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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200236047

June 10, 2002
T:EP:RA:T1

UIL Nos.: 401.29-00,402.00-00

Attn:

Legend:

University.. .....

Medical Practice.....

Plan A.....

Plan B.....

System C.....

403(b) Plan.....

Retirement Plan.....

State D.....

Dear :

This is in response to ruling requests submitted by your authorized representatives by letter dated July 12,1999, as supplemented by correspondence received through May 3,2002. These ruling requests relate to sections 401(k) and 402(g) of the Internal Revenue Code ("Code"). You submitted the following facts and representations in support of the requested rulings.

Medical Practice is a nonprofit, non-stock membership corporation organized under the laws of State D and is exempt from tax under Code section 501(a) as an organization described in section 501(c)(3). Medical Practice is a clinical medical practice which is designed to further the missions and goals of University, a political subdivision of State D. At the request of the University's president, the Medical Practice was established on , pursuant to the University's statutory authority to make contracts and develop health care delivery systems that are necessary or appropriate to carry out the University's missions and goals.

Central to the University's missions and goals is educating students and residents of the University's Medical and Nursing Schools. The Bylaws of the Medical Practice provide that its purposes include supporting the clinical, educational, and research missions of the University through the involvement of the Medical Practice's employees in patient care, teaching and scholarship.

The Medical Practice has two classes of members, the University Member and the Faculty Members. University is the University Member and a Faculty Member must belong to the faculty of the University School of Medicine or Nursing and be engaged in a clinical practice. Medical Practice is governed by a Board of Directors consisting of Individuals. The University Member elects and can remove of these individuals. The Board of Directors selects the officers of the Medical Practice, including the Medical Director and President, from the Board of Directors. You represent that the University and Medical Practice are not treated as a single employer under Code section 414(b) or section 414(c). *You* make no representation with respect to whether Medical Practice and University are members of an affiliated service group' under section 414(m).

The University maintains three retirement arrangements. Under Plan B, all University employees are eligible to make salary reduction contributions to purchase annuities intended to be described in Code section 403(b). In addition, eligible University employees have the option of participating in either Plan **A,** a defined contribution plan intended to qualify under section 401(a), or System ***C,*** a defined benefit plan also intended to qualify under section 401(a).

The Medical Practice has adopted its own 403(b) plan, the 403(b) Plan, effective which is intended to satisfy the requirements of Code section 403(b). Some time after the receipt of favorable rulings, the Medical Practice anticipates amending the 403(b) Plan (the "Amendment"), adopting the Retirement Plan, a defined contribution plan intended to qualify under section 401(a), and implementing the one-time irrevocable elections described below. Most participants in the Medical Practice plans are or will be participating in Plan A or System C, and possibly Plan B as well, with respect to their University earnings.

The 403(b) Plan provides **for** Medical Practice to contribute an amount determined by Medical Practice each year ("Discretionary 403(b) Contribution"). The Discretionary 403(b) Contribution is a mandatory, non-elective contribution allocated to participants in proportion to their eligible compensation from Medical Practice. Discretionary 403(b) Contributions have been made under the 403(b) Plan at the rate of 11 percent of eligible compensation from the Medical Practice. Under the Amendment, each participant will be permitted to make a one-time irrevocable election **of** a level of contribution ("Alternative 403(b) Contribution") that will be made in lieu of the Discretionary 403(b) Contribution, subject to any maximum or minimum that may be imposed by Medical Practice in order to comply with applicable coverage and nondiscrimination rules under Code sections 401(a)(4) and 410(b). Each Alternative 403(b) Contribution shall be expressed **as** a percentage **of** eligible Medical Practice compensation, as a dollar amount, or another formula amount, and will be made only from Medical Practice

compensation without taking into account University compensation. Absent a timely election by a participant of an Alternative 403(b) Contribution, Discretionary 403(b) Contributions would be made for that participant for all periods of participation. A participant electing an Alternative 403(b) Contribution would not be eligible for Discretionary 403(b) Contributions.

Participants in the 403(b) Plan as of the effective date of the Amendment may make one-time elections of Alternative Contributions by a deadline to be established by the Medical Practice, which will be no later than the effective date of those elections. Discretionary 403(b) Contributions will be made for these participants for periods prior to the effective date of the elections, and Alternative 403(b) Contributions will be made for periods on and after that effective date.

Employees who become participants in the 403(b) Plan after the effective date of the initial one-time elections may make one-time elections of Alternative 403(b) Contributions before they become participants in the 403(b) Plan. If Alternative 403(b) Contributions are elected by such a participant, they will be made for all periods of participation. No Alternative or Discretionary 403(b) Contributions will be made for these individuals for any period before they become participants.

