Significant Index No. 4980.00-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, O.C. 20224

DEC 28 2001

200212035

T:EP:RA:T:A1

In re:

This letter is in response to a request by your authorized representative for rulings on the excise tax applicable to a reversion of surplus assets to the Company on account of the termination of the DB Plan and the transfer of all or a portion of the surplus to a new profit-sharing plan to be established by the Company (the "Profit-Sharing Plan"). Communications dated November 7 and 29 and December 13, 2001 modified and supplemented the request.

The DB Plan, a defined benefit plan, has been terminated and the Service has issued a favorable determination letter with respect to the termination of the DB Plan. All benefits have been distributed from the DB Plan.

The DB Plan includes a provision under which any assets remaining in the trust after the satisfaction of all accrued benefits under the plan, and after payment of termination expenses of the plan, will be returned to the Company. In connection with the termination of the DB Plan, there is an amount of surplus assets ("the surplus"). All of the maximum reversion available to the Company (determined after the satisfaction of all liabilities of the DB Plan but prior to any transfers of surplus assets to the Profit-Sharing Plan or reversion to the Company) will be transferred to the Profit-Sharing Plan. Such maximum reversion is equal to the surplus.

The Company will establish the Profit-Sharing Plan. The Profit-Sharing Plan will be a profit sharing plan that includes a cash or deferred arrangement under § 401 (k) of the Internal Revenue Code. The Profit-Sharing Plan is intended to be a "qualified replacement plan" under § 4980(d).

Under the Profit-Sharing Plan, no employee contributions will be made. Rather, the Company will contribute a portion of its profits to the Profit-Sharing Plan. The Company's allocations will be based on each participants compensation and (on a weighted-based formula) service. It was represented in the December 13, 2001 letter that the Company expects to transfer and directly allocate the entire surplus in 2002.

However, if such allocation would cause the Company to have non-deductible contributions, then the Company would transfer 25% of the surplus into a suspense account within the Profit-Sharing Plan. The remaining 75% of the surplus would also be transferred to the Profit-Sharing Plan but directly and immediately allocated among the plan's participants.

Under the terms of the Profit-Sharing Plan, amounts held in the suspense account (including income thereon) will be allocated to the accounts of participants in the Profit-Sharing Plan in lieu of employer contributions or, alternatively, as a supplement to the Company's regular contributions. The amounts, plus earnings, will be allocated to participant accounts no less rapidly than ratably over seven years from the date of transfer.

The Company has stated that, as of January 29, 1998, there were 671 active employees covered by the DB Plan. The Company has represented that more than 99% of the active participants who are still currently employed by the Company will be active participants (i.e., they will receive an allocation) each year under the Profit-Sharing Plan.

Amounts released from the suspense account in the Profit-Sharing Plan (attributable to the amount transferred from the DB Plan and income thereon) will be treated as employer contributions for purposes of sections 401(a), 401(m) and 415 of the Code. The Profit-Sharing Plan further provides that all such amounts allocated from the suspense account will be treated as annual additions for the plan year in which the amounts are allocated to the accounts of participants.

Based on the foregoing, the following rulings are requested:

(1) The Profit-Sharing Plan constitutes a "qualified replacement plan" within the meaning of Code § 4980(d)(2).

(2) The assets transferred directly from the DB Plan to the Profit-Sharing Plan are not includible in the Company's gross income.

(3) The transfer of assets directly from the DB Plan to the Profit-Sharing Plan will not be treated as an employer reversion under Code § 4980.

(4) The transfer of surplus assets directly from the DB Plan to the Profit-Sharing Plan will not subject the Company to an excise tax under Code § 4980 with respect to those assets,

(5) The requested rulings would not be affected by whichever of the alternative methods (offset or supplement) is used for allocating the transferred surplus from the Profit-Sharing Plan suspense account.

(6) That if any excise tax is due under Code § 4980 as a result of the transfer of more than 25% of the DB Plan surplus to the Profit-Sharing Plan, such tax shall be at the 20% rather than 50% under Code § 4980(a) and such tax, in any event, shall not apply to the first 25% of such surplus.

The Company withdrew a request for a seventh ruling,

Section 401(m)(4)(A) of the Code provides that matching contributions are considered as employer contributions on behalf of an employee.

Section 404 of the Code places limits on the deductibility of contributions to pension trusts. For profit-sharing plans, § 404(a)(3) provides that the deductible limit is equal to the greater of:

1. 15% of the compensation otherwise paid to the beneficiaries during the taxable year, or
2. the amount the employer is required to pay under § 401(k)(11) for such taxable year,

Section 4972(a) of the Code provides that nondeductible contributions (as defined) are subject to a 10 percent tax.

Section 4980(a) of the Code provides for a 20% excise tax on the amount of any reversion from a qualified plan. Section 4980(d) provides, in general, that the excise tax under § 4980(a) shall be increased to 50% with respect to any employer reversion from a qualified plan unless the employer either establishes or maintains a qualified replacement plan, or the plan provides for certain benefit increases which take effect immediately on the termination date.

Section 4980(c)(2)(A) of the Code provides that the term “employer reversion” means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

Section 4980(d)(2) of the Code, in relevant part, defines a “qualified replacement plan” as a qualified plan established or maintained by the employer in connection with a qualified plan termination for which:

(A) At least 95% of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan, and

(B) A direct transfer is made from the terminated plan to the replacement plan before any employer reversion, and the transfer is an amount equal to 25% of the maximum amount the employer could receive as an employer reversion without regard to that section, and

(C) Meets the allocation requirements described below.

