Qualified Plan Tax Opinions in Lieu of Determination Letters

by Robert W. Wood

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Tax opinions are standard fare, but opinions about qualified plans are less so. However, the IRS's change to its determination letter policies is altering that. Wood examines the changing landscape, offering tips for opinion writers in this new era.

This discussion is not legal advice.

Effective January 1, 2017, the IRS substantially eliminated something that companies, lawyers, and pension consultants relied on for decades: the practice of issuing determination letters on qualified plans. Specifically, the IRS eliminated the five-year remedial amendment cycle for individually designed qualified plans under its determination letter program. The IRS will issue determination letters when a plan is established or terminated or in other specific circumstances under which it has announced in the Internal Revenue Bulletin that a determination letter application is permitted.

Moreover, the IRS has left a door open, suggesting that it may issue determination letters in other circumstances, too. There have even been suggestions that the IRS might change course and go back to issuing determination letters more generally despite this sea change. But until that happens, we all must move on.

One effect of the change might be that more employers adopt preapproved plans. That way plan sponsors don't have to wonder if the plan qualifies in form. But clearly, not everyone can or will do that.

One issue not covered by preapproved plans, and not covered by the IRS ruling program, is what occurs beyond the four corners of the plan document. Whatever the written terms of the plan provide, how does it operate in real life? That is not an issue typically addressed during the determination letter process, and plan operations are certainly not covered by the determination letter ruling.

In that sense, the IRS process yields half a loaf, or maybe less. You might know that the plan document *itself* is OK. But in practice, much can go wrong *outside* the plan document.

From that viewpoint, perhaps this is a wake-up call about what assurances clients want and what can go wrong. It is worth assessing what we had in decades of qualified plan ruling practice. It is appropriate to ask what we can do now and how we can comply with the law while maximizing benefits for a company and its employees. Moreover, how can we limit our liability?

Employers should not forget about the liability question, and neither should professionals. Several law firms are trying to fill the gaps with opinion letters. For many tax lawyers, this may be a natural fit. After all, opinion letters are often an alternative to getting a ruling from the IRS.

But determination letters are used somewhat differently than typical IRS letter rulings. In part, this may reflect the history that IRS determination letters were the standard. Yet they only covered the plan document, saying nothing about the peaks and valleys of actual plan practice with employees.

Indeed, in many respects, a determination letter is not as good as a typical IRS letter ruling that might be issued on a host of tax issues. Letter rulings address the relevant documents, but they also address facts outside the documents. They often cover who is doing what, when, and how. In that sense, determination letters are more skeletal. As we consider what is available now, and what clients should want, here are some ideas and guideposts.

Make Lemonade

Any change this big is tough. The qualified plan industry was accustomed to getting IRS determination letters as a matter of course. You receive one at the start of a plan. You receive one on termination. And you receive one at many points in between because qualified plans are frequently amended and restated.

Third-party reliance by all kinds of entities was also the norm. A copy of an IRS determination letter historically provided assurances to third parties that a plan met the tax qualification requirements in form. In contrast, tax opinions tend to be sent only to clients or, at the most, to clients and tax return preparers.

Yet legal opinions are a natural to fill the gaps now. And arguably, they can offer more than determination letters in several respects.

Which Opinion Template?

Law firm qualified plan opinion letters could replicate IRS determination letters, seeking to express an opinion only on the plan document itself. Those opinions would effectively replace the determination letters the IRS used to hand out. Law firms will surely be clear that those opinions will cover only the plan document itself.

A more comprehensive opinion could cover the *operation* of the plan for the specified period, too. Because plans must operate in the real world, opinions that go beyond the mere plan document to also address actual plan operations should be more helpful to clients. Perhaps few law firms will perform this more comprehensive task.

However, it is at least worth discussing. It seems likely that most significant defects are not in the plan documents themselves. Rather, the defects are in operations. Compensation definition failures, participant loans, and many other problems may not be evident from the plan document itself.

For lawyers unwilling to offer an opinion on operational issues, an opinion on the form of the plan (one that serves as a surrogate for a determination letter) can still be coupled with an operations review that assesses compliance with the tax-qualification rules, in operation. Clients should want this, regardless of whether they know it! The mere fact that clients want a surrogate for a determination letter should encourage discussion about what that opinion will (and will not) provide.

Those interactions can (and perhaps often should) segue into whether an operations review is appropriate. Operations reviews offer a unique opportunity to catch mistakes and self-correct them under the IRS Self-Correction Program (SCP), without a penalty or disclosure to the IRS. If an error cannot be corrected under SCP (because it doesn't meet the relevant eligibility requirements), it might be eligible for correction through an application to the IRS under its fairly broad Voluntary Correction Program (VCP), for which there is a relatively modest filing fee.

