requests correction of its violation should not be significantly worse off than it would have been had it acted properly in accordance with the rules. In applying these principles, the voluntary closing agreement procedures set forth in Rev. Proc. 97-15 should not be viewed as the exclusive means to resolve violations, and should not restrict the settlement approaches taken by the IRS in this context.

With respect to violations that result in more tax advantaged bonds being outstanding longer than permitted, the voluntary exaction should involve forfeiting the benefit received related only to the Bonds allowed to remain outstanding longer than they would in compliance.

A. Eligibility For VCAP or SVCAP Should Not Always Require a Statement Of Date of Issuance Reasonable Expectations

The existing VCAP procedures set forth in the IRM provide that certain information is required to be included in a VCAP request and that failure to include any of these items will result in the Service declining to consider the request. One of the required items is "Statements of good faith including…a statement that, on the issue date, the issuer reasonably expected to comply with section 103 and all related provisions of the Code." IRM 7.2.3.1.6. The ACT believes that a requirement that the issuer state that it had compliant reasonable expectations as of the date of issuance is not necessary or appropriate in the case of many types of VCAP requests, including SVCAP requests for Direct Pay Bonds.

If, for example, an issuer of Direct Pay Bonds that are Build America Bonds has excess proceeds, the issuer may reasonably seek to enter into a closing agreement to resolve, as a conservative measure, that the Service will not in the future challenge the reasonableness of its expectations as of the date of issuance. There are many other instances where an issuer may similarly seek a closing agreement to protect, as a conservative measure, against a challenge to the reasonableness of its expectations.

Another example arises when an issuer of build America bonds seeks to enter into a closing agreement because of a concern that bonds may have been issued with an issue price containing more than the permitted amount of premium. In such a situation, it could be argued that all of the information relevant to the determination could have been known by the issuer on the date of issuance. Thus the reasonable expectations certification may not be possible.

The ACT agrees that a statement establishing good faith is a reasonable requirement of the VCAP program, but that good faith can reasonably be established without a rigid requirement of a statement of date of issuance compliant reasonable expectations. For that reason, the ACT recommends that IRM 7.2.3.1.6.E be revised to provide that an issuer is required to make statements of good faith “which may include” certain enumerated items, including possibly favorable reasonable expectations, or inadvertent errors, but possibly other criteria.

B. Automatic Additional Payment Amounts Are Not Generally Appropriate

The current SVCAP procedures set forth in the IRM contemplate that an issuer will be required to make an additional payment amount or “penalty” in the event that a period of time passes between the date of a violation and the date the issuer submits a request for a voluntary closing agreement. For example, the procedure for “excessive nonqualified use” provides that an issuer will pay 100 percent of taxpayer exposure on nonqualified bonds if the request is submitted within 180 days of a violation, and 110 percent of taxpayer exposure if the request is submitted after 180 days and within one year of the violation. The evident intention of these “penalties” is to provide an incentive for issuers to promptly identify violations and submit requests for voluntary closing agreements.

As a practical matter, however, a delay in seeking a voluntary closing agreement does not necessarily reflect a lack of good faith on the part of an issuer. The eligibility requirements for tax-exempt bonds and tax credit bonds are highly complex, sometimes very costly to monitor, and often subject to difficult questions of legal interpretation. Moreover, an issuer seeking a voluntary closing agreement already suffers a “penalty” to the extent that interest at the underpayment rate is added to the settlement amount. Accordingly, the general presumption should be that no additional payment amount is required, provided that the issuer can reasonably demonstrate its good faith. The ACT emphasizes that the act of seeking a voluntary closing agreement itself should reasonably be regarded as one factor demonstrating good faith.

If the Service believes that additional payments are in some cases appropriate, a better approach than under the current IRM would be to generally require additional payments only if the issuer failed to request a voluntary closing agreement within a reasonable period (for example, 180 days) of discovery of a violation. Such an approach would be comparable to the approach taken with respect to rebate payments that are not timely made in Rev. Proc. 2005-40. In general, under this procedure, an issuer is permitted to correct a late rebate payment by making a payment, including interest at the underpayment rate, *provided* that the Service does not find that the late payment was due to "willful neglect" within a period of 90 days of the date the payment is made.

Furthermore, the IRS should articulate the most important factors in determining the extent of any additional payment amounts. We believe that the guidelines should state that key factors should include the following: (1) whether the issuer acted in good faith by taking steps to implement a post-compliance procedure for all or a significant portion of its outstanding bonds; and (2) the timeliness of making a voluntary closing agreement submission after discovering the possible violation.

We appreciate the need to encourage prompt correction of violations and believe that it is appropriate for closing agreement amounts to require a limited amount of additional payment for dilatory behavior. For this reason, it is reasonable in some instances to require a modest amount of additional settlement payments if more time has passed from either the discovery of the violation or the violation itself. However, we believe that the IRS should generally require such additional payment amounts as part of voluntary settlements in a measured and limited manner with clear maximum percentage amounts applicable in all but the most egregious circumstances. For example, we believe that such additional payment amounts should only rarely exceed ten percent (10%) of the otherwise appropriate amount. (This ten percent (10%) additional payment is already expressed in some of the existing SVCAP procedures.) Perhaps more importantly, the IRS should articulate the principles that will be used to determine the degree of such additional payment amounts. We acknowledge that ordinarily any VCAP settlement would include interest for any delayed payment.

In all events, the ACT recommends that there should be no rigid time period during which an issuer must seek a voluntary closing agreement for a specified violation.

C. Minimal IRS Action Is Desirable

In the case of a violation that can be self-corrected by the issuer in a reasonable manner, the preferred approach is that such self-correction should not require IRS action or should require minimal IRS action. Requiring signed closing agreements in cases where the corrective action is clear only makes the program less efficient, more costly and more administratively onerous for both the IRS and issuers and borrowers. Ideally, the IRS should adopt procedures that provide that written notification to the IRS of certain corrections should constitute compliance with the VCAP procedures. The IRS' bias should be towards settlements that are self-correcting. If TEB believes it lacks the authority to accept self-correcting VCAP submissions without the need for execution of formal closing agreements, the procedures provided in the Internal Revenue Manual should nonetheless encourage mechanical and automatic closing agreement terms where possible. This should be especially true in matters that have been well defined in the Internal Revenue Manual as eligible for the Streamlined VCAP program (*"SVCAP"*). It would be appropriate for regulations or a revenue procedure to provide that if the terms provided in the IRM for the particular SVCAP violation are met then the IRS will execute the closing agreement in the manner provided unless it objected in a short period of time (ninety (90) days). The ACT understands that this result may not be achievable through a simple modification of the IRM. However, the IRM could provide that where a VCAP request includes a statement that the request meets the criteria provided for one of the identified SVCAP violations and otherwise includes all of the requirements for an SVCAP settlement, TEB would be required to respond within a short period (90 days) indicating whether TEB would agree to settle under the terms outlined in the IRM for such identified violation. Where TEB indicates that it is not willing to settle according to the terms provided for such specified violation in the IRM, TEB could be required to explain why the settlement terms provided in the IRM for the violation are not appropriate in the given case. Given such an IRM provision, TEB would, we believe be likely in most cases to agree to quickly settle such requests according the prescribed remediation provided in the IRM. This would allow the applicant in most cases to know the terms of its settlement even before it receives the signed closing agreement back from the IRS. In the circumstance under which TEB provides an explanation of why such terms are inappropriate, the issuer would quickly have an explanation of the disagreement.

D. SVCAP Should Be More Inclusive

In order for the SVCAP procedures to be most effective, the program should be designed so that more closing agreements should fit into the SVCAP patterns. For this reason, the descriptions of the violations should be broad, and the settlement terms should include clear determinations of the amount of any settlement payment and other settlement terms. Rather than limiting the SVCAP process to applicants that met certain time lines, a preferable approach would be to allow such violators to meet the SVCAP terms, but to require additional payments on a clearly defined basis, if appropriate.

E. VCAP Should Remain Flexible and Use Should be Encouraged

The IRS should focus on the principle of flexibility in the application of its VCAP relief in order to encourage more issuers to use the voluntary compliance program.

Additionally, the mere fact that an issuer has come to the IRS before for VCAP relief with respect to the same bond issuance or the same or other possible violations with respect to a different issue should not be a negative factor; in fact, it should be viewed as a positive factor to the extent that such multiple submissions demonstrates diligence on the part of the issuer. A history of chronic violations by an issuer that are discovered in examination, however, may be a negative factor.

The SVCAP procedures clearly provide a framework for establishing possible settlements. However, actual facts related to specific violations may indicate other settlement terms. TEB should remain flexible in implementing closing agreements on terms more favorable than those outlined in the SVCAP procedures based on facts and circumstances.

F. Special Procedures Should Apply For Small Violations

A number of the eligibility requirements for tax-exempt bonds and tax credit bonds are drafted in a manner that literally provides that even very small violations can cause an entire bond issue to fail to comply. Examples include the requirement for qualified 501(c)(3) bonds in section 145(a) of the Code that 100 percent of the financed property "is to be owned" by a 501(c)(3) organization and the requirement of section 54AA(g) that 100 percent of certain available project proceeds "are to be used" for capital expenditures. One way to mitigate the administrative burden of such rules is to establish reasonable de minimis rules by regulation or other guidance. The Service has in fact taken such an approach in the regulations interpreting the "spending exceptions" under section 148, which provide for certain de minimis relief from the spending exception requirements.

The ACT submits that a comparable approach is generally appropriate under the VCAP and SVCAP program. Because the technical consequence of even very minor violations can be that an entire bond issue is ineligible, issuers may reasonably seek VCAP even for relatively small violations. In the case of a relatively small violation involving use of bond proceeds, it is in particular often unreasonably costly to require an issuer to establish a yield restricted defeasance escrow to defease bonds. In such an instance, a reasonable approach should be to permit an issuer to apply the required remedial action to the next maturing principal payment, or to other maturities in any reasonable manner.

The ACT recommends that an appropriate standard for such streamlined procedures be a use of proceeds that is less than $250,000 or 3 percent of the issue price of a bond issue. Such relief should be available for multiple violations separately meeting the de minimis standard, *provided* that the violations occur at least one year apart, and the issuer demonstrates good faith in compliance.

