HUNTON& WILLIAMS

RIVERFRONT PLAZA, EAST TOWER
951 EAST BYRD STREET
RICHMOND, VIRGINIA 23219-4074

TEL 804 • 788 • 8200
FAX 804 • 788 • 8218

MARK S. DRAY
DIRECT DIAL: 804-788-8408
EMAIL: mdray@hunton.com

September 9, 2002

The Honorable Evelyn A. Petschek
Commissioner - Tax Exempt &
Government Entities Division (T)
Internal Revenue Service
1750 Penn Building, Room 684
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William Sweetnam
Associate Benefits Tax Counsel
Department of the Treasury
1000 Main Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Inappropriate Sanctions

Dear Ms. Petschek and Mr. Sweetnam:

Introduction

With the help and guidance of the Internal Revenue Service (the "Service") and the dedication of many of its long serving and loyal employees and the benefits community, sponsors of qualified plans are in the process of winding up the so-called "GUST" process. The process has not been simple and in and of itself provides credibility regarding issues raised in Paul Schultz's "White Paper" on *The Future of the Employee Plans Determination Letter Program* (the "White Paper"). Without the final two months' extension of the compliance deadline for calendar year plans, albeit perhaps unfortunately resulting from events arising out of one of the sadder moments in this Country's modern history, many of us--no matter how diligent--would not have met the deadline. Although I congratulate the Service on its overall administration of the process, I write to request and encourage reconsideration or modification of at least one decision made fairly late in the process and the application of the sanctions that flow from it.

Issue

The issue relates to the Service's decision to treat the amendments made by section 314(e) of the Community Renewal Tax Relief Act of 2000 ("CRA") to sections 403(b)(3), 414(s)(2), and 415(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"), as "disqualifying provisions," terminating the (and, as discussed below, we believe inappropriately shortening the otherwise applicable) remedial amendment period with respect to such changes pursuant to Treas. Reg. § 1.401(b)-1(c)(3), and imposing the sanctions announced in Rev. Proc. 2002-35, 2002-24 IRB 1 (May 29, 2002), in the circumstances discussed below.

Although we believe there are one or more legal bases that indicate the above decisions should be reconsidered, more importantly, we believe that good policy and equity require it. In short, we believe it is the right thing to do and that it will help ". . . dispel the notion . . . that maintaining retirement plans for . . . employees is too complex and costly and presents too great a liability."[1] At a minimum, we believe the Service in the very near future should announce that it will waive the otherwise applicable sanctions under Rev. Proc. 2002-35 in appropriate circumstances. Again, we are not suggesting that sanctions are inappropriate in situations where there has been a total disregard of the deadlines and no effort has been made to comply. On the other hand, as discussed herein, we believe there are circumstances and employers as to which their imposition is inappropriate or that at a minimum the $3,000 and $10,000 penalties are out of sync with the defect.

Background

Footnote 1 in Rev. Proc. 2002-35 states that "GUST" refers to the legislation included in the table that follows. We have included the date of enactment, the earliest effective date for a relevant statutory provision, and the extended GUST deadline applicable thereto for a private sector taxable sponsor's calendar year plan. Clearly, plan sponsors and their advisors had considerably more time to deal with compliance issues with most of this legislation than they did with respect to CRA. Indeed, if you compare the period under the Uruguay Round Agreements Act with CRA, we are essentially talking about seven years compared to one. Further, the CRA compliance period was only six months (if the final two month extension is disregarded) after Notice 2001-37, 2001-25 IRB 1340 (June 4, 2001) was issued.

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[1] From write-up regarding the August 13, 2002, Internet forum *Tax Talk Today: Advising Clients on Retirement Plans*, in which Carol Gold participated. See Bureau of National Affairs, Inc. *Daily Tax Report*, p. G-6, August 14, 2002.

Act	Date of Enactment	Earliest Effective Date	Extended GUST Deadline
Uruguay Round Agreements Act, Pub. L. 103-465	12/8/94	Limitation years beginning after 12/31/94	Later of 2/28/02 or last day of 2001 plan year
Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353	10/13/94	Reemployments after 12/12/94	Later of 2/28/02 or last day of 2001 plan year
Small Business Job Protection Act of 1996, Pub. L. 104-188	8/20/96	Plan years beginning after 12/31/96	Later of 2/28/02 or last day of 2001 plan year
Taxpayer Relief Act of 1997, Pub. L. 105-34	8/5/97	8/5/97	Later of 2/28/02 or last day of 2001 plan year
Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206	7/22/98	Distributions after 12/31/98	Later of 2/28/02 or last day of 2001 plan year
Community Renewal Tax Relief Act of 2000, Pub. L. 106-554	12/21/00	Retro to plan years beginning after 12/31/97 or plan year beginning after 12/31/00	Later of 2/28/02 or last day of 2001 plan year

As you will recall, the so-called GUST I process opened April 27, 1998. *See* Rev. Proc. 98-14, 1998-4 IRB 23 (January 12, 1998). The Service then issued Rev. Proc. 00-27, 2000-26 IRB 1272 (June 12, 2000), announcing that GUST II letters would be available starting June 26, 2000, and indicating that plan sponsors who had pending GUST I letters on that date could request GUST II letters without a new filing. Note, at this point GUST did not include the CRA. We have four plans that were issued GUST II letters dated December 5, 2000. The CRA was enacted December 21, 2000.