SCP and VCP are *voluntary* correction programs under the IRS Employee Plans Compliance Resolution System (EPCRS). And under EPCRS, corrections are considered voluntary only if they have been identified *before* the IRS discovers them on examination. This is what makes operations reviews especially valuable — they identify plan errors so they can be corrected on a favorable basis under SCP or VCP.

Further, the back-and-forth that takes place during the compliance review process often reveals design or administrative changes that can be made to improve plan operations on multiple levels. At a minimum, an operations review could at its conclusion recite what was analyzed, what was identified, and what is recommended. This

should have enormous value to the client and the IRS.

If one can show all this diligence to the IRS, problems that come up are likely to be mitigated. With traditional income tax opinions, their best use can be the process of writing them. Even if an operations review does not have an opinion letter at its conclusion, it is better to spot potential problem issues early and to self-correct.

Opinion Timing

The best opinions are interactive. The opinion can become part of shaping the plan and its operation. Even when an opinion is addressing the past, it is not uncommon for additional documentation to be solicited and provided as part of the opinion due diligence.

Certificates and declarations (affirming the accuracy or completeness of documents and due execution) could help the strength and scope of an opinion. Those items can shore up documentation and plug perceived holes, and they are likely to be more helpful if prepared contemporaneously.

Certificates, declarations, and the like are rarely as effective if prepared several years later during an audit. But they can often be helpful if they are more timely prepared. This same self-adjusting practice used for income tax opinions can be applied to opinions on qualified plans.

Opinion Standards

Some tax advisers may find the gradations of tax opinions to be familiar ground. Pension lawyers and plan consultants may find them less so. But unlike an IRS ruling or determination letter, any opinion is just that. It might be strong or weak depending on the facts and documents.[1]

Tax opinion standards generally conform to one of the following choices:

> Not Frivolous: There's about a 10 percent to 20 percent chance your argument will prevail.
>
> Reasonable Basis: There's a roughly one chance in three you'll win.
>
> Substantial Authority: There are cases both ways, but there's probably about a 40 percent chance you'll win.
>
> More Likely Than Not: The odds are better than 50 percent that you'll win.
>
> Should: It's about 60 percent likely that you'll win.
>
> Will: Your tax treatment is nearly assured.

Under IRS standards, all these opinions assume there will be an IRS examination. That is, whatever the real-life odds of examination, the opinion writer must assume there will be an audit. The opinion's conclusion cannot be based on audit lottery.

Opinion standards are not an exact science and can involve matters of judgment. But professionals will probably agree more than they disagree. And discussions with clients can sometimes be interactive and conditional.

That too can be useful. In my experience, the bottom line of an opinion standard may tie into a client's requests. A client who wants the plan document to allow X might be willing to forgo X if it means the difference between a level or two in opinion standards. This can be a healthy debate, so risk and reward can be adjusted.

Cover Pro and Con

IRS letter rulings and determination letters give a binding conclusion by the IRS. IRS letter rulings usually give reasons for their conclusions. IRS determination letters generally do not. In any case, the reader generally just wants the answer.

Plainly, however, a good tax opinion considers both helpful and adverse authorities, and the reasoning and authorities are important. An opinion may conclude that it is more likely than not that a specific tax treatment applies. Even so, for the opinion's conclusion to have meaning, it should be accompanied by a thorough examination of the facts and relevant authorities.

Moreover, an opinion should develop and document the arguments against as well as for the conclusion. Only by evaluating (and hopefully knocking down) those potential objections one by one can an adviser reach a thorough and well-

[1] *See* Robert W. Wood, "What Good Is a Tax Opinion, Anyway?" *Tax Notes*, Sept. 6, 2010, p. 1071.

reasoned opinion. Shouldn't the same principles apply to qualified plan opinions?

Some opinion authors — and some clients — prefer a short opinion, regardless of the subject. If so, the opinion is usually supported by a long memo in the file, which is *referenced* in the opinion. My own preference is not to bifurcate an opinion in this way and to stick to a comprehensive opinion. For one thing, having a comprehensive opinion avoids the awkwardness of the opinion being subject to a memo that is usually not incorporated by reference.

A longer opinion also seems preferable — that is, the topic of letters to third parties summarizing the conclusion of the opinion. If writing a shorter opinion (subject to a big memo), it may be tempting to provide third parties with the (short) opinion itself, rather than a short summary of the longer opinion. From an attorney-client privilege waiver perspective, providing the opinion itself seems unwise. A waiver of the privilege for the short letter may well waive the privilege for the memo, too.