Prior to the effective date of the initial one-time elections, no contributions will be made by Medical Practice to the 403(b) Plan or any other plan or arrangement under Code section 403(b) pursuant to a salary reduction agreement. However, the Amendment may provide for voluntary, salary reduction contributions under the 403(b) Plan on or after the effective date of the initial one-time irrevocable elections. No special elections under Code section 402(g)(7) will be permitted under the 403(b) Plan.

The Retirement Plan will provide for the Medical Practice to contribute amounts, if any, determined by the Medical Practice from time to time as a percentage of eligible compensation from the Medical Practice ("Discretionary 401(a) Contributions"). The Retirement Plan will also allow each participant to make a one-time irrevocable election of contributions ("Alternative 401(a) Contributions") expressed as a dollar amount, a percentage of eligible compensation from Medical Practice, or other formula amount, and made only from Medical Practice compensation without taking into account any University compensation. The Alternative 401(a) Contributions will be subject to any minimum or maximum that Medical Practice may impose in order to comply with applicable coverage and nondiscrimination rules under Code sections 401(a)(4) and 410(b). Absent a timely election of Alternative 401(a) Contributions, Discretionary 401(a) Contributions would be made for that participant.

Employees who already satisfy eligibility and participation requirements at the time the Retirement Plan is established will be required to make their one-time irrevocable election of Alternative 401(a) Contributions by a deadline to be established by the Medical Practice which will be no later than the effective date of those elections. Alternative 401(a) Contributions will be made only for periods on and after that effective date; no Retirement Plan contributions will

be made for the participant for periods before that effective date.

Employees who first satisfy the eligibility and participation requirements of the Retirement Plan after the effective date of the initial one-time elections may make one-time elections of Alternative 401(a) Contributions before they satisfy those requirements. If such an election is made, Alternative 401(a) Contributions will be made for all periods ofparticipation. No Alternative or Discretionary 401(a) Contributions will be made for these individuals for any period before they become participants. If no election of Alternative 401(a) Contributions is made by an eligible employee before the applicable deadline, Discretionary 401(a) Contributions will be made for all periods of participation.

The terms of a one-time irrevocable election of Alternative 401(a) or 403(b) Contributions may not be changed or rescinded after the election becomes effective and will apply upon rehire by the Medical Practice after a termination of employment. Once the one-time irrevocable election becomes effective, the applicable amount, percentage, or other formula will not be adjusted to satisfy nondiscrimination or coverage requirements, although the Medical Practice may make additional contributions under the 403(b) Plan or the Retirement Plan, or both, for some or all non-highly compensated employees in order to satisfy those requirements. The 403(b) Plan and the Retirement Plan will provide that contributions will be reduced to the extent necessary to satisfy the section 415 limit.

Based on the above facts and representations, you have requested rulings that:

(1) Neither Discretionary 401(a) or 403(b) Contributions nor Alternative 401(a) or 403(b) Contributions will constitute elective deferrals under Code section 402(g)(3).

(2) A one-time irrevocable election under the Retirement Plan is not a "cash or deferred election" under Code section 401(k).

With respect to ruling request (1), Code section 402(g)(3) defines "elective deferral" as including any employer contribution under a qualified cash or deferred arrangement (as defined under section 401(k)) to the extent not includible in gross income and any employer contribution to purchase **an** annuity contract under a section 403(b) salary reduction agreement. Section 402(g) further provides that an employer contribution shall not be treated as an elective deferral made to purchase a 403(b) annuity contract if under the salary reduction agreement such contribution is made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement or similar one-time irrevocable election as specified in regulations.

Section 1.402(g)-1(c) of the federal Income Tax Regulations (the "regulations") provides that an employer contribution is not treated as an elective deferral if the contribution is made pursuant to a one-time irrevocable election made by the employee, in the case of an annuity contract under section 403(b), at initial eligibility to participate in the salary reduction agreement, or in the case

of a qualified cash or deferred arrangement, at a time when the election is not treated as a cash or deferred election under section 1.401(k)-1(a)(3)(iv).

In this case, the level of Discretionary 403(b) Contributions shall be established by Medical Practice in its discretion, and will not involve any individual elections by participants in the 403(b) Plan. In addition, the Amendment to the 403(b) Plan will require that the one-time irrevocable election will be made no later than the effective date of those elections. Employees who become participants in the 403(b) Plan after the effective date of the initial one-time irrevocable elections may make one-time elections of Alternative 403(b) Contributions before they become participants in the 403(b) Plan, and neither Alternative or Discretionary 403(b) Contributions will be made for any period before they become participants.