G. Expedited Implementation Should Not Require or Imply Substantive Interpretation of Eligibility Requirements

The ACT believes that expedited implementation of SVCAP procedures for Direct Pay Bonds does not require substantive interpretation of the new requirements that apply to Direct Pay Bonds. For example, Code section 54AA(g)(2) provides that, in the case of a Direct Pay Bond that is a Build America Bond, 100 percent of the excess of the available project proceeds over the amounts in a reasonably required reserve "are to be used" for capital expenditures. This wording is very similar to the wording of the use-of-proceeds requirements set forth in section 141 of the Code (for governmental bonds), section 145 of the Code (for qualified 501(c)(3) bonds) and section 142 of the Code (for exempt facility bonds). In part because Build America Bonds build upon the framework for governmental bonds under section 141 of the Code, the ACT believes that the best interpretation of this requirement is that the “are to be used” requirement means that the issuer must reasonably expect to use 100 percent of available project proceeds (other than amounts in a reasonably required reserve fund) for capital expenditures, and must not subsequently take a “deliberate action” to spend such amounts on capital expenditures. Under this interpretation, a Direct Pay Bond that is a Build America Bond would not fail to qualify because of a failure to spend proceeds on capital expenditures because of events that were not reasonably expected.

The ACT acknowledges, however, that the interpretation of the “are to be used” expenditure requirement may require approval at the high levels of the IRS and the Treasury. By comparison, the interpretation of the “are to be used” requirement under section 141 was one of the most important interpretive decisions made in the private activity bond regulations published in 1997. Accordingly, the ACT acknowledges that interpretation of all of the substantive requirements may be somewhat delayed.

Even assuming that the Service and Treasury interpret the 100 percent capital expenditure requirement in the same manner as the private activity bond requirements of section 141 (that is, based on date of issuance reasonable expectations and subsequent “deliberate actions”), the availability of SVCAP for Direct Pay Bonds will be important and useful. For example, suppose an issuer fails to spend a portion of proceeds of Direct Pay Bonds on Build America Bonds because of an event that was not reasonably expected on the date of issuance. Even if the issuer believes that the best analysis is that the Build America Bonds qualify with the requirement, the issuer might want to assure that the Service would not challenge the reasonableness of its expectations. In such an instance an issuer might, as a conservative measure, seek a voluntary closing agreement relating to the failure to expend proceeds on capital expenditures to foreclose a possible future challenge, even if the issuer believed that the best analysis is that the bonds continue to qualify.

H. Certain Specific Changes to Existing SVCAP Procedures Are Desirable

In general, the ACT believes that the SVCAP settlement standards for the “identified violations” set forth in IRM 7.2.3.3.2 are a helpful step forward for both the Service and issuers of tax-exempt bonds and tax credit bonds. The ACT believes, however, that certain of the settlement standards are unduly harsh. In particular, the settlement standard for a use of proceeds that results in the weighted average maturity of a bond issue exceeding 120 percent of the weighted average economic life of the financed property can be unduly punitive. The existing settlement procedure would require an issuer or conduit borrower to redeem or defease bonds to reduce the weighted average maturity of the bond issue to 110 percent of the weighted average economic life of the financed property. Under existing practice, many issuers have corrected such violations by redeeming or defeasing bonds of an issue to reduce weighted average maturity to the 120 percent standard set forth in section 147(b). A better approach than under the existing SVCAP procedure would be to acknowledge that such “self-help” remediations will be effective to comply with the 120 percent bond maturity requirement. In cases where such “self-help” remediations are not possible, the ACT believes that the settlement standard should be based on the 120 percent test set forth in section 147(b), and not the lower 110 percent test set forth in the existing procedures.

The requirement in IRM 7.2.3.3.2.1 that a defeasance escrow be established before the date the closing agreement is executed by the IRS is needlessly restrictive. The process could be sped up through a closing agreement that requires such establishment within a short time frame. We also note that under IRM 4.81.6.5.1.2 in the case of bonds being redeemed under a closing agreement that settles an examination, a defeasance escrow need not be established until 90 days after the execution of the closing agreement.

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II. ADDITIONS TO VCAP — DIRECT PAY BONDS

Issuers of Build America Bonds (*"BABs (Direct Pay)"*), Recovery Zone Economic Development Bonds (*"RZDBs (Direct Pay)"*) and other recently authorized direct pay and tax credit bonds collectively *"Direct Pay Bonds"*), which qualify for the credit under section 6431 of the Code, are in need of guidance regarding how to remediate possible violations of certain statutory requirements relating to Direct Pay Bonds. Such violations could void the credits otherwise available to an issuer. The Direct Pay Bond programs enacted as part of the American Recovery and Reinvestment Act of 2009 are intended by Congress to provide economic stimulus. We understand that The Treasury Department has proposed a permanent extension of the Direct Pay Bond program so that such bonds are expected to be a long-term component of public finance. Issuers are in need of guidance with respect to the ability to remediate certain violations in the form of a reduction in payments that is commensurate with the violation. Lack of such guidance may be a deterrent to the use of these stimulus provisions and the efficiency of the federal subsidy made possible with Direct Pay Bonds. Additionally, certain remediation rules available in the case of tax-exempt bonds are not well suited to apply to Direct Pay Bonds. For example, section 1.141-12 permits an issuer of tax-exempt bonds to remediate through the redemption of so-called "non-qualified bonds." Direct Pay Bonds, however, are often sold with make-whole redemption features that allow the Direct Pay Bonds to be redeemed at any time but often at a punitively high redemption premium. Even if a Direct Pay Bond is callable at par, remediating such infraction through the redemption of the Direct Pay Bonds in a high interest rate environment could unduly penalize an issuer of Direct Pay Bonds. A Direct Pay Bondholder would receive a windfall because the Direct Pay Bond would be replaced with a higher coupon taxable bond. For tax-exempt bonds, however, redemption of "non-qualified bonds" removes the tax subsidy for bonds that do not warrant the subsidy. For Direct Pay Bonds, the tax subsidy for "non-qualified bonds" may be removed without the need to redeem the Direct Pay Bonds.

Recently authorized direct pay versions of qualified school construction bonds, qualified zone academy bonds, new clean renewable energy bonds and qualified energy conservation bonds should generally benefit from the concepts discussed herein for direct pay bonds. However, there are certain requirements of these newer types of direct pay bonds that may prevent the application of proposed SVCAP provisions to those bonds. The proposed SVCAP additions are intended to apply primarily to Direct Pay build America bonds including recovery zone economic development bonds.

Ultimately, we believe that the best approach is modification of the remediation regulations under Treas. Reg. §1.141-12 (or promulgation of similar regulations under Section 6431 of the Code) to allow notification of the IRS that the credit under Section 6431 of the Code will no longer be claimed for "non-qualified bonds." Such remediation regulations may however not be available in the short run to provide issuers with the comfort that a violation may be cured. Issuers of Direct Pay Bonds need immediate guidance regarding the manner in which to remediate. As such, the IRS should provide some form of guidance with respect to the manner in which certain violations may be remedied under the Voluntary Closing Agreement Program (*"VCAP"*) and in particular, the Streamlined Voluntary Closing Agreement Program (*"SVCAP"*) described in the Internal Revenue Manual (*"I.R.M."*). We recommend that these I.R.M. additions should be implemented as quickly as possible to provide issuers with needed guidance.

There exist a large number of potential violations for Direct Pay Bonds. Identified herein are certain of types of possible violations that may be suitable for the SVCAP. The list focuses on violations relating to use of proceeds and does not include violations due to noncompliance under the arbitrage rules in Section 148 of the Code. We note that the list includes situations for which the existence of a violation may be less than clear given the current status of substantive guidance in this area. We recommend that an issuer be able to avail itself of the SVCAP process if the issuer has reason to believe that a violation may have occurred. SVCAP should be available to protect an issuer that is concerned that there may have been a violation.

In order to implement an efficient VCAP program for Direct Pay Bonds, it is important to provide common methodology for reducing the federal subsidy as a method of remediation. The same procedures could be used in all VCAP settlements regardless of whether the violation was covered by SVCAP. Also these procedures could inform the development of subsequent regulations that could allow remediation without the need for formal closing agreements.

A. Elements Common to All Direct Pay Bond VCAP Matters (Both Streamlined and Otherwise)

The basic form of remediation is provided to avoid an issuer from losing its federal interest subsidy on Direct Pay Bonds because it possibly does not meet the programmatic requirements for Direct Pay Bonds. In each case, the VCAP settlement should include treating the bond issue as downsized to a smaller issue (or outstanding for a shorter period of time) to assure that Section 6431 credits are not obtained in situations in which they are not warranted.

To effect this reduction in future credits, the issuer would submit a *"Direct Pay Reduction"* that would notify the IRS of the re-sizing of the future credit payments. The Direct Pay Reduction would be submitted with the VCAP request, but it might also be submitted before the VCAP Request to enable the issuer to avoid receipt of credits for which it did not expect to be eligible. We envision that it would be attached to a Form 8038-CP filed with respect to the particular issue of bonds. Each Direct Pay Reduction would include the following information:

1. The effective date (*"Effective Date"*) of the reduction. Generally, this will be a date on or shortly after (ninety (90) days after) the date of the violation. It cannot, however, precede the date of an interest payment that was related to a Form 8038-CP filed before the date of the Direct Pay Reduction. Note that the Effective Date need not be an interest payment date, and that it may be a date that is significantly earlier than the date that the Form 8038-CP is due. The

interest subsidy to be paid on such 8038-CP would be re-calculated using the reduced interest amount accruing from the Effective Date. To the extent that the violation occurred earlier than the Effective Date, the issuer could make up the difference through payment of a Correction Amount described below.

2. The schedules originally attached to the Form 8038-G, Form 8038-B, Form 8038, or Form 8038-TC (or in the case that a Direct Pay Reduction was previously filed, the schedules attached to such previous Direct Pay Reduction) indicating the dates and amounts of anticipated principal and interest payments, outstanding principal as of each interest payment date and the amount of the anticipated credit on each interest payment date;

3. The reduction of outstanding principal (and therefore interest payments) eligible for the credits under Section 6431 of the Code as of the Effective Date together with the resulting schedules of the remaining dates and amounts of anticipated principal and interest payments, outstanding principal as of each interest payment date and the amount of the anticipated credit on each interest payment date.

In addition to showing a total principal reduction, it is necessary for any Direct Pay Reduction to set forth how such reduction will be applied to the individual maturities and sinking fund installments of the bond issue. To keep the process simple, the ACT recommends that if the amount of any Direct Pay Reduction (together with any previous Direct Pay Reduction) is less than the lesser of $250,000 or three percent (3%) of the par amount of the issue (the *"De Minimis Amount"*), then the principal schedule may be reduced by choosing any particular maturities or sinking fund payments to achieve the reduction. In cases in which the amount of such reduction exceeds the De Minimis Amount, the reduction amount must reduce the principal maturities in the manner prescribed in Treas. Reg. §1.141-12(j).[1]

In cases of violations occurring before the Effective Date of the Direct Pay Reduction, a payment (the *"Correction Amount"*) to the IRS of the amount of credits claimed and received in excess of those that would have been received if the transaction had been structured to eliminate the violation, or permitted remediation had eliminated the violation may be required as an additional condition for the settlement. In measuring this amount, the issuer should be treated as having taken actions (including adopting accounting methods) that would have minimized the violation. This does not mean that the issuer should have the benefit of hindsight. Only actions and allocations that at the time of the violation would have acted to reduce the scope of the violation should be

1 The *de minimis* rule is intended for convenience and to accommodate minor mishaps. The general rule is intended to mimic the private use remediation rules. We note that Prop. Treas. Reg. §1.141-12(j) would modify the private activity remediation regulations. These procedures are intended to follow whatever rules apply under the private activity remediation regulations. Most of the contemplated violations are related to expenditures. The proposed de minimis rule is based on the rule for the spending exceptions to arbitrage rebate.

considered. Purely as a matter of convenience, the Correction Amount may be based on the highest coupon rate on any of the bonds of the issue.