Section 4980(d)(2)(B)(iii) of the Code, in general, provides that in the case of a transfer to a qualified replacement plan in an amount equal to 25% of the maximum amount which the employer could receive as an employer reversion, such amount transferred shall not be includible in the gross income of the employer and such transfer shall not be treated as an employer reversion for purposes of § 4980.

Section 4980(d)(2)(C)(i) of the Code provides, that if the replacement plan is a defined contribution plan, the amount transferred to the replacement plan must be:

(I) Allocated under the plan to the accounts of participants in the plan year in which the transfer occurs, or

(II) Credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over the seven-plan-year period beginning with the year of the transfer.

Section 4980(d)(4)(B) of the Code provides, in part, that the allocation of any amount (or income allocable thereto) to any account under § 4980(d)(2)(C) shall be treated as an annual addition for purposes of § 415.

Of the active employees who were participants in the DB Plan and are still employed by the Company, it has been represented that more than 99% of them will receive an allocation under the Profit-Sharing Plan. Thus, at least 95% of the active participants in the DB Plan who remain as employees of the Company after the termination are active participants in the Profit-Sharing Plan.

Under the terms of the Profit-Sharing Plan, as amended, any amount transferred from the DB Plan into the suspense account of the Profit-Sharing Plan will be allocated no less rapidly than ratably over the seven-year-period beginning with the year of the transfer.

Therefore, with regard to your first ruling request, the Profit-Sharing Plan constitutes a "qualified replacement plan" within the meaning of § 4980(d)(2) of the Code provided that the Company transfers an amount equal to 25% of the surplus after termination into a suspense account in the Profit-Sharing Plan. The Profit-Sharing Plan will also constitute a "qualified replacement plan" within the meaning of § 4980(d)(2) provided that the Company allocates in the year of transfer an amount equal to at least 25% of the surplus after termination into the Profit-Sharing Plan. The Profit-Sharing Plan will cease to be a "qualified replacement plan" in any year in which less than 95% of the active participants in the DB Plan who remain as employees of the Company (in such year) after the termination are active participants (i.e., receive an allocation) in the Profit-Sharing Plan, As we held above, the Profit-Sharing Plan is a "qualified replacement plan" provided the amount transferred to the suspense account in the Profit-Sharing Plan equals 25% of the surplus or an amount equal to at least 25% of the surplus is directly allocated in the year of transfer. Pursuant to § 4980(d)(2)(B)(iii), because 25% of the surplus will be allocated directly to participant accounts or into a suspense account, such amount is not treated as an employer reversion for purposes of § 4980. However, § 4980(d)(2)(B)(iii) only applies to the 25% of the surplus specified in § 4980(d)(2)(B)(i). Thus, an amount equal to 25% and only 25% of the surplus transferred from the DB Plan to the Profit-Sharing Plan is not considered as a reversion for purposes of § 4980.

Therefore, with regard to your second ruling request, only an amount equal to 25% of the surplus transferred directly from the DB Plan into the suspense account in or directly allocated to the Profit-Sharing Plan is not inctudible in the Company's gross income. Pursuant to § 4980(d)(2)(B)(iii) of the Code, any amount greater than 25% of the surplus transferred directly from the DB Plan to the Profit-Sharing Plan or to the Company would be includible in the Company's gross income. This is the case regardless of whether the 25% of the surplus is allocated directly in the year of transfer or is allocated to a suspense account in the Profit-Sharing Plan. We also note that § 4980(d)(2)(C) only provides for the allocation to a suspense account of the 25% of surplus described in § 4980(d)(2)(B)(i). Accordingly, if more than 25% of the surplus is allocated to the Profit-Sharing Plan suspense account then the its tax-qualified status of the Profit-Sharing Plan becomes an issue.

Witb regard to your third ruling request, under § 4980(d)(2)(B)(iii) of the Code, the Company will not be subject to the excise tax under § 4980 of the Code with respect to the transfer of 25% of the surplus from the DB Plan. However, the Company will be subject to the excise tax under § 4980 with respect to the transfer or reversion of the remaining 75% of the surplus from the DB Plan.

As we held above, the amount of the transferred surplus in excess of 25% of the surplus is a reversion to the Company. Such amount is then regarded as a contribution to the Profit-Sharing Plan and it is subject to the deduction limits of § 404 of the Code. To the extent that any part of the transferred amount in excess of 25% exceeds the deductible limits of § 404, the Company is subject to the 10% excise tax of § 4972.

As ruled above, the Profit-Sharing Plan is a "qualified replacement plan". Therefore, with regard to your fourth and sixth ruling requests, the excise tax on the reversion of assets from the DB Plan to the Company will be imposed at a tax rate of 20% of the reversion amount. Such reversion amount is determined after the transfer of 25% of the surplus to the Profit-Sharing Plan.

With regard to your fifth ruling request, the Code does not specify the treatment of such allocations, i.e., whether they must be in lieu of employer contributions or in addition to employer contributions. The only restriction applies to amounts that would exceed the limits of § 415(c). Accordingly, the Company may use amounts transferred to the Profit-Sharing Plan suspense account to offset its regular contributions or to supplement its regular contributions. However, in order for the allocation provisions of the Profit-Sharing Plan to be definitely determinable, the Profit-Sharing Plan should specify how such transferred amounts are used.

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

These rulings are based on the assumptions that the DB Plan and the Profit-Sharing Plan are qualified under § 401(a) of the Code and that their related trusts are tax-exempt under § 501 (a) at all times relevant to this ruling.

We have sent a copy of this letter to your authorized representative pursuant to a Form 2848 (power of attorney) on file with our office. If you have any questions, please contact me. Or, you may contact

Sincerely,

James E. Holland, Jr.

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1