As of the effective date of the Amendment, employees will have participated in the 403(b) Plan but will not have been eligible to participate in a salary reduction agreement under a 403(b) plan maintained by Medical Practice. Participants in the 403(b) Plan who are not newly hired by University and Medical Practice will have been previously eligible to participate in University's Plan B, an elective 403(b) plan. However, because you represent that University and Medical Practice are not treated as a single employer under Code section 414(b) or 414(c), we need not address the issue of whether eligibility for a salary reduction election under University's Plan B would prevent the applicability of section 1.402(g)-1(c) of the regulations because of the aggregation principles of section 414(b) or 414(c). Therefore, eligibility for Plan B is disregarded for purposes of determining whether a one-time irrevocable election to make an Alternative Contribution under the 403(b) Plan will be made by the participant at initial eligibility to participate in a salary reduction agreement. In addition, the Alternative and Discretionary Contributions under the 403(b) Plan are made from compensation paid by the Medical Practice. Accordingly, we conclude, with regard to ruling request (1), that neither the Discretionary 403(b) Contributions, nor the Alternative 403(b) Contributions made pursuant to the one-time irrevocable election, constitute elective deferrals under section 402(g)(3).

Regarding ruling request (2), section 1.401(k)-1(a)(2) of the regulations provides that a "cash or deferred arrangement" generally means an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions under a plan intended to satisfy the requirements of Code section 401(a).

Section 1.401(k)-1(a)(3)(iv) of the regulations provides that a cash or deferred election does not include a one-time irrevocable election made upon an employee's commencement of employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions in a specified amount or percentage of compensation made by the employer to the plan and any other plan on behalf of the employee for the duration of an employee's employment with the employer. This section further provides that in no event is an election made after December 23, 1994 treated as a one-time irrevocable election for purposes of this paragraph if the election is made by an employee who previously became eligible under

another plan of the employer.

Section 1.401(k)-1(g)(6) of the regulations defines the term "employer" by reference to the definition of "employer" in section 1.410(b)-9. Section 1.410(b)-9 defines "employer" to mean the employer maintaining the plan and those employers required to be aggregated with the employer under Code section 414(b), (c), (m) and (o).

Section 1.401(k)-1(g)(11) of the regulations provides that the term "plan" means a plan as defined under section 1.410(b)-7(a). Section 1.410(b)-7(a) sets forth a definition of "plan" for purposes of sections 401(a) and 403(a), and defines the term to mean a plan described under Code section 414(l) (which imposes requirements on a plan intended to be qualified under section 401(a), 403(a), or 405), with certain exceptions not relevant to this ruling request.

As indicated above, a cash or deferred arrangement means an arrangement under which an employee may make a cash or deferred election, but a cash or deferred election does not include a one-time irrevocable election made at initial eligibility to participate in any plan of the employer. In this case, eligible employees of the Retirement Plan will have been previously eligible to participate in the System or Plan **A,** and Plan B, maintained by the University. You represent that the University and Medical Practice are not aggregated under Code section 414(b) or 414(c). Therefore, the System, Plan **A** and Plan B are not "plans of the employer" under section 1.401(k)-1(a)(3)(iv) of the regulations. In addition, by referencing only sections 401(a) and 403(a), section 1.410(b)-7(a) indicates that the term "plan" does not include a 403(b) plan for purposes of the regulation. Thus, with regard to ruling request (2), we conclude that a one-time irrevocable election under the Retirement Plan will not be a cash or deferred arrangement under section 401(k).

The above rulings are based on the taxpayer's representation that Medical Practice and University are not treated as a single employer under section 414(b) or section 414(c). The above rulings do not address whether the result would be the same if section 414(m) applies. The above rulings do not address whether the plans of the Medical Practice or the University qualify under section 401(a) or 403(b). The determination of the status of the plans under section 401(a) is within the jurisdiction of the Pacific Coast Office.

Also, no opinion is expressed as to whether the contributions that are the subject of this ruling request are subject to tax under the Federal Insurance Contributions Act, and no opinion is expressed as to whether the amounts in question are being paid pursuant to a "salary reduction agreement" within the meaning of Code section 3121(v)(1)(B).

This ruling is addressed only to the taxpayer who requested it. Code section 6110(k)(3) provides that it may not be relied on or cited by others as precedent.

Copies of this letter are being sent to your authorized representatives pursuant to powers of

attorney on file with this office. Should you have any concerns regarding this letter, please contact.

Sincerely yours,

Donzell Littlejohn, Acting Manager
Employee Plans Technical Branch 1

Enclosures:
Copy of deleted ruling
Notice **437**

cc: