200404050

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

OCT 20 2003

UICs: 401.04-00 4972.02-00
404.02-00 4979.00-00
415.02-00

ATTN:

T:EP:RA:T3

LEGEND:

Company A:

Company B:

Company E:

Plan X:

Province C:

Country D:

Ladies and Gentlemen:

This is in response to the , letter, as supplemented by correspondence dated , , and , in which you request a series of letter rulings under sections 401(a)(4), 401(k)(3), 401(m), 402(g), 404, 415, 4972, and 4979 of the Internal Revenue Code. The following facts and representations support your ruling request.

Company E sponsors Plan X, a profit-sharing plan with a cash or deferred feature described in Code § 401(k). It is represented that Plan X is qualified under Code § 401(k). Company E has converted one or more group annuity contracts held in Plan X to a group annuity contract issued by Company A which contains an MVE feature described below. Plan X currently invests in the annuity contract with Company A which contains the MVE feature.

Company A is a United States subsidiary of Company B, a multinational insurance and financial services company. Company A has its principal offices in Province C, Country D.

Company A markets group annuity contracts to employee benefit plans that are primarily participant-directed Code section 401(k) plans. The group annuity contracts typically provide specific investment alternatives that the plan sponsor has selected from the range of investment alternatives made available by Company A. Company A's investment alternatives are generally held in separate accounts or sub-accounts established by Company A and include equity funds, fixed income funds, and money market accounts.

Company A uses sales agents to market its group annuity contracts, and its sales agents are generally paid commissions that are a percentage of the value of the group annuity contract. A plan may choose to pay its commissions in full or it may choose to amortize any commission over the life of a contract. If a plan chooses to amortize any commission owed Company A, its base asset charge is increased in order for Company A to recover from the plan the commissions that Company A has advanced to its sales agents.

Company A's group annuity contracts include a discontinuance charge for "early termination" whenever commissions have been amortized over the life of a contract. Typically, a termination prior to the end of the seventh contract year is considered an early termination. Discontinuance charges enable Company A to recover the commissions which it has advanced to qualified plans.

On occasion, a plan will shift an annuity contract (or contracts) held with another company to Company A. In order to facilitate its ability to generate additional business, i.e. to increase the willingness of plan sponsors to purchase its group annuity contracts, Company A proposes to offer to "gross up" a plan's individual accounts by the amounts which a previous contract vendor deducts as a contract discontinuance charge. Company A refers to this practice as a "gross-up" or as a "Market Value Equalizer" (hereinafter MVE).

In cases where Company A has provided an MVE to a plan that has converted group annuity contracts held with another company to group annuity contracts held with Company A, the plan remains obligated to repay the MVE in full. Your authorized representative asserts that the MVE represents the transfer to a new vendor, Company A, of an obligation owed an old vendor. Your authorized representative gives as an example a discontinuance change of 1% which is not assessed at the time vendors change but which Company A recaptures by amortizing the one percent cost of the MVE over the early-termination period applicable under the new contract issued by Company A.

If a plan terminates its contract with Company A before the end of the contract's early termination period, Company A's discontinuance charge will include an amount to recover any outstanding MVE.

Company A's MVE recapture feature insures that plans that convert annuity contracts purchased from other companies to Company A's annuity contracts will fully repay the MVE to Company A either through ongoing-plan amortization changes or through discontinuance charges.

An MVE constitutes the entire amount of an early discontinuance charge that is paid either by a plan or, occasionally, by Company A to a prior service provider. In short, an MVE is a "new" fee imposed by Company A that is triggered by the payment of a discontinuance charge to a prior vendor. In effect, an MVE is a separate fee that replaces a discontinuance fee.

Thus, in summary, an MVE is a fee imposed by Company A in addition to the early discontinuance charge that Company A imposes on all plans that defer the payment of sales charges owed to Company A. In addition to the MVE-related charges, Company A will also amortize any Company A sales charges that have been deferred by increasing the annual asset charge over a period set in a contract-generally seven years. In turn, there would be an early discontinuance charge for the deferred sales charges if a plan discontinues Company A's services prior to the completion of the seven year period (which sales charge declines over the seven year period).

If the plan which incurs an obligation to repay an MVE is a defined contribution plan, the MVE is allocated pro rata (or proportionally) to the accounts of all affected plan participants.

Based on the above, you, through your authorized representative, request the following letter rulings:

That the MVE, described above, paid by Company A to the accounts of affected plan participants:

1. will not constitute a "contribution" or other payment subject to the provisions of either Code section 404 or Code section 4972;

2. will not adversely affect the qualified status of a Plan pursuant to either Code § 401(a)(4) or Code § 415;

3. will not, when made to a plan, result in taxable income to affected plan participants or their beneficiaries;

4. will not constitute a plan contribution for purposes of Code § 401(k)(3);

5. will not constitute a plan contribution for purposes of Code § 401(m);

6. will not constitute a plan contribution for purposes of Code § 402(g)(3)(A);

7. will not constitute a plan contribution for purposes of Code §4979.

With respect to your ruling requests, Code § 401(a)(4) generally provides that the contributions or benefits provided under a qualified retirement plan may not discriminate in favor of highly compensated employees.

Code § 401(k)(3) contains participation and nondiscrimination standards applicable to elective contributions made to qualified cash or deferred arrangements (CODAs). An elective contribution is generally an employer contribution made to a CODA that was subject to a cash or deferred election of a plan participant.