Opinions to Third Parties

A legal opinion is usually prepared by lawyer for client and is subject to attorney-client privilege. The client is the holder of the privilege. Be careful whom you copy, since that simple act may waive the privilege.

Here, there may be big differences between most tax opinions and plan determination letters. IRS determination letters are routinely provided to accountants and others. And they, in turn, clearly rely on those determination letters in their own work. Will they rely in the same way on a law firm's opinion letter that a plan is qualified in form?

They may have to. This fact alone could cause law firms to be especially reticent to venture beyond an opinion that considers only the plan document. For this reason, an operations review should at least be considered, to complement the document opinion and to give further assurances that the plan as a whole likely meets the qualified plan rules.

Arguably, they might not need to know all the fine points of the opinion, and they might not need to follow all the technical arguments. If the full opinion is short and there are no privilege concerns, they will want it (but perhaps not also the detailed memo). If the opinion and memo are really one, a summary letter about the opinion may suffice.

A summary letter written by the author of the opinion can note that there is an opinion, that it is privileged, and that it will not be provided. The same procedure is usually appropriate for income tax opinions. Third parties can be provided with a short summary letter that:

- notes that the lawyer was engaged by the client to render an opinion on a particular issue, such as the qualification of the plan (just the document, or as it applies in operation);
- notes that the client asks the lawyer to provide this summary;
- recites that the opinion is protected by attorney-client privilege, which is not waived by the summary;[2] and
- summarizes that the opinion concludes that the plan is more likely than not qualified (or other standard).

Could the IRS assert that even this short letter operates to waive the privilege on the full opinion? This assertion could be made, but it seems unlikely to be successful. If cases such as *Long Term Capital* are any indication, the worst that could happen is that the IRS could succeed in accessing the specific portions of the full opinion that are summarized or quoted in the short letter.[3]

Of course, that is the express purpose of the short letter. Indeed, it is written if not with the knowledge that it will be disclosed, then at least with the awareness that the accountant recipient might (wittingly or not) end up disclosing it.

The summary letter is conclusory and directive by nature, not discursive. It is unnecessary, and probably inappropriate, for the short letter to actually invite the third party to rely on it. But there is little doubt that in some sense

[2] *But see Long Term Capital Holdings v. United States*, No. 3:0-cv-1290 (D. Conn. 2003) (holding that disclosure to an accountant of the opinion's conclusion waived the attorney-client privilege to the limited portion of the opinion that reflected what was disclosed).

[3] *See also In re von Bulow*, 828 F.2d 94, 102 (2d Cir. 1987) (holding that "extrajudicial disclosure of an attorney-client communication — one not subsequently used by the client in a judicial proceeding to his adversary's prejudice — does not waive the privilege as to the undisclosed portions of the communication").

the letter may be read in that way. That brings us to the topic of liability.

Third-Party Reliance

With reliance comes liability. There is surely some liability with distributing something that lawyer and client may intend to provide comfort (or even induce reliance) to a third party. Historically, however, most lawyers have not been held liable even for negligent misconduct in suits brought by non-clients.

A lack of privity of contract usually prevents those not in contract from seeking damages in tort for the attorney's conduct. Over time, however, courts have chipped away at the privity doctrine. For example, in *Glanzer v. Shepard*,[4] a court found a duty of care on a "public weigher" despite a lack of privity of contract with a buyer.

Several legal theories can give non-clients a cause of action against an attorney rendering legal advice.[5] Often, legal malpractice will be pleaded in the alternative to misrepresentation or fraud. To provide a remedy for a non-client, the non-client must prove that the primary purpose and intent of the attorney-client relationship itself was to benefit or influence a third party.

In *Greycas Inc. v. Proud*,[6] the attorney wrote a letter for the sole purpose of attempting to influence a bank. The court found that the attorney had a duty to use due care to see that the information was correct. The attorney breached that duty by stating that he had performed a search when he had not.

In *Geaslen v. Berkson, Gorov & Levin*,[7] the court reviewed the nature of the duty owed by an attorney to a non-client and how it interacts with the duty owed to her client. There was a duty of accuracy even to the non-client. The court recognized the inherent tension between the attorney's duty to the client and to others.

In *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*,[8] an opinion on a deal was the subject of liability claims by non-clients. Once again, the question was about the accuracy of the opinion. The lawyer writing the opinion knew of legal problems he did not mention and failed to include this information in his opinion letter. Omitting a material fact from an opinion can create liability.