Following the passage of the CRA, we unfortunately concluded (before Notice 2001-37) that it could be ignored unless a plan sponsor had or wished to offer a qualified transportation fringe under Code § 132(f)(4). Indeed, in the case of two plan sponsors for whose plans we already had GUST I letters, prior to becoming aware of Notice 2001-37, we advised them in writing that if they did not offer this benefit they did not need to worry about this change or request a

GUST II letter. In short, at the time, it seemed to us that if we already had a GUST I or II letter, and the CRA change **would have no operational impact on a plan**, there should be no need to amend a plan to cover it.

Notice 2001-37, is clear and unequivocal with respect to the Service's position. Indeed, it provides a lot of flexibility with respect to allowing a plan sponsor to make this change retroactively. On our compliance checklists, however, plans which had GUST I or II letters or as to which we had communicated with our client regarding going for a GUST II letter and had a negative response were done. Again, this tack was consistent with the Service's general effort to discourage folks from seeking determination letters on every little change--notwithstanding a long-held bias among most benefits practitioners that actually do plan work to do so. Indeed, under Notice 2001-37, the Service said it would not even issue determination letters with respect to model CRA 2000 amendments. We are confident that there are many similarly-situated plan sponsors and practitioners out there.

The concern we have about the Service's position in Notice 2001-37 is both technical and practical. First, most benefits practitioners think of the 401(b) regulations as providing extended relief.[2] Thus, for example, a calendar year plan sponsor would normally have until the filing date of its federal income tax return--normally the 15th day of the ninth month following the date a disqualifying provision became effective to amend its plan (in this case, September 15, 2002, for a plan amendment effective January 1, 2001), or, if it requested a determination letter, until ninety days after the date a favorable determination letter was issued--to make any amendment required by the Service. Thus, although we believe the Service was trying to help plan sponsors deal with the GUST process, Notice 2001-37 appears to have actually shortened what would have been the normal remedial amendment period. Further, although we do not dispute the Service's authority to make the CRA changes disqualifying provisions under Treas. Reg. § 1.401(b)-1(b)(3), we believe its reliance on Treas. Reg. § 1.401(b)-1(c)(3) is misplaced. That provision authorizes the Commissioner to "impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision **during the remedial amendment period**." (Emphasis added.) We do not believe this provision authorizes the Commissioner to otherwise shorten a remedial amendment period even when the Service is attempting to be helpful by doing so.

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[2] See, e.g., footnote 7 to the White Paper.

Although it is certainly appropriate for the Service to take a hard line and impose appropriate "tolls" or sanctions on those plan sponsors which ignored compliance deadlines, to impose sanctions on those who heeded the Service's call to comply and filed early would certainly confirm that indeed "No responsible Action Goes Unpunished!" Further, unlike the extended reliance period offered to plan sponsors under Section 13 of Revenue Procedure 93-39 with respect to the last major compliance cycle, plan sponsors with GUST letters who timely amended their plans for GUST (absent CRA) appear to have been offered no extended reliance on their GUST letters issued prior to CRA. It is submitted that this is unfair and bad or, at least, uninformed policy.

Discussion

Throughout the GUST process, concerned about a potential queuing problem, persons at the Service responsible for its administration continually and publicly encouraged plan sponsors and their advisors not to procrastinate with respect to compliance amendments and the related filings. Once again, as is so often the case, those who were trying to help their clients, the Service, and themselves have been disadvantaged. Those who were wise enough, fortunate enough, or just had no choice but to wait until the last minute have benefited. This is not the right result or good policy.

Clearly, it seems to us that any plan sponsor who effects the required CRA amendment by the traditional remedial amendment deadline should not be subject to the sanctions provided under Rev. Proc. 2002-35 or be required to seek a new favorable determination letter solely with respect to the CRA amendment--especially in light of the language in Notice 2001-37 mentioned above stating that "The Service will not issue new opinion, advisory or determination letters for plans that are amended solely to add the model amendments."

