Internal Revenue Service

Department of the Treasury

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contact Person:

Telephone Number:

In Reference to:

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Date:

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LEGEND:

Taxpayer A

Plan B

Plan C

Plan D

Distributee E -

Sum F

Sum G

Sum H

Sum I

Sum J

Distributee K -

Sum L

Dear

This is in response to a letter dated , as amended by letters dated , and , submitted on your behalf by your authorized

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representative, in which a private letter ruling was requested under section 72 of the Internal Revenue Code ("Code"). Your authorized representative submitted the following facts and representations:

Taxpayer A sponsors Plan B. Plan B was more recently restated to be effective as of , by an amendment executed on Plan B is the result of the merger of Plan C and Plan D, which were merged effective January 1, 1995. Plan B has received a favorable determination letter from the Internal Revenue Service dated

Under the terms of Plan C, but not Plan D, a participant could make voluntary contributions. Under section 12.2 of Plan C, participants could withdraw these contributions- prior to termination of service with Taxpayer A. This provision was in effect as of May 5, 1986.

Each Plan B participant's account is maintained with several separate subaccounts. Each participant's account is allocated among a "Profit Sharing Plan Account" and a "Pension Plan Account," and if necessary, a "Deferral Contributions Account," "Participant's Contribution Account," and a "Rollover Contribution Account." Upon the Merger of Plan C and Plan D, a participant's balance in Plan C (referred to as the "Profit Sharing Plan" in Plan B) was considered a "Rollover Contribution" for purposes of the participant's separate accounts. As such, it is allocated to the "Rollover Contribution Account," except that to the extent it is attributable to the participant's after-tax contributions, in which case it is allocated to the "Participant's Contribution Account."

Each participant can select among a number of investment options for the investment of his account. The options that are offered are selected by Taxpayer A and can include registered investment companies, collective investment funds for employee plans, the trustee of which is a company in the same affiliated group as Taxpayer A, loans to participants, and other investment media. Each participant elects in writing or electronically among the options for the investment of his account, and as a practical matter can change his investment options at his demand.

A participant can elect the form of distribution of retirement benefits from his "Profit Sharing Plan Account," which for these purposes includes any amounts allocated to a participant's "Deferral Contributions Account," "Participant's

Contributions Account," or "Rollover Contribution Account". Under section 12.2(a) of Plan B a participant can elect to withdraw his "Profit Sharing Plan Account" in the form of (1) a lump sum distribution, (2) substantially equal installments over a period certain (though no longer than the participant's life expectancy or the joint and survivor life expectancy of the participant and his spouse), or (3) any reasonable combination of the first two options or any other reasonable time or manner of distribution, provided only that payments shall not in any event be made or guaranteed for the life of any person ("Option Three") . Any option selected must conform to the requirements of section 401(a) (9) of the Code and sections 1.401(a)(9)-1 and 1.401(a) (9)-2 of the Proposed Income Tax Regulations.

Under section 12.3(a) of Plan B, a participant- can also elect the form of distribution of retirement benefits from his "Pension Plan Account." With spousal consent, if married, a participant can elect to withdraw his "Pension Plan Account" in the form of (1) a lump sum distribution, (2) substantially equal installments over a period certain (though no longer than the participant's life expectancy or the joint and survivor life expectancy of a participant and his spouse), or (3) any reasonable combination of the first two options or any other reasonable manner of distribution ("Option Three"). Any option selected must conform to the requirements of section 401(a)(9) and sections 1.401(a) (9)-1 and 1.401(a) (9)-2 of the Proposed Regulations. In default of an election, the participant is to receive as a distribution a fixed or variable annuity contract payable over his own life. If he is married, the annuity contract must cover the lives of the participant and his spouse, unless both elect otherwise. Plan B is in no event ever to become liable to pay benefits for the life of any person.

If a participant elects to withdraw distributions in installments over a period certain in accordance with Plan B, the amounts of the installments are determined by dividing the balance of the participant's account at the beginning of the year in which the installment is to be paid by the number of years remaining in the period certain chosen by the participant.