Kline v. First Western Government Securities[9] involved various forward contracts packaged by First Western. Arvey, Hodes, Costello & Burman issued three opinion letters over a two-year period concerning the tax consequences of the investments. All three opinion letters written by Arvey Hodes were addressed to First Western.

Each was intended for First Western's use only and warned against any reliance by anyone else. Even so, the court found the plaintiff's reliance to be reasonable. Arvey Hodes's disclaimers were insufficient to prevent liability. In most of these cases, the key issue is whether the information provided to a third party is accurate.

Audits

If you receive an IRS ruling or determination letter, you might not worry about an audit unless you undertake some action that is clearly not covered by the ruling or determination letter. If you receive an opinion instead, it may protect against penalties, but it hardly makes an audit irrelevant. The opinion process does, however, help one to prepare.

There is rarely time to obtain good and thoughtful work from scratch at the audit stage. Opinions are invaluable in audit defense. Timing dovetails with penalties, too. A taxpayer must first receive advice in order to claim good-faith reliance on it.[10] Besides, if a plan or other position has been attacked, all writing will be geared toward advocacy. In developing the opinion and assessing the positive and negative, the nuances should be explored then.

[4] *Glanzer v. Shepard*, 233 N.Y. 236 (1922).

[5] *See* Ellen S. Eisenberg, "Attorney's Negligence and Third Parties," 57 *N.Y.U.L. Rev.* 126 (1982); Benjamin C. Zipursky, "Legal Malpractice and the Structure of Negligence Law," 67 *Fordham L. Rev.* 649 (1998).

[6] *Greycas Inc. v. Proud*, 826 F.2d 1560, 1563 (7th Cir. 1987).

[7] *Geaslen v. Berkson, Gorov & Levin*, 200 Ill. App. 3d 600 (1991).

[8] *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104 (1976).

[9] *Kline v. First Western Government Securities*, 24 F.3d 480 (3d Cir. Pa. 1994).

[10] *See Long Term Capital Holdings v. United States*, 330 F. Supp.2d 122, 206-207 (D. Conn. 2004), *aff'd*, No. 04-5687 (2d Cir. 2005); *Cordes Finance Corp. v. Commissioner*, T.C. Memo. 1997-162, *aff'd without pub. opinion*, 162 F.3d 1172 (10th Cir. 1998).

Controversies and Penalties

For qualified plans that end up in potential hot water with the IRS, there will be deadlines. If a client has 30 days to respond to an IRS missive, that may not be enough time to do a thorough job of gathering information, analyzing it, and preparing a written response to the IRS. To be able to open the file and withdraw a thorough legal opinion on the facts, and covering the pertinent authorities, is a real luxury. It can spell the difference between a good and a bad result.

Moreover, depending on the standard of the opinion, there are varying degrees of protection from an assertion of penalties. With a regular income tax opinion, the client wants much more than merely to avoid penalties. In a qualified plan setting, avoiding penalties is more likely to be a goal unto itself.

Updating Liability

Traditionally, opinion letters generally expressly negate the duty of the author to update the letter for future events. Well-meaning advisers often send update items to clients, noting a new case or development. But professionals want to avoid liability for changes that occur after the date of an opinion.

That should surely be true for qualified plan opinions, too. No opinion should imply that it covers events that occur later. Indeed, an opinion should make sure to state the contrary. Especially when there is an express statement of this sort, common sense should preclude finding liability for an alleged failure to update that opinion letter. Disclaimers reduce the appropriateness and risk of reliance. The same should be true of summary letters to third parties.

Conclusions

Several law firms are rolling out tax opinion programs designed to address qualified plan issues. That is appropriate, and there will probably be more firms doing so in the future. Most may limit their opinions to the form of the plan, replicating an IRS determination letter as closely as a private opinion can.

Yet it may be worth using this opportunity to emphasize the importance of operational reviews. Some clients might not even understand that the IRS determination letter does not address operations. With regular tax opinions, some clients believe their lawyer's opinion binds the IRS, and they need an express statement to the contrary.[11] Lawyers offering qualified plan opinions should surely emphasize that plan operations contain the bigger potential for problems.

Regardless of whether the lawyer is willing to issue an opinion on plan operations, the give-and-take that an operational review entails (and the opportunity it provides for early correction) should be invaluable. In that sense, the similarities between the new world of qualified plan opinions and traditional tax opinion practice seem more numerous than the differences. Vive les similarities! ■

[11] Wood, "Debunking 10 Myths About Tax Opinions," *Tax Notes*, Aug. 17, 2015, p. 789.