

Beyond The ABCs Of ESOP Restatements And Submissions Can You Spell . . . Opportunity?

Kevin G. Long, Esq.

By now, all companies sponsoring ESOPs should be aware that their plan documents must be restated and submitted to the IRS every five years for a letter of determination of their tax qualified status. What they may not realize is that the ESOP restatement process offers potentially unrealized opportunities for cost efficiency, employer protection and creative re-design. This is the time for ESOP companies to look beyond the ABCs of basic ESOP restatements and maximize whatever opportunities the law allows.

WHO CAN BENEFIT?

Restated ESOP plan documents must be submitted to the IRS in one of five annual "cycles," A through E, based on the employer identification number. Cycles A, B, and C have ended and Cycle D is underway. If your EIN ends in 4 or 9, your time is now. While Cycle D filers are ideally poised to take a closer look at the potential for cost savings and fiduciary protection, opportunities may yet be available for those Cycle A, B, and C filers that are still in the process of IRS approval. For every company, the process begins by asking the right questions.

WHO'S GOT YOUR BACK?

The proper approach begins with a team meeting of the company's internal administration staff and fiduciaries, the third party administrator (TPA), and ESOP counsel responsible for rewriting the plan. Simply using a boilerplate ESOP document will leave virtually all planning points on the drafting table, if they are even spotted. That's why all of the company's advisors must bring to bear their entire experience with the company's historical operation and the potential issues that may come up due to the employer's ever-changing circumstances.

ARE THE TRUST AND FIDUCIARY PROVISIONS SOUND?

Have the plan's trust and fiduciary's provisions been examined to address such subtleties as who is directing whom, their indemnification provisions (which, by the way, are currently the subject of controversy in the federal courts), or potentially the need for external fiduciaries or trustees, which will require significant alterations to your ESOP document and trust document. For

example, how does a fiduciary invoke his or her indemnification? How does this mesh with your fiduciary coverage?

CAN YOU SAVE MONEY BY COMBINING PLANS?

Is the company maintaining a 401(k) plan in addition to its ESOP? Should the plans be combined? Should the profit sharing component of the 401(k) plan or its matching provisions be used differently to allocate benefits that are currently held in the employee's stock accounts? Will combining plans save administration costs? Some of these planning points fly in the face of conventional wisdom, which argues for separating 401(k) and ESOP plans. But in changing times, traditional assumptions should be questioned.

HOW CAN PROFIT SHARING OR STOCK BONUS PLANS BE HELPFUL?

Should the ESOP contain a profit sharing plan or stock bonus plan to allocate stock benefits differently? Profit sharing plans or stock bonus plans can use different allocation formulas that are not available to ESOPs. They can be a part of your ESOP plan document. More creative plan design may be important for those most valuable employees whom you need to reward and retain.

WHAT CAN YOU DO NOW TO FACILITATE FUTURE REPURCHASE LIABILITY?

Are the plan's distribution and diversification provisions best drafted for the company's current circumstances? Is this the right time to make changes to distribution provisions or policies, (which should be done by the employer and not the plan fiduciaries), to ensure that future repurchase liability or corporate strategic planning are facilitated? For example, is it desirable to retire or redeem shares rather than recirculate shares while stock prices are low to allow an ascending value of benefits when stock values improve?

HOW CAN I USE THE PROCESS TO BE READY FOR AN IRS AUDIT IN THE FUTURE?

Have there been plan administration procedures applied by the company's TPA that don't strictly follow the terms of the plan document? Is there a need for a "reformative amendment" to be adopted as part of the plan restatement that must be submitted as an EPCRS filing in tandem with the determination letter Form 5300? In most cases, it's not terribly costly, and it's cheap insurance against an IRS audit. Take advantage of it now.

AND WHAT IF THERE IS A DOL INVESTIGATION?

Are all of the company's ESOP transaction documents, trustee minutes and director's minutes in order in the event of IRS or DOL audit or investigation? As we will detail in an upcoming article, we are seeing renewed enforcement interest in ESOP administration and transactions.

BUT WE'VE ALREADY SUBMITTED ... NOW WHAT?

All of these are great planning pointers if you are in Cycle D and about to go through the restatement and submission process. However, we have found in the last three years that the determination letter process is excruciatingly slow.

We are still waiting for the IRS to complete some Cycle B and C determination letter filings to be completed due to the manner in which the IRS distributes ESOP plan documents for review among agents. In some cases, we have found that determination letter submissions have become "mini audits" in which the IRS requests endless pieces of documentation, that go beyond the plan document itself. If you are a Cycle A, B or C filer, and your determination letter filing is still open, you may wish to go back and reconsider some of the issues raised in this article, and see if there is anything that might be worth revising or adjusting. It is possible to make supplemental submissions to the IRS while your Form 5300 is still being processed. The IRS will incorporate such changes into your plan document and issue the final determination letter based upon all of the elements of your submission.

IN SUMMARY

You are required by law to go through the restatement process every five years. There is no reason to do it half-heartedly. Much thought may have been put into your ESOP at the front end. However, times have changed and so have your ESOP issues and needs. All ESOP sponsors should turn this exercise into an advantage.

For further information on the nuances of plan design as it is impacted by plan administration, contact us for a reprint of our in-depth article published in the National Center for Journal Of Employee Ownership Law and Finance, Vol. 20, No. 3, "Designing And Drafting ESOPS," or contact us for general information at info@seethebenefits.com.

Editor's Note: We did the best we could to make sure the information and advice in this article were current as of the date of posting to the web site. Because the laws and the government's rules are changing all the time, you should check with us if you are unsure whether this material is still current. Of course, none of our articles are meant to serve as specific legal advice to you. If you would like that, please call us at (916) 357-5660 or email us at contactus@seethebenefits.com.