The Correction Amount should be calculated to include interest at the underpayment rate prescribed in Section 6621 of the Code for the period from the time of the violation to the time of payment with adjustments to facilitate calculation. As with interest on late rebate payments, it is reasonable, for example, to cut off the late interest at some arbitrary date (e.g. 10 days) before the payment is actually made.

When the Effective Date occurs significantly after the date of the violation, it may be appropriate to add an "additional payment amount" to the Correction Amount. When the Effective Date is less than five (5) years after the Violation date, we believe that the additional payment amount should be limited to ten percent (10%) of the otherwise computed Correction Amount.

However, we do not believe that this additional payment amount should be automatically added to all Correction Amounts. Even when there is a significant period of time between the date of the violation and the Effective Date, we believe that any additional payment amount may be waived by TEB on a showing of good faith.

When the Effective Date is before, or within a short period of time of the violation (e.g., ninety (90) days) the Correction Amount should be set to zero. The remediation in such situations should be only the elimination of future Direct Credit Payments.

Alternatively, in lieu of making a payment of the Correction Amount to the IRS contemporaneously with the closing agreement, the IRS should consider allowing prospective credits to be reduced by the Correction Amount plus interest from the date that the payment would otherwise be due to the IRS. In lieu of paying the amount as a settlement amount, the issuer may request that its future interest subsidy payment be reduced in an amount equal to the settlement amount plus interest calculated at the rate for underpayments prescribed in Section 6621 of the Code (the *"Interest Subsidy Reduction"*).

In order to expedite the process, an issuer applying for the VCAP should in each case file a request for the reduction of future credits contemporaneously with (or before) submitting the VCAP application. The issuer may not receive the Closing Agreement for some time after submitting it to the IRS but the IRS should require that the effect of the credit reduction must be immediate or nearly immediate.

The request for reduction of future credits should be simple to complete, uniform in appearance, and be easy to understand.

If TEB does not choose to create a new tax form or modify an existing tax form for this purpose, it may simply require a notification of TEB of itemized information and requested relief. Although the information could be included directly in the VCAP request, a separate notification may cause it to be acted on immediately by TEB so as to affect future Form 8038-CP credit requests. Regardless of the form it takes, we refer to this submission as a *"Direct Pay Reduction."*

One simple method of providing the notification would be to require the issuer to attach a schedule to the Form 8038-CP it next files after submitting a VCAP request or, if the issuer prefers, before filing its VCAP request. Because on many Direct Pay Bonds, Forms 8038-CP are only required to be filed semiannually, and because an issuer may wish to file a Direct Pay Reduction before the next Form 8038-CP is due, if this method is adopted then for purposes of a VCAP request, the Direct Pay Reduction will be considered filed at the earlier of the date the Form 8038-CP is filed with the attached Direct Pay Reduction or the date that the VCAP request is filed if the VCAP request includes a copy of the Direct Pay Reduction. Note that even if the Form 8038-CP and the Direct Pay Reduction are filed long after the Effective Date, the subsidy is eliminated as of the Effective Date.

We are advised that, under current IRS procedures, a Form 8038-CP is compared to information on file as a result of the Form 8038-G or Form 8038-B filed on or around the date of issuance of the bonds. The effect of submitting this modifying information should be to change the information that TEB uses to compare the Form 8038-CP submissions filed after the Effective Date.

A suggested format for such Direct Pay Reduction is attached. The effect of submission of a "Direct Pay Reduction" will be to reduce the amount of any future credit payments to no more than the reduced scheduled amount. Our expectation is that the Direct Pay Reduction be filed as an attachment to a Form 8038-CP filed with respect to the issue.

B. Specific Streamlined VCAP Additions to Identified Possible Violations of Direct Pay Bonds Eligibility Requirements[2]

The particular violations addressed herein to be included in the SVCAP program are set forth below:

1. Failure to spend proceeds for statutorily prescribed purposes.[3]
2. Exceeding the 2% Cost of Issuance limitations on expenditure of Direct Pay Bond proceeds.
3. Allocating BAB (Direct Pay) proceeds to non-capital costs (that are not costs of issuance within permitted levels).
4. Allocating proceeds of RZDBs (Direct Pay) to costs that are not for "qualified economic development purposes" (and are not costs of issuance within permitted levels).
5. Private use violations.
6. Issue price premium violations.

Additional guidance is needed to clarify the rules giving rise to some of these violations; however, this proposal is not intended to and does not provide substantive guidance on the rules giving rise to the violations. For example, in certain situations, the amount of premium and the limit on premium may be unclear. This proposal assumes that a possible violation has been identified and that the issuer wishes to correct the violation, in certain cases by following a very conservative interpretation of the underlying substantive requirements. The guidance set forth herein is not intended to provide a framework for determining if a violation has occurred.

Attached are proposed additions to the IRM to cover certain violations. To better understand these proposed rules, the following explanation is provided. In each case, the general concepts described above, including, Effective Date, Direct Pay Reduction, Correction Amount, and Interest Subsidy Reduction are used. Please refer to Section IIA for the meaning of these common terms.

1. *Excess Proceeds Violations.* The issuer identifies sale proceeds or investment earnings thereon that it does not expect to spend on capital

2 Violations of Code Section 54A or of Code Sections 54B through 54F are not included as SVCAP additions in this project. Direct Pay Bonds subject to Section 54A of the Code are too new for the ACT members to have determined likely common violations. In some cases, the violation of certain Section 54A provisions (e.g. limitation on financing costs of issuance) should be treated in the same manner as violations of the corresponding provisions of Section 54AA.

3 This is not by itself a violation, but it might set up an inevitable future violation that would occur when the bond proceeds are eventually spent for a purpose other than as anticipated.

expenditures or qualified economic development purposes, as applicable (or on costs of issuance within permitted levels).

A violation (an *"Excess Proceeds Violation"*) occurs when the issuer reasonably determines that it will not spend proceeds of a Direct Pay Bond on costs permitted under Code Section 54AA or 1400-U-2, as applicable due, for example, to a cost underun for the project (the *"Excess Proceeds Amount"*). An Excess Proceeds Violation may be viewed as an anticipation of an Expenditure Violation, as described below. The remediation should be the same but we do not believe that an issuer should have to wait until an inevitable Expenditure Violation occurs.

If the issuer submits the Direct Pay Reduction within ninety (90) days of the date that it reasonably determined that it would not be spending all of the proceeds of such bonds and investment earnings thereon as permitted, the Effective Date of the Direct Pay Reduction will be the date ninety (90) days after the date that it reasonably determined that there would be an Excess Proceeds Amount. The total amount of the reduction identified in the Direct Pay Reduction will be equal to no less than the Excess Proceeds Amount. If the amount of such reduction is not greater than the De Minimis Amount, the principal may be reduced from any particular maturities or sinking fund payments that the issuer selects. In cases in which the Excess Proceeds Amount exceeds the De Minimis Amount, the reduction amount must be made in the manner prescribed in Treas. Reg. §1.141-12(j). The VCAP will provide that the Excess Proceeds Amount may then be spent for any purpose that the issuer selects including use for the payment of principal of or interest on the Direct Pay Bonds (within State law constraints and other than use in a manner that could adversely affect the status of another tax-exempt bond, tax credit bond, or Direct Pay Bond). Use of the Excess Proceeds Amount (in the amount of the reduction) will no longer be taken into account for compliance purposes and, following the Effective Date, such amounts will not be taken into account as proceeds for arbitrage purposes. No payment of a Correction Amount is required to cure this possible violation because no violation will occur until after the Effective Date of the Direct Pay Reduction.

2. *Expenditure Violation.* The issuer made (or has been deemed to have made) a final allocation of proceeds of the BABs (Direct Pay) to costs that possibly were not financeable because (1) the costs were for costs of issuance in excess of 2%, (2) the costs were not capital costs, or (3) the issuer spent proceeds of RZDBs (Direct Pay) on an expenditure that was not for a "qualified economic development purpose" (the *"Impermissible Expenditure"*).

A possible violation (an *"Expenditure Violation"*) occurs if the issuer makes a final allocation of proceeds of the Bonds to expenditures for purposes not permitted under Section 54AA or 1400U-2, as applicable. This violation does not occur simply because of a direct tracing of such proceeds to such expenditures if the issuer timely adopts a method of accounting that allocates such proceeds to another permitted purpose. The amount of the Impermissible Expenditure should take into account any final allocations or accounting method adopted by the issuer under Treas. Reg. § 1.141-6 or §1.148-6.

The Effective Date of the Direct Pay Reduction for an Expenditure Violation will be the date that is ninety (90) days after the first expenditure giving rise to the Expenditure Violation.

The total amount of the reduction identified in the Direct Pay Reduction will be at least equal to the amount of the Impermissible Expenditures.[4]

If the Effective Date of the Direct Pay Reduction is more than ninety (90) days after the Expenditure Violation, and the amount of the Impermissible Expenditures is greater than the De Minimis Amount, the issuer will also pay a Correction Amount or agree to an Interest Subsidy Reduction in an amount equal to the amount of credit received before the Effective Date of the Direct Pay Reduction with respect to an amount of bonds equal in principal to the amount of the Impermissible Expenditure. If more than one interest rate applies to different Bonds in an issue, the Correction Amount (or the Interest Subsidy Reduction) may be calculated at the highest interest rate applicable to any Bond of the Issue[5]. If the principal amount outstanding has been reduced prior to the Effective Date of the Direct Pay Reduction, the settlement payment amount may be conservatively calculated by treating the bonds that relate to the settlement payment as remaining outstanding until the Effective Date of the Direct Payment Reduction.

If the Effective Date is more than eighteen (18) months after the date of the Expenditure Violation, an additional amount may be added to the Correction Amount. If the Effective Date is less than five (5) years after the Expenditure Violation, the late penalty should ordinarily be no more than ten percent (10%) of the otherwise computed Correction Amount.

If the principal amount outstanding on the effective date is less than the original principal amount, the amount of the Direct Pay Reduction may be proportionately reduced in a manner consistent with Treas. Reg. § 1.141-12(j).