Distributee E attained age 70½ in 1996. In March 1997, with respect to both his Profit Sharing Plan Account and Pension Plan Account, he filed a distribution election form and elected Option Three for both accounts. In a rider attached to his Benefit Election Form, Distributee E specified that he would from time to time be paid amounts specified in his discretion, but in no event less than the minimum distributions required under section 401(a) (9). Distributee E's wife consented to this

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election. His distribution election satisfies section 401(a)(9) by paying installments by the end of each calendar year. The installments are to be paid over a period certain of no longer than years, which is the joint and survivor life expectancy of Distributee E and his spouse per section 1.72-9 of the Internal Revenue Regulations. In accordance with section 12.2(a) and 12.3(a) of Plan B, no life expectancies are to be recalculated to change the period certain. The amount of each year's installment is determined by dividing the value of Distributee E's account as of the end of the prior year by the remaining number of years in the period certain.

On or just before April 1, 1997, Distributee E received the first minimum distribution he was required to take under section 401(a)(9) of the Code in the amount of Sum F. At the end of December 1997, he received his second minimum required distribution in the amount of Sum G. For 1998 and later years, he will continue to receive minimum required distributions by the end of each December, unless he decides to withdraw more than the minimum, or to withdraw it sooner than the end of December. He will exhaust the balance of his account balance in Plan B in any event by the end of the period certain. He could exhaust it before then by withdrawing more than the minimum required distribution. It could also be exhausted before then if poor investment performance brings the value of the account below the minimum required distribution for a year. If Distributee E dies before the end of the period certain and his wife survives him, then she can take action which will allow her to extend the period certain over which distributions must be made (such as rolling over Distributee E's account balance into an individual retirement account of her own).

Distributee E's balance in Plan B includes contributions that he made of amounts which had been included in his adjusted gross income for income tax purposes (the "after-tax contributions"). All of his after-tax contributions were made prior to 1987 and were made to Plan C. The total amount of his after-tax contributions is Sum H. Taxpayer A has issued a Form 1099-R for 1997 to the Internal Revenue Service and to Distributee E. Taxpayer A reported the total distributions of Sum I in box 1 on the Form 1099-R and reported only Sum J as the taxable amount in box 2a. The amount of Distributee E's after-tax contributions was listed in Box 5. Taxpayer A has treated all of Distributee E's after-tax contributions as recovered in full with his I997 distributions.

Distributee K attained age 70½ on In 1998, he filed a distribution election form with respect to both his Profit Sharing Plan Account and his Pension Plan Account and elected Option Three for each of the accounts. He specified that he would take minimum distributions required under section 401(a) (9) of the Code but effectively reserved the right to withdraw more at his option. Distributee K is married and his spouse consented to this election. Distributee K requested the term certain method for which the amount of each distribution may vary from year to year. The installments are to be paid over a period certain of no longer than years, which is the joint and survivor life expectancy of Distributee K and his spouse per section 1.72-9 of the Income Tax Regulations. In accordance with section 12.2(a) and 12.3(a) of Plan B, no life expectancies are to be recalculated to change the period certain. The amount of each year's installment is determined by dividing the value of Distributee K's account as of the end of the prior year by the remaining number of years in the period certain.

In 1998, Distributee K withdrew Sum L. This amount was in excess of the required minimum distribution for 1998 and equaled the amount of his after-tax contributions. All of Distributee K's after-tax contributions were made prior to 1987 and were made to Plan C. Taxpayer A has issued a Form 1099-R to Distributee K and reported as the total distribution in Box 1, Sum L. Taxpayer A reported zero as the taxable amount in Box 5. Taxpayer A has treated all of Distributee K's after-tax contributions as recovered in full with his 1998 distributions.

Based on the above, you request the following letter rulings:

1. None of the distributions from Plan B received 'by Distributee E and K under the terms of their individual distribution election is an amount received as an annuity under Section 72 of the Code.

2. Because none of the distributions from Plan B under Distributee E's and K's elections is an amount received as an annuity, (a) there is no "annuity" as defined under Section 72 of the Code, (b) there is no "annuity starting date" as defined under section 72(c) (4) and section 1.72-4(b) of the Income Tax Regulations, (c) all of the distributions have been and will be

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considered made before the "annuity starting date" and (d) all of the distributions will be subject to section 72(e) (2) (B) of the Code.