We admit that the issues raised with respect to the impact of the CRA amendment under the various Code sections discussed in Notice 2001-37 are valid. On the other hand, **they are absolutely irrelevant** with respect to plan sponsors which do not offer a Code § 132(f)(4) benefit. Clearly, the position taken by the Notice is at odds with the treatment of other forms of deferred income under Code § 415(c)(3) and with the Service's long-held position prior to the enactment of the Code § 415(c)(3)(D) changes made by the Small Business Job Protection Act of 1996, with respect to plan years after December 31, 1997. Indeed, we have many favorable determination letters for plans of private sector taxable sponsors for which we have not listed Code § 403(b) or § 457 deferrals as being included in Code § 415 compensation.

Requiring qualified plans to include irrelevant, inapplicable language that is meaningless to plan sponsors does not do much in the way of eliminating unnecessary complexity or encouraging responsible small businesses to adopt them. For example, should we include all of the standard 401(k) provisions in every profit sharing plan whether or not cash or deferred options are offered? I don't believe this is the right approach.

Finally, we note that the Service is not requiring employers to adopt various changes, e.g., the new Code § 415 limits, enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. Law No. 107-16 (June 7, 2001) ("EGTRRA") and that it gave sponsors of calendar year plans 14½ months to adopt good faith amendments (and four years to finalize them) from the date Rev. Rul. 01-51, 2001-45 IRB 1 (October 16, 2001) was issued. This tack seems curious based on the Service's position regarding the Code § 132(f)(4) changes under CRA as to which some employers would have had only about six months to adopt after Notice 2001-37 was issued (but for the two month extension).

Clearly, Rev. Proc. 2002-35 was a helpful step and consistent with the Service's good work with respect to its Employee Plan Compliance Resolution Program. On the other hand, its sanctions should apply to egregious situations and not with respect to plan sponsors (or their advisors) who made good faith efforts to assure compliance with the GUST requirements as understood at the time or who adopt the CRA amendment within the traditional 401(b) remedial amendment period as opposed to the shorter deadline--however well intended--announced in Notice 2001-37. Indeed, we believe the Service should offer relief solely with respect to adopting CRA amendments in the following circumstances:

1. The plan sponsor had a GUST II letter prior to the passage of CRA and adopts the required amendment within the traditional 401(b) remedial amendment period.

2. The plan sponsor adopts the model amendment within the traditional 401(b) remedial amendment period or by the date by which it needs to adopt "good faith" amendments under EGTRRA which passed within six months of the CRA, if later, whether or not it offers Code § 132(f)(4) benefits.

3. The plan sponsor complied with GUST I or II generally, but received written advice from its advisor that it did not have to amend its plan for the CRA if it did not offer a Code § 132(f)(4) benefit, and who adopts the model amendment within the traditional 401(b) remedial amendment period or by the date by which they need to adopt "good faith" amendments under EGTRRA, if later.

4. A plan sponsor who believed it was subject to Section 19 of Rev. Proc. 2000-20, 2001-6 IRB 1 (January 21, 2000), and whose M&P sponsor or volume submitter specimen practitioner failed to submit an application for a GUST opinion or advisory letter by the due date. These plan sponsors should not suffer through no fault of their own, and need some reasonable period or options to allow them to become compliant without incurring significant penalties.

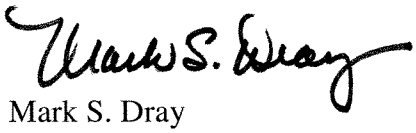
5. Public and private tax exempt or governmental plan sponsors, most of which are struggling with limited staff knowledgeable about such matters and limited resources. Again, assuming they fix any problems within a reasonable period, it seems ludicrous to penalize these entities. They are already struggling on many fronts because of the recent economic downturn (lack of grants, revenue shortfalls, and increased pension obligations, etc.), and the Service or the Constitution already exempts them from most taxation.

Summary

In short, we believe the plan sponsors in the above circumstances who attempted to and believed they had complied with GUST should not be penalized if they adopt the CRA amendments within the traditional 401(b) remedial amendment period or perhaps the EGTRRA good faith amendment date. Although there may be less sympathy for tax exempt sponsors with more than a CRA problem, the Rev. Proc. 2002-35 approach raises questionable policy issues with respect to such organizations. Clearly, the Service should have had and should exercise some discretion in the indicated circumstances.

I would welcome the opportunity to discuss this matter with you or other interested parties. Thanking you in advance for your consideration, I am

Very truly yours,



Mark S. Dray

MSD/llbf

cc: The Honorable Charles O. Rossotti
Mr. Thomas D. Terry
Ms. Carol D. Gold
Mr. Paul T. Shultz
Mr. Richard J. Wickersham
Mr. James Flannery