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4 We propose a principal reduction equal to the proceeds improperly spent. $1 of proceeds may be attributable to less than $1 of principal amount if the bonds are sold with slight premium or because of investment earnings. Thus, when the bonds are sold at par or with premium, the required reduction will be slightly more than the amount that is economically correct. When BABs (Direct Pay) are sold at a discount, the reduction might not result in lowering the proceeds traceable to the “disqualified bonds” by quite the right amount. However, because Section 6431 credits are not computed on accrued OID, the mismatch only relates to the portion of the effective interest cost of the Issuer not eligible for a federal subsidy.

5 This is for convenience only.

The VCAP will provide that facilities financed with such expenditure violations will not be treated as financed with proceeds of the Direct Pay Bonds.

3. *Premium Violation.* The issue price of any maturity of an issue of Direct Pay Bonds exceeded the limit contained in Section 54AA of the Code.[6]

A violation (a *"Premium Violation"*) occurs when the issuer discovers that any maturity of the bonds possibly was treated as sold at a price or prices in excess of that permitted under Section 54AA(d)(2)(C) of the Code.

The Effective Date of the Direct Pay Reduction will be the interest payment date on the bonds occurring most recently before the date of the submission (or the date of issue if submitted before the first interest payment date). The total amount of the reduction identified in the Direct Pay Reduction will be at least the amount necessary to reduce the credits under Section 6431 of the Code to no more than the amount of the credit that would have been available if the bonds had been sold with only the permitted amount of original issue premium. In the case of a bond with at least twelve complete years between the issue date and the maturity date, the amount of the reduction will not be more than the amount by which the actual premium on such bonds exceeded the premium limit applicable to such bonds[7]. The reduction will be applicable to the affected maturity only. If that maturity is subject to mandatory redemption, then the reduction will apply first to the final maturity payment and then to the longest sinking fund installments. The VCAP submission should identify both the issue price and the limit imposed under Section 54AA(d)(2)(C) of the Code. The method of determining the issue price of each such group of substantially similar bonds should also be included in the VCAP request.

If the Effective Date of the Direct Pay Reduction is more than six (6) months after the date of issue, as a condition for a closing agreement, the issuer must also pay a Correction Amount equal to the credits received by the issuer prior to the Effective Date of the Direct Pay Reduction on the amount of the Reduction (or arrange for an Interest Subsidy Reduction to be made). Such amount will be calculated at the coupon rate of the bonds having an impermissibly high premium.

If the Effective Date of the Direct Pay Reduction is more than one (1) year after the date of issue of the bonds, the issuer may be required to increase the Correction Amount by an additional amount. If the Effective Date of the Direct

6 The ACT recognizes the ambiguity in the definition of premium for purposes of Section 54AA and is not attempting in this document to provide guidance on how that premium should be measured. This is a matter in need of separate guidance.

7 ACT members ran and reviewed computations showing that for bonds of at least twelve (12) years of maturity a reduction by the amount of the excess premium would at least reduce the available credit to no more than what the credit would have been without the violation.

Pay Reduction is less than five (5) years after the date of issue of the bonds, the additional amount should ordinarily be no more than ten percent (10%) of the otherwise computed Correction Amount. The additional amount may be waived by TEB on showing of good faith.

The VCAP will provide that the bonds for which the Direct Pay Reduction has been made will be treated as not having a higher premium than permitted.

4*. Private Activity Violation.* The issuer uses bond financed property, secures the bonds, or receives payments with respect to privately used property in a manner that would cause Direct Pay Bonds to be private activity bonds. The ACT recognizes that now[8] and in the future, certain private activity bonds may be permitted to be Direct Pay Bonds. In such case, of course, no violation will occur as a result of private use, private security or private payments. In the case of Direct Credit 501(c)(3) bonds if permitted by future legislation, a Private Activity Violation also could occur if the 501(c)(3) borrower allows the use or ownership of the bond financed property to violate the requirements of Section 145 of the Code.

A violation (a *"Private Activity Violation"*) occurs when the issuer takes a deliberate action that causes the Direct Pay Bonds to be private activity bonds (or in the case of permitted Direct Credit 501(c)(3) bonds to not be qualified 501(c)(3) bonds because of use or ownership of bond financed property).

The Effective Date of the Direct Pay Reduction will be the date ninety (90) days after the date of the Deliberate Action giving rise to the violation, or if submitted after an interest payment on the bonds occurring more than ninety (90) days after the date of the deliberate action, the date of the interest payment date next preceding the date of submission. The total amount of the reduction identified in the Direct Pay Reduction will be an amount equal to the nonqualified bond.[9] However, if the issuer disposes of property in a manner that causes a private use problem, the remuneration is solely for cash and the cash is less than the amount of the "nonqualified bonds," then the amount of such nonqualified bonds should be limited to the amount of cash received by the issuer. In determining this amount, any remedial actions taken and permitted under Treas. Reg. § 1.141-12 shall be taken into account.

8 Currently such bonds are limited to bonds qualifying under Section 54A of the Code.

9 We propose a principal reduction equal to the proceeds improperly spent. $1 of proceeds may be attributable to less than $1 of principal amount if the bonds are sold with slight premium or because of investment earnings. Thus, when the bonds were sold at par or with premium the required reduction will be slightly more than the amount that is economically correct. When build America bonds are sold at a discount, the reduction might not result in lowering the proceeds traceable to the "disqualified bonds" by quite the right amount. However, because Section 6431 credits are not computed on accrued OID, the mismatch is really only cutting into the uncompensated portion of the effective interest cost of the Issuer.

If the Effective Date of the Direct Pay Reduction is more than ninety (90) days after the date of the deliberate action giving rise to the Private Activity Violation, the issuer will also pay a Correction Amount equal to the amount of the direct credit received or accrued between the date of the deliberate action and the Effective Date with respect to bonds in the amount of the Direct Pay Reduction or arrange an Interest Subsidy Reduction to be made. Where more than one interest rate applies to different bonds of the issue, the settlement payment Correction Amount may be calculated at the highest interest rate applicable to any bond of the issue or on a pro rata basis. If the principal amount outstanding has been reduced prior to the Effective Date of the Direct Pay Reduction, the Correction Amount (or Interest Subsidy Reduction) shall be calculated by treating the bonds that relate to the settlement payment as remaining outstanding until the Effective Date of the Direct Payment Reduction.

If the Effective Date of the Direct Pay Reduction occurs more than two (2) years after the Private Activity Violation, a late penalty may be added to the Correction Amount. When the Effective Date is no later than five (5) years after the Private Activity Violation, the additional payment amount should ordinarily be no more than ten percent (10%) of the otherwise computed Correction Amount. This additional amount may be waived by TEB on a showing of good faith.

The VCAP will provide that the Bonds will not be treated as private activity bonds as a result of the identified Private Activity Violation.

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CONCLUSION

This project includes specific recommendations with respect to VCAP and SVCAP for inclusion in the IRM. Of particular importance are workable VCAP rules for the correction of violations of rules applicable to Direct Pay Bonds. Many of the rules applicable to direct pay bonds include no room for error. A minor violation may result in the loss of all direct payments for an entire issue or for an entire maturity of an issue. A workable VCAP program will ensure issuers that violations may be remediated voluntarily with a cost commensurate to the violation.

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SUGGESTED FORM OF DIRECT PAY REDUCTION[10]

PART I [Not required if attached to a Form 8038-CP]

1. Name of Bond Issuer: ______________________________

2. E.I.N. of Bond Issuer: ______________________________

3. Number and Street Address:

   Suite or Room #: ______________________________

4. City, State and Zip Code: ______________________________

5. Name and title of officer or legal representative whom the IRS may call for more information: ______________________________

6. Telephone number of officer or legal representative: ______________

7. Date of Issue: ______________________________

8. Name of Issue: ______________________________

9. Report Number of 8038-G or 8038-B:______________________

10. Cusip Number: ______________________________

11. Check if direct pay (qualified) Build America Bond: ☐

12. Check if Recovery Zone Economic Development Bond: ☐

10 This form does not accommodate direct pay QSCBs, QZABs, NCREBs, or QECBs. Modifications for those types of bonds would be required.

PART II

13. Effective Date of Reduction: ________________________ ____/_______/20____

14. Reason for and amount of Reduction:

a) Failure to spend all proceeds $________________

b) Cost of issuance limit exceeded $________________

c) Proceeds allocated to non-capital costs $________________

d) Proceeds of Recovery Zone Economic Development Bonds allocated to costs that are not qualified economic development purposes $________________

e) Private use violation $________________

f) Private payment or security violation $________________

g) Issue price premium violation $________________

h) Other, PLEASE EXPLAIN $________________

____

15. Total Reduction Requested: $________________

16. For Issue Price Premium Violation please provide for each maturity affected by a violation:

(a) Maturity Date	(b) Original Par	(c) Issue Price	(d) Issue Price permitted under IRC 54AA

17. Reduction:

Maturity Date	Indicate if Term Bond subject to Mandatory Redemption	Original Par	Reduction	Remaining Par
TOTAL		$__________	$__________	$__________

18. For each Term Bond subject to Mandatory Redemption:

Maturity Date	Redemption Date	Original Scheduled Redemption	Reduction	Revised Scheduled Redemption

19. Qualified (Direct Pay)) Build America Bond (35% Credit.) For variable rate bonds indicate VAR in interest payment column and leave credit amount blank:

Interest Payment Date	Reduced Principal Outstanding	Interest Payment - to be subsidized	Amount of credit to be requested (35%)

20. Recovery Zone Economic Development Bond (45% Credit) For variable rate bonds indicate VAR in interest payment column and leave credit amount blank:

Interest Payment Date	Reduced Principal Outstanding	Interest Payment - to be subsidized	Amount of credit to be requested (45%)

SUGGESTED INTERNAL REVENUE MANUAL REVISIONS

Part 7. Rulings and Agreements

Chapter 2. TE/GE Closing Agreements

Section 3. Tax Exempt and Tax Credit Bonds Voluntary Closing Agreement Program

7.2.3 Tax Exempt Bonds and Tax Credit Bonds Voluntary Closing Agreement Program

7.2.3.1 (11-01-2008 revised __-__-2010)

In General

1. This section sets forth procedures for the voluntary closing agreement program for tax-exempt bonds and tax credit bonds known as TEB VCAP. Through TEB VCAP, issuers of tax-exempt bonds and tax credit bonds can voluntarily resolve violations of the Internal Revenue Code (the "Code") on behalf of their bondholders through closing agreements with the Service.

2. The Tax Exempt Bonds Compliance & Program Management ("CPM") function is responsible for the administration and oversight of TEB VCAP as part of its voluntary compliance initiatives. The TEB VCAP Inventory Coordinator will review the operations of the program and report to the Manager, Compliance & Program Management.

3. Notice 2008-31 provides general guidance on the scope of authority and procedural requirements applicable to TEB VCAP.

7.2.3.1.1 (11-01-2008 revised __-__-, 2010)
Objectives

1. The primary objective of TEB VCAP is to encourage issuers and other parties to the tax-exempt bond or tax credit bond transaction to exercise due diligence in complying with the Code and applicable Income Tax Regulations (the "Regulations") and to provide a vehicle to correct violations of the Code and applicable Regulations as expeditiously as possible. TEB VCAP reflects the continuing policy of TEB to attempt to

resolve all violations of federal tax law applicable to tax-exempt bonds and tax credit bonds at the transaction level instead of the bondholder level.

2. TEB VACP reflects the continuing policy of TEB to attempt to resolve all violations of federal tax law applicable to tax-exempt bonds and tax credit bonds at the transaction level instead of the bondholder lever.

3. It is the intention of TEB that TEB VCAP closing agreements impose sanctions commensurate with the violation being addressed. A party to a TEB VCAP closing agreement should be no better off than had the party complied with the tax law so that there was no violation, but it should also not be significantly worse off than if the parties to the transaction had acted in accordance with tax law. Although the terms of a TEB VCAP closing agreement may require additional settlement payments for various reasons including failure to seek relief quickly, such additional payment amounts when required of parties acting in good faith should ordinarily not exceed 10% of the amount determined by TEB to represent an amount commensurate with the violation.

4. The terms of and basis for entering into closing agreements under VCAP should be more favorable to the issuer and more flexible than the terms of and bases for entering into closing agreements to resolve examinations.

5. TEB acknowledges that it may be appropriate to provide VCAP settlements in instances in which an issuer seeks to remove doubt concerning compliance even when the issuer believes that the bond issue is compliant.

7.2.3.1.2 (11-01-2008 revised __-__-, 2010)
Scope

1. Gross income does not include interest on any state or local bond that meets the requirements of section 103 and related provisions of the Code. Violations of section 103 or related provisions of the Code or applicable Regulations may be resolved under TEB VCAP with certain exceptions.

2. A credit against tax is provided to a holder **or issuer** of a qualified tax credit bond issued under section 54, **54A, 54AA,** 1397E or 1400N**, 1400U-2,** that meets the requirements of those sections and related provisions of the Code. Violations of section 54, **54A, 54AA,** 1397E~~, or~~ 1400**N** or **1400U-2** or related provisions of the Code or applicable Regulations may be resolved under TEB VCAP with certain exceptions.

3. TEB VCAP is generally not available if, absent extraordinary circumstances, the violation can be **reasonably** remediated under existing remedial action provisions or tax-exempt bond closing agreement programs contained in regulations or other published guidance. **This limitation on TEB VCAP will generally not prevent an issuer of bonds for which the issuer receives a credit (direct pay bonds) from**

using TEB VCAP to resolve violations that may be remediated under provisions not designed for such direct pay bonds.

> An issuer may remediate violations impacting tax-exempt bonds under sections 1.141-12, 1.142-2, 1.144-2, 1.145-2, and 1.147-2 of the Regulations.
>
> An issuer may remediate violations impacting tax credit bonds under section 1.1397E-1T(h)(7) of the Regulations.
>
> An issuer may resolve certain violations resulting from a change in the use of tax-exempt bond proceeds or tax-exempt bond-financed property through the execution of a closing agreement under the program described in Rev. Proc. 97-15, 1997-1 C.B. 635.

4. TEB VCAP is not available if the bond issue is under examination. A bond issue is generally treated as under examination on the date a letter opening an examination on the bond issue is sent.

5. TEB VCAP is not available if the tax-exempt status of the tax-exempt bonds or qualified status of the tax credit bonds is at issue in any court proceeding or is being considered by the IRS Office of Appeals.

6. TEB VCAP ~~is~~ **may** not **be** available if TEB determines that the violation was due to willful neglect.

7.2.3.1.3 (11-01-2008)
Effect of TEB VCAP Closing Agreement

1. Closing agreements, including closing agreements executed under TEB VCAP, are final and conclusive and may not, in the absence of fraud, malfeasance, or misrepresentation of material fact, be reopened as to matters agreed upon or be modified by an officer, employee or agent of the United States.

2. Any violation resolved pursuant to a closing agreement under TEB VCAP will not be reopened by the Service in any future examination of the tax-exempt bond issue or tax credit bond issue unless so permitted under section 7121 of the Code.

7.2.3.1.4 (11-01-2008 modified __-__-, 2010 **)**
Audit Selection of VCAP Cases

1. Absent extraordinary circumstances, a bond issue will not be classified and selected for examination while it is under review in TEB VCAP **or for a period of up to 90 days after the issuer submits notification to CPM of its intention to submit a VCAP request concerning or a specified violation related to the bond issue**.

2. Any bond issue previously reviewed in TEB VCAP will be subject to general or project classification and may be selected for examination. However, the resolution of any specific violation through a closing agreement under TEB VCAP will be final and conclusive and may not be reconsidered under examination unless so permitted under section 7121 of the Code.

7.2.3.1.5 (11-01-2008)
Special Procedures for Anonymous Requests

1. A TEB VCAP request may be submitted to inquire as to the appropriate resolution terms for an identified violation on an anonymous basis. The anonymous request option is intended to assist issuers in evaluating complex or unique violations as part of their post-issuance compliance due diligence. It is not intended to encourage issuers to delay the submission of a fully disclosed TEB VCAP request relating to relatively simple or straightforward violations. As such, when evaluating an anonymous request concerning a straightforward violation, CPM will consider whether the submission of the anonymous request represents a less than good faith effort on the part of the issuer to resolve the identified violation as expeditiously as possible.

2. An anonymous request may be made on behalf of one issuer or a group of similarly situated issuers. However, the execution of a closing agreement must be between the Service and a disclosed issuer, and all terms of a closing agreement must be consistent with section 7121 of the Code.

3. Until the name of the issuer and the bond issue are disclosed to the Service, a request for a closing agreement under TEB VCAP will not prevent the Service from beginning an examination of the bond issue. An issue relating to an anonymous request which has been opened for examination prior to identification to CPM will no longer be eligible for TEB VCAP.

7.2.3.1.6 (11-01-2008 modified __-__-, 2010**)**
Information Required in Submission Request

1. The following information and items are required to be included in a TEB VCAP submission request. The failure to include any of these items will result in CPM declining to consider the request.

2. An issuer or its authorized representative requesting a closing agreement under TEB VCAP must submit a statement(s) under penalty of perjury including the following information:

    A. Information identifying the governmental issuer of the bond issue including: (1) the name; (2) employer identification number; (3) street address, city, state, and zip code; and (4) name, title, and telephone number of an official of the issuer who may be contacted for additional information.

B. Information identifying the bond issue including: (1) the name of the bond issue; (2) issue price; (3) final maturity date; (4) CUSIP number; and (5) type of Form 8038 series information return filed with respect to the issuance of the bonds.

C. Information identifying the violation including: (1) a clear statement of the specific federal tax requirement which is the subject of the violation; (2) a description of the violation, including its nature, when it occurred, and the facts and circumstances surrounding it; and (3) a statement as to when and how the violation was discovered.

D. Description of the proposed settlement terms for resolving the identified violation. If the proposal includes the payment of a closing agreement amount, include a description of the computation methodology determining the amount and a statement that such payment will not be made with proceeds of bonds described under IRC section 103. If the proposal includes the redemption, defeasance, or tender of any amount of the bonds comprising the bond issue, include a statement of the source of funds to be used to effectuate such action.

E. ~~Statements of good faith including: (1) a~~ **A** statement that the bond issue is not under examination, the subject in any court proceeding, or under consideration by the IRS Office of Appeals~~; (2~~**.**

F. Statements of good faith, which may include: (1) a statement that, on the issue date, the issuer reasonably expected to comply with section 103 and all related provisions of the Code; (~~3~~**2**) a description of the policies or procedures which have been or will be implemented to prevent this type of violation from recurring with this or any other bond issues; ~~and~~ **(3) a statement that the violation was inadvertent, or** (4) a statement that the request for a closing agreement was promptly undertaken upon the discovery of the violation.

3. The statement(s) described in paragraph (2) above must be submitted under the following declaration, signed by the party making the submission: “Under penalties of perjury, I declare that I have examined this submission, including accompanying documents and statements, and to the best of my knowledge and belief, the submission contains all the relevant facts relating to the request, and such facts are true, correct, and complete.”

4. The request must include a copy of the Form 8038 series information return filed in connection with the issuance of the bond issue.

5. The request may include an executed Form 2848, Power of Attorney and Declaration of Representative, declaring a representative authorized to represent the issuer before the Service with respect to the bond issue.

7.2.3.1.7 (11-01-2008 modified __-__-, 2010**)**
Receipt and Perfection of Submission Request

1. Submission requests under TEB VCAP are typically emailed to TEBVCAP@irs.gov and/or may be mailed to:

Internal Revenue Service

Attn: TEB VCAP

1122 Town & Country Commons

St. Louis, MO 63017

2. Upon receipt of a TEB VCAP submission request, the TEB VCAP Inventory Coordinator will review the submission request to verify that all of the required information described in section 7.2.3.1.6 is complete.

3. If the submission request is complete, the Coordinator will process the case for assignment in accordance with section 7.2.3.2.

4. If the submission request is not complete, the Coordinator will provide the issuer with written notification that the request has been received, but that certain missing information is required before the request can be processed for assignment. The Coordinator will also contact the authorized representative (if any) by telephone to request the missing information. If the Coordinator is unable to obtain the missing information after reasonable attempts, the submission request will be closed without resolution.

5. Absent extraordinary circumstances, if a VCAP request includes a statement that the violation meets the requirements of section 7.3.3.2 or 7.3.3.3 relating to identified violations and the request contains all required information including a description of the violation that shows it is described in section 7.3.3.2 or 7.3.3.3, then within ninety (90) days TEB will notify the requesting issuer whether it intends to enter into a closing agreement on the terms specified in section 7.3.3.2. or 7.3.3.3. If TEB notifies the requesting issuer that it does not intend to enter into a closing agreement according to the terms of one of the identified violations described in sections 7.3.3.2 or 7.3.3.3, TEB will include an explanation of the reasons that such settlement are inappropriate under the circumstances.

7.2.3.2 (09-01-2008)
TEB VCAP Case Processing Procedures

1. This section sets forth the case processing procedures for TEB VCAP cases.

7.2.3.2.1 (11-01-2008)
Case Establishment and Assignment

1. Upon determining that the submission request is complete, the TEB VCAP Inventory Coordinator will request that the TEB Inventory Processing Unit establish a compliance activity within the TE/GE Reporting & Electronic Examination System (“TREES”) for the TEB VCAP case. For this purpose, each individual Form 8038 series information return relating to the submission request is established as a separate compliance activity.