3. Because (a) all of the distributions from Distributee E's and K's Profit Sharing Plan account balance in Plan B have been and will be considered made before the annuity starting date, and (b) as of May 5, 1986, Plan C allowed participants to withdraw after-tax contributions before separation from service, Section 72(e) (8) (D) will apply to allow Distributee E and K to recover without income tax the entire. amount of their after-tax contributions made in years before 1987 before any portion of their distributions from their Profit Sharing Plan account will be subject to income tax.

Section 402(a) of the Code provides, in general, that the amounts actually distributed to any distributee by an employee's trust described in section 401(a) shall be taxable to him in the year in which such amounts are distributed, under section 72 of the Code.

Section 72(a) of the Code provides the rules for amounts "received as an annuity" and section 72(e) of the Code provides the rules relating to "amounts not received as an annuity". Section 72(e) of the Code further distinguishes ‘amounts not received as an annuity" by designating them as either amounts "received on or after the annuity starting date" or as amounts "received before the annuity starting date."

Pursuant to section 72(e) (2) (A), an amount that is "not received as an annuity" and that is "received on or after the annuity starting date" is included entirely in the distributee's gross income when received, without an offset for the distributee's investment in the contract (as that term is defined in section 72(e) (6)). However, pursuant to section 72(e)(2) (B)of the Code an amount that is "not received as an annuity" and that is "received before the annuity starting date" is included in the distributee's gross income to the extent allocable to income on the contract, and not included in gross income to the extent allocable to the distributee's investment in the contract.

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Section 72(e) (2) (8) (A) of the Code provides the rules for distributions from qualified plans that are "amounts not received as an annuity" and that are "received before the annuity starting date". Section 72(e) (2) (8) (A) of the Code provides that Section 72(e) (2) (B) of the Code applies to such amounts. Therefore, those distribution are included in gross income to the extent allocable to income on the contract, and not included in gross income to the extent allocable to the distributee's investment in the contract.

Section 72(e) (8) (D) of the Code provides a special grandfather provision to 72(e) (2) (8) (A) for distributions from qualified plans (that are "amounts not received as an annuity" **and that are** "received before the annuity starting date") that on May 5, 1986 permitted withdrawal of employee contributions before separation from service. In general, distributions from such plans are not included in the distributee's income until **all of his after-tax contributions (i.e. his investment in the** contract) that were made in years prior to 1987 are recovered tax-free.

Q&A-13 of Internal Revenue Service Notice 87-13, 1987-l C.B. 432 describes the grandfather provision outlined in Section 72(e) (8) (D) of the Code. It provides that if a plan (for example, Plan C) that, on May 5, 1986, permitted in-service distributions of employee contributions is merged after May 5, 1986 with a plan (for example, Plan D) that, on May 5, 1986, did not permit such in-service distributions, investment in the contract on December 31, 1986 under Plan C (or the portion of the merged plan that comprises Plan C) will continue to qualify for the special grandfather provision under section 72(e) (8) (D) of the Code. Investment in the contract on December 31, 1986 under Plan D (or the portion of the merged plan that comprises Plan D) will not qualify for the grandfather and thus is to be treated under the merged plan, for purposes of section 72(e), as though it is not part of the investment in the contract on December 31, 1986.

Section 1.72-1(b) of the Income Tax Regulations defines the term "amounts received as an annuity" and provides that they are amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts which are so payable or the period for which they are to be paid can be determined as of that date. Any other amounts to which the provisions of section 72 apply are considered to be "amounts not received as an annuity".

Section 1.72-2(b)(2) of the Income Tax Regulations provides that amounts are considered "amounts received as an annuity" only if all of the following tests are met:

(i) they must be received on or after the 'annuity starting date" as that term is defined in section 1.72-4 of the Income Tax Regulations;

(ii) they must be payable in periodic installments at regular intervals (whether annually, semiannually, quarterly, monthly, weekly, or otherwise) over a period of more than one full year from the annuity starting date; and

(iii) the total of the amounts payable must be determinable at the annuity starting date either from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.72-2(b)(3) of the regulations goes on to state, in part, that if amounts are to be received for a definite or determinable time under a contract which provides that the amounts of the periodic payments may vary in accordance with investment experience (as in certain profit-sharing plans), costs of living indices, or similar fluctuating criteria, each such payment received shall be considered, to the extent enumerated therein, as an amount received as an annuity.