2. Once the compliance activity is established within TREES, the Manager, Compliance & Program Management (“CPM Manager”) will assign the activity to a CPM specialist. A CPM team leader will concurrently be assigned as a reviewer.

7.2.3.2.2 (11-01-2008)
Case Development

1. Upon receipt of an assigned TEB VCAP case within TREES, the specialist will notify the issuer or its authorized representative of the specialist’s contact information.

2. Upon initiation of the case, the specialist will update the case to status 12 within TREES and notify the TEB VCAP Inventory Coordinator of the status update. The specialist will review the submission request to determine if any additional information is necessary. If additional information is necessary, the specialist will request the information from the issuer or its authorized representative and will generally follow up with a written request specifying the information requested and the due date.

3. Upon receipt of all required information, the specialist (with the assistance of the assigned reviewer) will analyze the information, make a determination as to the recommended resolution of case, and take appropriate steps for case resolution.

> If the violation identified in the submission request is covered in section 7.2.3.3, the specialist will prepare the Committee Briefing Memorandum following the applicable resolution standards and forward the Committee Briefing Memorandum through the reviewer to the CPM Manager for review and concurrence.

If the violation identified in the submission request is not covered in section 7.2.3.3, the specialist will prepare a Memorandum for Reviewers which will include a discussion of the key facts, applicable law, issuer's proposed settlement offer, and specialist's recommendation for case resolution. The specialist will forward the Memorandum for Reviewers through the reviewer to the CPM Manager for review and concurrence.

If it is determined to resolve the case through the execution of a closing agreement, upon concurrence of the CPM Manager, the specialist will prepare and forward both a Committee Briefing Memorandum and a draft closing agreement through the reviewer to the CPM Manager for review and concurrence.

If it is determined to resolve the case through correspondence (e.g. an anonymous request), upon concurrence of the CPM Manager, the specialist will prepare and forward both a Committee Briefing Memorandum and the appropriate resolution letter through the reviewer to the CPM Manager for review and concurrence.

7.2.3.2.3 (11-01-2008)
Case Resolution

1. If the proposed resolution requires approval of the TEB Closing Agreement Committee, the CPM Manager will forward the Committee Briefing Memorandum to the Closing Agreement Committee for review. If approved by the Committee, upon notification from the CPM Manager, the specialist will follow the closing agreement execution procedures provided in section 7.2.3.2.4. If disapproved by the Committee, the CPM Manager will notify the specialist of the need for further development.

2. If the proposed resolution does not require approval of the TEB Closing Agreement Committee, the CPM Manager will review the resolution letter and notify the specialist of concurrence or the need for further development. Upon approval of the CPM Manager, the specialist will prepare the case for closure.

7.2.3.2.4 (11-01-2008)
Closing Agreement Execution

1. Upon approval of the draft closing agreement by the CPM Manager, the specialist will forward the draft to the issuer or its authorized representative for comments. The specialist will discuss any comments with the reviewer and CPM Manager and make any necessary changes.

2. Once the closing agreement is finalized, the specialist will electronically send the final closing agreement, the transmittal letters (i.e., the execution cover letter and transmittal letter to power of attorney) to the TEB VCAP Inventory Coordinator. The Coordinator will make the required number of agreement copies (number of signatories plus one), coordinate the signing of the transmittal letters and mail the package to the issuer. A copy of the closing agreement and transmittal letter to the issuer will be mailed to the authorized representative.

3. The Coordinator will notify the specialist following the mailing of the packages. The specialist will notify the issuer or its authorized representative that the closing agreements have been mailed. The specialist will also remind the issuer or its authorized representative that: (i) the closing agreement payment (if any) must be submitted prior to execution; (ii) the executed agreements must be returned to the CPM office in St. Louis, Missouri; and (iii) a copy of the confirmation of the Electronic Federal Tax Payment System ("EFTPS") deposit (if any) must be included with the executed agreements.

4. Upon receipt of the closing agreement from the issuer, the Coordinator will verify that the agreement has not been altered, check for required signatures, and monitor receipt and proper accounting of the closing agreement payment, if applicable. Once the payment has been confirmed, the Coordinator will forward the closing agreement to the CPM Manager for execution and notify the specialist that the case is ready for closure.

7.2.3.2.5 (11-01-2008)
Case Closing

1. The specialist will electronically forward the final case closing letter and transmittal letter to power of attorney (if applicable) to the TEB VCAP Coordinator to coordinate signature and transmission.

> If the case resolution requires a closing agreement, the issuer is notified that the case is closed through the executed closing agreement letter transmitted with the executed copy(s) of the closing agreement.
>
> If the case resolution does not require a closing agreement, the issuer is notified that the case is closed through the approved resolution letter.

2. Upon the execution and mailing of the applicable closing letter, the Coordinator will notify the specialist that the applicable closing letter has been signed and transmitted. The specialist will then provide the issuer or its authorized representative with a status update, request closure of the case within TREES, and forward the paper file, if any, to the CPM Manager.

3. After reviewing the case, the CPM Manager will approve closure within TREES.

**7.2.3.2.6 (11-01-2008)
Unresolved Case Resolution**

1. In certain situations, it is appropriate to close a TEB VCAP case without a final resolution. For example, an issuer may withdraw the submission request. Alternatively, CPM may determine that an issuer's nonresponsiveness to requests for additional information rise to the level of willful neglect for purposes of establishing eligibility for TEB VCAP under Notice 2008-31. In these or other situations, the specialist and reviewer will recommend to the CPM Manager to initiate an unresolved closure of the case.

2. The specialist will prepare the appropriate closing letter and forward through the reviewer to the CPM Manager for review and concurrence. Upon approval of the CPM Manager, the specialist will follow the case closing procedures in section 7.2.3.2.5.

7.2.3.3 (11-01-2008, revised __-__, 2010**)
TEB VCAP Resolution Standards**

1. Under Notice 2008-31, the Service requested comments regarding the operation of TEB VCAP, including suggestions with regard to the standardization of closing agreement terms and amounts that may be specified for particular violations. Additionally, on June 11, 2008, the Advisory Committee on Tax Exempt and Government Entities issued a report titled *The Streamlined Closing Agreement For Tax-Exempt Bonds: A Cure For Common Violations* providing recommendations for the creation of programs to provide streamlined treatment of certain tax law violations. **On June 9, 2010, the Advisory Committee on Tax Exempt and Governmental Entities issued a report titled *Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds* providing further recommendations.**

2. This section of IRM section 7.2.3.3 sets forth resolution standards under TEB VCAP for specific violations. TEB anticipates expanding the list of resolution standards for specified violations over time.

7.2.3.3.1 (11-01-2008, revised __-__, 2010**)
Objectives and Scope**

1. The primary compliance objective of the TEB VCAP resolution standards identified in this section is to promote due diligence on the part of issuers and other parties to the tax-exempt bond or tax credit bond transaction in resolving violations. The Service recognizes that due diligence is encouraged by providing certainty to issuers and other parties in understanding the methodology available to resolve their particular violation(s).

2. The primary administrative objective of the TEB VCAP resolution standards identified in this section is to streamline the closing agreement process with respect to the specific violations resulting in the more efficient processing of cases.

3. The resolution standards under this section are not available when:

A. The specific violation is not within the jurisdiction of TEB VCAP.

B. The specific violation identified in the TEB VCAP request is not a violation identified under this section.

C. CPM determines that the violation is not appropriate for resolution under the terms described in this section.

4. With respect to TEB VCAP closing agreements related to bond issues under which the issuer of the bonds may obtain credits directly from the United States under IRC section 6431 but the owner of the bond receives no special tax benefits, the following special rules will apply:

A. Ordinarily the closing agreement will not require the early redemption of any bonds.

B. The closing agreement will establish an "Effective Date" beginning on which date the amount of any credit available under IRC section 6431 should be computed based on a smaller outstanding amount of bonds. The recipient of such a closing agreement must submit a request for such reduction in principal (a Direct Pay Reduction). The Direct Pay Reduction must specify the modified principal amount of each maturity to be eligible for credits under IRC section 6431. If the amount of any Direct Pay Reduction (together with any previous Direct Pay Reduction) is less than the lesser of $250,000 or three (3%) percent of the par amount of the issue (the "De Minimis Amount"), then the principal schedule may be reduced by any particular maturities or sinking fund payments to achieve the reduction selected by the applicant for the closing agreement. In cases in which the amount of such reduction exceeds the De Minimis Amount, the reduction amount must reduce the principal maturities in the manner prescribed in Treas. Reg. §1.141-12(j).

C. The closing agreement may require a cash payment related to the time period that the violation may have existed before the Effective Date (the Correction Amount). The Correction Amount should be calculated to include interest at the underpayment rate prescribed in IRC section 6621 for the period from the time of the violation to ten days before the time of payment with adjustments to facilitate calculation.

D. When the Effective Date occurs significantly after the date of the violation, an “additional payment amount” may be added to the Correction Amount. If the issuer demonstrates good faith, no additional payment amount will be required. In any case, absent unusual circumstances, the additional payment amount is ordinarily limited to ten percent (10%) of the otherwise computed Correction Amount.

E. In lieu of paying the amount as a settlement amount, the applicant may request that its next occurring future interest subsidy payments under IRC section 6431 be reduced in an amount equal to the Correction Amount plus interest calculated at the rate for underpayments prescribed in IRC section 6621 (the Interest Subsidy Reduction).

7.2.3.3.2 (11-01-2008, modified __ - __ - 2010**)**
Identified Violations — Tax Exempt and Tax Credit Bonds

1. *Excessive Nonqualified Use.* Certain use of proceeds requirements are imposed upon governmental bonds and various qualified private activity bonds **and tax credit bonds** under IRC sections **54A, 54B, 54C, 54D, 54AA,** 141(b), 142(a), 143(b)(1), 144(a)(12)(B), 144(b)(2), 144(c)(1), 145(a), 147(g), 1394(a), **1400U-2, 1400-3** and 7871(c)(3)(B). These provisions allow for certain defined percentages of proceeds to be allocated to nonqualified purposes.

A violation ~~occurs~~ **may occur** when the amount of proceeds allocated to such nonqualified purposes exceeds the defined percentage limitations.

When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under the following closing agreement terms when the amount of proceeds allocated to nonqualified purposes exceeds the defined percentage: (1) The issuer (or the conduit borrower ~~through the issuer~~) will pay an amount equal to 100% of the taxpayer exposure on the nonqualified bonds for the period beginning on the date of the deliberate action and ending on the date the nonqualified bonds are either redeemed or defeased; and (2) The issuer will redeem **(or in** the **case of direct pay bonds, the** nonqualified bonds **establish a Direct Pay Reduction corresponding to the nonqualified bonds)** prior to the date the closing agreement is executed by the IRS. If the nonqualified bonds **(other than direct pay bonds)** cannot be redeemed prior to the execution date, the issuer will either: (a) redeem the nonqualified bonds on the earliest call date and calculate the amount described above to include the extended period of time that the nonqualified bonds will remain outstanding; or

(b) ~~prior to~~ **within 90 days of** the date the closing agreement is executed by the IRS, establish a defeasance escrow to defease the nonqualified bonds on their first call date.

When the issuer submits the request more than 180 days ~~but within 1 calendar year of~~ **after** the date of the deliberate action, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

2. *Failure to Provide Notice of Defeasance.* Under ITR sections 1.141-12(d)(3) and 1.150-5(a)(1), an issuer remediating nonqualified bonds through the establishment of an irrevocable defeasance escrow must provide written notice to CPM within 90 days of the date the defeasance escrow is established.

A failure to successfully remediate nonqualified bonds occurs when the issuer fails to timely provide CPM with written notice of the establishment of a defeasance escrow to remediate nonqualified bonds under ITR section 1.141-12(d).

This failure may be resolved under a closing agreement whereby the issuer agrees to pay an amount equal to the lesser of $1/day for the period beginning the date of the failure to notify and ending of the date written notification was provided to CPM or $1,000.

3. *Failure to Defease Within 10.5 Years of Issuance.* Under ITR section 1.141-12(d)(4), an issuer may only remediate nonqualified bonds through the establishment of defeasance escrow if the period between the issue date of the bonds and the first call date of the bonds is 10.5 years or less.

A failure to successfully remediate nonqualified bonds occurs when all or a portion of the bonds comprising the issue are not callable within 10.5 years of the issue date.

This failure may be resolved under a closing agreement whereby the issuer agrees to pay an amount equal to the taxpayer exposure on the bonds with the offending maturities for the period beginning on the date 10.5 years after the issue date and ending on the date the bonds will be redeemed under the defeasance escrow.

4. *Alternative Minimum Tax Adjustment.* Under IRC section 57(a)(5), the interest on certain qualified private activity bonds is treated as an item of tax preference

for purposes of the alternative minimum tax. IRC section 57(a)(5)(C)(ii) provides an exception to this rule for qualified 501(c)(3) bonds.

> A violation occurs where a change in the use of the proceeds of a governmental issue occurs resulting in the bonds being recharacterized as certain qualified private activity bonds other than qualified 501(c)(3) bonds.
>
> When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under a closing agreement requiring the payment of an amount equal to 100% of the alternative minimum tax adjustment with respect to the bonds of the issue from the date of the deliberate action to the date the bonds are no longer outstanding.
>
> When the issuer submits the request more than 180 days but within 1 calendar year of the date of the deliberate action, this violation may be resolved as described in the above paragraph, substituting 110% of the alternative minimum tax adjustment for 100% of the alternative minimum tax adjustment in calculating the closing agreement payment.

5. *Capital Expenditure Limitation Failure.* Under IRC section 144(a)(4), an issuer may elect for certain qualified small issue bonds to apply a $10,000,000 limitation on the sum of the aggregate amount of certain outstanding qualified small issue bonds described in IRC section 144(a)(2) and the aggregate amount of capital expenditures with respect to facilities described in IRC 144(a)(4)(B) (as modified by IRC section 144(a)(4)(G), when applicable).

> A violation occurs when the sum of outstanding bonds and capital expenditures to be taken into account for purposes of this requirement exceeds $10,000,000 (as modified by IRC section 144(a)(4)(G), when applicable).
>
> When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under the following closing agreement terms: (1) The issuer (or the conduit borrower through the issuer) will pay an amount equal to 100% of the taxpayer exposure on the nonqualified bonds for the period beginning on the date the violation occurs and ending on the date the nonqualified bonds are either redeemed or defeased; and (2) The issuer will redeem the nonqualified bonds prior to the date the closing agreement is executed by the IRS. If the nonqualified

bonds cannot be redeemed prior to the execution date, the issuer will either: (a) redeem the nonqualified bonds on the earliest call date and calculate the amount described above to include the extended period of time that the nonqualified bonds will remain outstanding; or (b) prior to the date the closing agreement is executed by the IRS, establish a defeasance escrow to defease the nonqualified bonds on their first call date. For this purpose, the nonqualified bonds are an amount of the bonds equal to the amount exceeding the applicable limitation which will not result in the average maturity of the remaining bonds being greater than the average maturity of the bond issue.

When the issuer submits the request more than 180 days but within 1 calendar year of the date of the deliberate action, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

6. *Maturity Exceeding 120% of Economic Life.* Under IRC section 147(b), the average maturity of certain qualified private activity bonds may not exceed 120% of the average reasonably expected economic life of the facilities being financed with the net proceeds of the issue.

A violation occurs when the average maturity of the bonds exceeds 120% of the average reasonably expected economic life of the financed property.

This violation may be resolved under a closing agreement where the issuer and conduit borrower agree to redeem or defease an amount of the bonds sufficient to reduce the weighted average maturity to ~~110~~**120**% of the economic life of the financed property.

7. *Impermissible Advance Refunding.* Under IRC section 149(d), there is a general prohibition on the advance refunding of: (1) any qualified private activity bond issue other than a qualified 501(c)(3) bond issue; or (2) any governmental bond issue or qualified 501(c)(3) bond issue that has already been advance refunded. Under ITR section 1.150-1(d)(3), a current refunding issue is defined as a refunding issue that is issued not more than 90 days before the final payment of principal and interest on the prior refunded issue and an advance refunding issue is defined as a refunding issue which is not a current refunding issue.

A violation occurs when the proceeds of a refunding issue are used to pay the principal or interest on a prior issue more than 90 days from the issue date of the refunding issue when the prior issue is not permitted to be advance refunded under IRC section 149(d).

When the issuer submits the request within 180 days of the date of the violation, this violation may be resolved under a closing agreement where the issuer agrees to pay an amount equal to 100% of the taxpayer exposure on the refunding bonds for the period beginning on the issue date of the refunding bonds and ending on the date 90 days before the final redemption of the prior refunded issue.

When the issuer submits the request more than 180 days but within 1 calendar year of the date of the violation, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

8. *Failure to Timely Reinvest Proceeds into 0% SLGS.* Under IRC section 148(a), an issue shall be treated as consisting of arbitrage bonds if any portion of the proceeds are intentionally used directly or indirectly to acquire higher yielding investments. For this purpose, definitions of materially higher yield are provided under ITR section 1.148-2(d). For example, investments held in a refunding escrow are treated as higher yielding investments when the yield on those investments over the life of the escrow produces a yield which is more than 1/1000th of 1% higher than the yield on the bond issue.

A violation occurs where a party to the escrow agreement fails to meet their requirements under the agreement as a result of a failure to timely reinvest proceeds of a refunding issue as directed upon the maturity of investments (e.g., failure to reinvest in 0% U.S. Treasury Securities – State and Local Government Series (SLGS) in an efficient escrow).

When the issuer submits the request within 60 days of the next required computation date following the date of the reinvestment failure, this violation may be resolved under a closing agreement whereby the issuer (or the escrow agent through the issuer) agrees to pay an amount equal to the sum of the following: (1) An amount which, if treated as a payment with respect to the investments held in the escrow, reduces the yield on the escrow to the bond yield; plus (2) An amount equaling interest accrued at the underpayment rate under IRC section 6621 beginning on the date the payment would have been due if treated as a yield reduction payment and ending on the date the payment is actually paid to the IRS. For this purpose, proceeds held by the trustee due to this reinvestment failure may be treated as invested at the applicable federal funds rate where the trustee certifies under penalty of perjury that its customary practice is to invest its overnight balances at a rate which approximates the applicable federal funds rate and the proceeds were likely invested in such a manner.

7.2.3.3.3 (3__-__-2010)
Identified Violations for Direct Pay Bonds

1. *Excess Proceeds.* Certain use of proceeds requirements are imposed upon direct pay credit bonds under IRC sections 54AA and 1400U-2. These provisions may serve to prevent the allocation of proceeds of such bonds to other purposes. Because a bond issuer may not have reasonable conforming expenditures to which the issuer may allocate unspent proceeds, the issuer may anticipate a violation due to the allocation of excess remaining proceeds to a use that is not permitted.

So long as the issuer submits a Direct Pay Reduction in the amount of the excess unspent proceeds with an Effective Date being within ninety (90) days of the date that the issuer determines that it will not allocate such unspent proceeds as permitted under IRC sections 54AA or 1400U-2, no Correction Amount will be required.

If the amount of any Direct Pay Reduction (together with any previous Direct Pay Reduction) is less than the lesser of $250,000 or three percent (3%) of the par amount of the issue (the "De Minimis Amount"), then the principal schedule may be reduced by any particular maturities or sinking fund payments to achieve the reduction selected by the applicant for the closing agreement. In cases in which the amount of such reduction exceeds the De Minimis Amount, the reduction amount must reduce the principal maturities in the manner prescribed in ITR section1.141-12(j).

2. *Expenditure Violation.* A possible violation (an Expenditure Violation) occurs if the issuer makes a final allocation of proceeds of the bonds to expenditures for purposes not permitted under IRC section 54AA or 1400U-2, as applicable. This violation does not occur simply because of a direct tracing of such proceeds to such expenditures if the issuer timely adopts a method of accounting that allocates such proceeds to another permitted purpose.

The amount of the impermissible expenditure should take into account any final allocations or accounting method adopted (or allocations which could have been made) by the Issuer under ITR section 1.141-6

or 1.148-6. The Effective Date of the Direct Pay Reduction for an Expenditure Violation will be the later of the date that is ninety (90) days after the first expenditure giving rise to the Expenditure Violation or the bond interest payment date preceding the submission. The total amount of the reduction identified in the Direct Pay Reduction will be at least equal to the amount of the Impermissible Expenditures multiplied by the percentage of original principal amount of the bonds outstanding on the Effective Date.

If the Effective Date of the Direct Pay Reduction is more than ninety (90) days after the Expenditure Violation, and the amount of the Impermissible Expenditures is greater than the De Minimis Amount, the issuer will also pay a Correction Amount or agree to an Interest Subsidy Reduction in an amount equal to the amount of credit received before the Effective Date of the Direct Pay Reduction with respect to an amount of bonds (in the manner prescribed in ITR 1.141-12(j)) equal in total principal to the amount of the Impermissible Expenditure multiplied by the percentage of the original principal amount of the Bonds outstanding on the date of the violation. If more than one (1) interest rate applies to different bonds in an issue, the Correction Amount (or the Interest Subsidy Reduction) may be calculated at the highest interest rate applicable to any bond of the issue.