Section 1.72-4(b) of the Regulations, in general, defines an annuity starting date as the first day of the first period for which an amount is received an an annuity, except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954. The first day of the first period for which an amount is received as an annuity shall be whichever of the following is the later:

(i) the date upon which the obligations under the contract became fixed, or

(ii) the first day of the period (year, half-year, quarter, month, or otherwise, depending on whether payments are to be made annually, semiannually, quarterly, monthly, or otherwise) which ends on the date of the first annuity payment.

Whether the distributions received by Distributees E and K constitute "amounts not received as an annuity", we must determine whether these payment satisfy the definition of "amounts received as an annuity" found in sections 1.72-l(b) and

1.72-2(b) (2) of the Regulations. If they do not, then these amounts conversely satisfy the definition of 'amounts not received as an annuity".

Distributee E's election does not require that distributions be made at regular intervals. Although Distributee K's election does provide for periodic installments over a period of more than one full year, like Distributee E, he can demand distributions at any time and in any amount. The total amount of distributions that both Distributee E and K are to receive cannot be determined as of the commencement of distributions because they have the option to withdraw more than the minimum amount earlier than is otherwise required. Distributee E's and K's ability to change investment options make the rate of return unpredictable, which also-makes it impossible to comply with the third condition in section 1.72-2(b) (2) of the Regulations.

Therefore, with respect to ruling request number one, we conclude that none of the distributions from Plan B received by Distributees E and K under the terms of their individual distribution election is an amount received as an annuity under section 72 of the Code.

The distributions to Distributee E and K are "amounts not received as an annuity". Because these amounts are not received as an annuity, there is no annuity per se, and thus, the distributions can not be made "after" an annuity starting date. Therefore, these payments are treated under section 72(e) of the Code as "amounts received before the annuity starting date."

Accordingly, with respect to your second ruling request, we conclude that because none of the distributions from Plan B under Distributee E's and K's elections is an amount received as an annuity, (a) there is no "annuity" as defined under section 72 of the Code, (b) there is no "annuity starting date" as defined under section 72(c) (4) and section 1.72-4(b) of the Income Tax Regulations, (c) **all of the distributions have been** and will be considered made before the "annuity starting date" and (d) all of the distributions will be subject to section 72(e) (2)(B) of the Code.

You represented that as of May 5, 1986, Plan C permitted participants to withdraw their voluntary contributions. YOU also represented that Distributees E and K made after-tax contributions in years before 1987 to Plan C. Therefore, the grandfather provision of Section 72(e) (8) (D) will apply to **distributions from** Distributees E's and K's Profit Sharing accounts. Pursuant to Q&A-13 of IRS Notice 87-13, the grandfather provision will apply even though Plan C merged with Plan D to become Plan B.

Accordingly, with respect to your third ruling request, we conclude, that because (a) all of the distributions from Distributee E's and K's Profit Sharing Plan account balance in Plan B have been and will be considered made before the annuity starting date, and (b) as of May 5, 1986, Plan C allowed participants to withdraw after-tax contributions before separation from service, Section 72(e) (8) (D) will apply to allow Distributee E and K to recover without income tax the entire amount of their after-tax contributions made in years before 1987 before any portion of their distributions from their Profit Sharing Plan account will be subject to income tax.

This ruling is based on the assumption that Plan B is qualified under Code section 401(a), and its related trust tax-exempt under Code Section 501(a) at all times relevant to this ruling.

This ruling is directed only to the taxpayer who requested it. Section 6110(k) (3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

Pursuant to a power of attorney on file in this office, a copy of this letter ruling is being sent to your authorized representative.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2
Tax Exempt and Government Entities Division

Enclosures:

Deleted copy of letter ruling
Form 437