If the Effective Date is more than eighteen (18) months after the date of the Expenditure Violation, an additional amount may be added to the Correction Amount. If the Effective Date is less than five (5) years after the Expenditure Violation, the late penalty will be no more than ten percent (10%) of the otherwise computed Correction Amount.

The VCAP will provide that facilities financed with such expenditure violations will not be treated as financed with proceeds of the Direct Credit Bonds.

3. *Premium Violation.* IRC section 54AA(d)(2)(C) limits the issue price of certain direct pay credit bonds to a percentage of the principal amount of the bond.

A violation (a Premium Violation) occurs when the issuer discovers that any maturity of the bonds possibly was treated as sold at a price or prices in excess of that permitted under IRC section 54AA(d)(2)(C).

The Effective Date of the Direct Pay Reduction will be the interest payment date on the bonds occurring most recently before the date of the submission (or the date of issue if submitted before the first interest payment date). The total amount of the reduction identified in the Direct Pay Reduction will be at least the amount necessary to reduce the credits under IRC section 6431 to no more than the amount of the credit that would have been available if the bonds had been sold with only the permitted amount of original issue premium. In the case of a bond with at least twelve (12) complete years between the issue date and the maturity date, the amount of the reduction will not be more than the amount by which the actual premium on such bonds exceeded the premium limit applicable to such bonds. The reduction will be applicable to the affected maturity only. If that maturity is subject to mandatory redemption, then the reduction will apply first to the final maturity payment and then to the longest sinking fund installments.

The VCAP submission should identify both the issue price and the limit imposed under IRC section 54AA(d)(2)(C). The method of determining the issue price of each such group of substantially similar bonds should also be included in the VCAP request. If the Effective Date of the Direct Pay Reduction is more than six (6) months after the date of issue, as a condition for a closing agreement, the issuer will also pay a Correction Amount equal to the credits received by the issuer prior to the Effective Date of the Direct Pay Reduction on the amount of the reduction (or arrange for an Interest Subsidy Reduction to be made). Such amount will be calculated at the coupon rate of the bonds having an impermissibly high premium.

If the Effective Date of the Direct Pay Reduction is more than one (1) year after the date of issue of the bonds, the issuer may be required to increase the Correction Amount by an additional amount. If the Effective Date of the Direct Pay Reduction is less than five (5) years after the date of issue of the bonds, the late penalty will be no more than ten percent (10%) of the otherwise computed Correction Amount.

The VCAP will provide that the bonds for which the Direct Pay Reduction has been made will be treated as not having a higher premium than permitted.

4. *Private Activity Violation.* IRC section 141 imposes limits on the portion of the proceeds of a governmental bond issue that may be privately used, on the amount of payments derived from privately used property, and on the amount of private security that may be put on the bond issue. A violation of these rules may cause a bond to be a private activity bond. That may in turn prevent the bond from qualifying under IRC section 54AA as a direct pay credit bond. Although the rules of IRC section 141 apply to tax-exempt bonds as well as direct pay tax credit bonds, direct pay tax credit bonds present different possible

methods to correct a violation. This streamlined TEB VCAP procedure is intended to apply only to Direct Pay tax credit bonds.

A violation (a Private Activity Violation) occurs when the issuer takes a deliberate action that causes the Direct Credit Bonds to be private activity bonds (or in the case of permitted Direct Credit 501(c)(3) bonds to not be qualified 501(c)(3) bonds) because of use or ownership of bond financed property or security for the bonds or payments received with respect to privately used bond financed property.

The Effective Date of the Direct Pay Reduction will be the date 90 days after the date of the Deliberate Action giving rise to the violation, or if submitted after an interest payment on the Bonds occurring more than ninety (90) days after the date of the deliberate action, the date of the interest payment date next preceding the date of submission. The total amount of the reduction identified in the Direct Pay Reduction will be an amount equal to the nonqualified bonds.

In settling a Private Activity Violation on a direct pay bond, nonqualified bonds on any date are computed as the percentage of then outstanding bonds in the manner described in ITR 1.141-12(j).

However, if the issuer disposes of property in a manner that causes a private use violation, the remuneration is solely for cash and the cash is less than the amount of the "nonqualified bonds," then the amount of such nonqualified bonds is limited to the amount of cash received by the issuer as a result of the deliberate action. In determining the Direct Pay Reduction amount, any remedial actions taken and permitted under ITR section 1.141-12 shall be taken into account.

If the Effective Date of the Direct Pay Reduction is more than ninety (90) days after the date of the deliberate action giving rise to the Private Activity Violation, the issuer will also pay a Correction Amount equal to the amount of the direct credit received or accrued between the date of the deliberate action and the Effective Date with respect to nonqualified bonds. Where more than one interest rate applies to different bonds of the issue, the settlement payment Correction Amount may be calculated at the highest interest rate applicable to any bond of the issue or on a pro rata basis. If the Effective Date of the Direct Pay Reduction occurs more than two (2) years after the Private Activity Violation, an additional payment amount may be added to the Correction Amount. Where the Effective Date is no later than five years after the Private Activity Violation, the additional payment amount will not be more than ten percent (10%) of the otherwise computed Correction Amount.

The VCAP will provide that the Bonds will not be treated as private activity bonds as a result of the identified Private Activity Violation.

4.81.6.5.3.1 (11-01-2009 revised __-__-2010) Computation of Taxpayer Exposure

1. **Taxpayer** exposure represents the estimated amount of tax liability the United States would collect from the bondholders if the income realized from the bonds they held were included in gross income ~~during the calendar year(s)~~ **or be able to avoid paying or crediting to the bondholder or the issuer if the bonds had not been qualified direct pay obligations or bondholder credit obligations during the period** covered under the closing agreement.

2. The taxpayer exposure on **tax-exempt** bonds is computed as follows:

   A. *Step 1.* Determine the period to be covered under the closing agreement by identifying each past calendar year with open statutes of limitation and each future calendar year during which the bonds will remain outstanding. For this purpose, past calendar years with open statutes of limitation will generally include any calendar year for which a tax payment would be due within three years of the date the compliance failure was identified by TEB. A tax payment with respect to a calendar year is due on the April 15th following the conclusion of that calendar year. For examination purposes, TEB identifies a compliance failure on the date it provides written notification to the issuer of that identified issue. For voluntary compliance purposes, TEB identifies a compliance failure on the date the issuer submits its voluntary compliance request. The general three year open statute period may be increased to six years when TEB determines that the issuer or its representative has not acted in good faith in resolving the compliance failure.

   B. *Step 2*. Determine the amount of interest accrued or scheduled to accrue on the bonds in each calendar year within the closing agreement period based on the yield of such bonds. For bonds originally sold at a discount or premium of less than 5%, the actual amount of interest paid or to be paid may be used for this purpose. For variable rate bonds, the interest scheduled to accrue in future years may be determined using the average of the interest rates paid to date, the last interest rate paid on the bonds, or the appropriate fixed swap rate less 50 basis points, as appropriate under the facts and circumstances of each case.

   C. *Step 3*. Multiply each amount determined in Step 2 for each calendar year by the relevant tax percentage. The relevant tax percentage is based on the IRS's estimate of the average investor's highest tax bracket. This estimate will generally equal 29% unless a more accurate assessment of the investor's actual tax rate is determined.

D. *Step 4*. Determine the present value of each amount calculated in Step 3 for each calendar year in accordance with IRM section 4.81.6.5.3.6 by assuming it was due on April 15 in the following calendar year.

E. *Step 5*. Determine the sum of the present value amounts determined in Step 4 for all calendar years.

3. The taxpayer exposure on direct pay bonds is computed as follows:

A. *Step 1*. Determine the period to be covered under the closing agreement by identifying each past credit payment with open statutes of limitation and each future credit payment date year during which the bonds will remain outstanding and in non-compliance and for which a credit has been or will be paid. Credits that will be reduced or eliminated because of a Direct Pay Reduction should not be included. For this purpose, past credit payments with open statutes of limitation will generally include any payment within three years of the date the compliance failure was identified by TEB. For examination purposes, TEB identifies a compliance failure on the date it provides written notification to the issuer of that identified issue. For voluntary compliance purposes, TEB identifies a compliance failure on the date the issuer submits its voluntary compliance request. The general three year open statute period may be increased to six years when TEB determines that the issuer or its representative has not acted in good faith in resolving the compliance failure.

B. *Step 2*. Determine the amount of tax credits under Section 6431 of the Code accrued or scheduled to accrue on the bonds in each calendar year within the closing agreement period based on the interest rate of such bonds. For variable rate bonds, the interest scheduled to accrue in future years may be determined using the average of the interest rates paid to date, the last interest rate paid on the bonds, or the appropriate fixed swap rate less 50 basis points, as appropriate under the facts and circumstances of each case.

C. *Step 3*. Determine the present value of each amount calculated in Step 3 for each calendar year in accordance with IRM section 4.81.6.5.3.6 by assuming it was due on April 15 in the following calendar year.

E. *Step 4*. Determine the sum of the present value amounts determined in Step 3 for all calendar years.

4. The taxpayer exposure on bondholder credit bonds is computed as follows:

A. *Step 1.* Determine the period to be covered under the closing agreement by identifying each past credit payment with open statutes of

limitation and each future credit payment date year during which the bonds will remain outstanding and in non-compliance and for which a credit has been or will be paid. For this purpose, past credit payments with open statutes of limitation will generally include any payment within three years of the date the compliance failure was identified by TEB. For examination purposes, TEB identifies a compliance failure on the date it provides written notification to the issuer of that identified issue. For voluntary compliance purposes, TEB identifies a compliance failure on the date the issuer submits its voluntary compliance request. The general three year open statute period may be increased to six years when TEB determines that the issuer or its representative has not acted in good faith in resolving the compliance failure.

B. *Step 2*. Determine the amount of tax credits under Section 54A or 54AA of the Code accrued or scheduled to accrue on the bonds in each calendar year within the closing agreement period possibly based on the interest rate of such bonds. For variable rate bonds, the interest scheduled to accrue in future years may be determined using the average of the interest rates paid to date, the last interest rate paid on the bonds, or the appropriate fixed swap rate less 50 basis points, as appropriate under the facts and circumstances of each case.

C. *Step 3*. Multiply each amount determined in Step 2 for each calendar year by one minus the relevant tax percentage. The relevant tax percentage is based on the IRS's estimate of the average investor's highest tax bracket. This estimate will generally equal 29% unless a more accurate assessment of the investor's actual tax rate is determined.

D. *Step 4*. Determine the present value of each amount calculated in Step 3 for each calendar year in accordance with IRM section 4.81.6.5.3.6 by assuming it was due on April 15 in the following calendar year.

E. *Step 5*. Determine the sum of the present value amounts determined in Step 4 for all calendar years.

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