Code § 401(m) contains nondiscrimination tests for matching contributions and certain employee contributions. A matching contribution generally is any employer contribution to a defined contribution plan on account of an employee contribution to such plan, any employer contribution to a defined contribution plan on account of an elective deferral, and any forfeiture allocated on the basis of employee, matching or elective contributions. An employee contribution means generally any mandatory or voluntary contribution to the plan that is treated at the time of the contribution as an after-tax employee contribution.

Code § 402(g) limits the dollar amount of elective deferrals for any individual in a taxable year. An elective deferral includes an employer contribution under a CODA to the extent that it is not includible in gross income for a year under Codes section 402(e)(2).

Code section 404(a) provides that if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, then such contributions or compensation shall not be deductible under this chapter; but, if they would otherwise be deductible, they shall be deductible under this section, however, subject to the limitations contained therein.

Code section 415(a) provides, in part, that a trust which is part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if: A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceeds the limitations of subsection (b); or, B) in the case of defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitations of subsection (c).

Section 1.415-6(b)(2) of the Income Tax Regulations provides that the term "annual additions" includes employer contributions which are made under the plan. Section 1.415-6(b)(2) further provides that the Commissioner may, in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer or certain allocations to participants' accounts as giving rise to annual additions.

Code section 4972 imposes on an employer an excise tax on nondeductible contributions to a qualified plan. Section 4972(c) defines "nondeductible contributions" as the excess (if any) of the amount contributed for the taxable year by the employer to or under such plan over the amount allowable as a deduction under section 404 for such contributions (determined without regard to subsection (e) thereof), and the amount determined under subsection (c) for the preceding year reduced by the sum of the portion of the amount so determined returned to the employer during the taxable year and the portion of the amount so determined deductible under section 404 for the taxable year (determined without regard to subsection (e) thereof).

Code § 4979 imposes a 10 percent excise tax on the sum of any excess contributions and any excess aggregate contributions under a "plan", if the excess contributions and the excess aggregate contributions are not distributed before the close of the first 2 ½ months of the following plan year. For purposes of § 4979, a "plan" includes a plan qualified under Code sections 401(a) or 403(a). In general, excess contributions are the excess of employer contributions contributed to the plan on behalf of highly compensated employees over the maximum amount of such contributions that are permitted under limitations found in the Code. In general, excess aggregate contributions are the excess of matching contributions and after-tax employee contributions made to a plan on behalf of highly compensated employees over the maximum amounts of such contributions permitted under limitations found in the Code.

Code § 402(a) generally provides that amounts held in a trust that is exempt from tax under Code § 501(a) and that is part of a plan that meets the qualification requirements of Code § 401(a) will not be taxable until such time as such amounts are actually distributed to distributes under such plan.

With respect to your ruling requests, as noted above, the MVE represents an additional charge that Company A fronts to a plan and subsequently recovers over a period of years. Thus, at the time Company A fronts an MVE to a plan, Company A is entitled to receive the MVE back over a period of time that generally will not exceed seven years. Thus, in general, an MVE is not intended to represent a permanent addition to a plan or to the accounts of affected plan participants. In many, or most instances, plan participants may benefit from the gains, if any, attributable to an MVE during the period that it remains in the plan.

Thus, the issue presented in this case is whether a Company A MVE, an addition to a plan that represents a fee substituting for a discontinuance charge owed and paid to another insurance vendor, is a "contribution" as that term is used in the Code sections referenced above.

The Service has analyzed the facts in this case and has arrived at the conclusion that an MVE is not to be treated as a "contribution" for purposes of the above-referenced Code sections. To begin with, the Service notes the intended, general, lack of permanency cited above. Furthermore, the Service notes that a contract early discontinuance fee, for which an MVE is a substitute, must be paid either from amounts previously contributed to a plan which were subject to the limits found in the Code sections referenced above at the time(s) the contributions were made or from gains attributable to such contributions which gains are not subject to said limits. Since contract discontinuance fees described above either have already been funneled through Code sections 401(a)(4), 404, 415 etc., or do not have to be so funneled, MVEs, which substitute for contract plan discontinuance fees, will be given the same treatment. Thus, the Service will not subject an MVE to testing under Code sections 401(a)(4), 404, 415, 4972 etc. since the MVE will be treated as having already been so tested or, in the alternative, as gains on contributions and, as such, not subject to testing.

Furthermore, it is apparent that an MVE, when placed in a plan, including Plan X, will, in many cases, not accrue to the benefit of affected plan participants and will not be distributed to them.

Therefore, with respect to your ruling requests, the Service concludes as follows:

That the MVE, described above, paid by Company A to the accounts of affected plan participants:

1. will not constitute a "contribution" or other payment subject to the provisions of either Code section 404 or Code section 4972;

2. will not adversely affect the qualified status of a Plan pursuant to either Code § 401(a)(4) or Code § 415;

3. will not, when made to a plan, result in taxable income to affected plan participants or their beneficiaries;

4. will not constitute a plan contribution for purposes of Code § 401(k)(3);

5. will not constitute a plan contribution for purposes of Code § 401(m);

6. will not constitute a plan contribution for purposes of Code § 402(g)(3)(A);

7. will not constitute a plan contribution for purposes of Code §4979.

This ruling is based on the facts and representations contained therein.

No opinion is expressed as to the Federal income tax consequences with respect to the transactions described above under any other provisions of the Code.

Additionally, the representations made herein that the MVEs described in this letter ruling will substitute for contract discontinuance fees, like all factual representations made to the Internal Revenue Service in applications for rulings, are subject to verification on audit by Service field personnel.

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file in this office.

If you have any questions, please call , T:EP:RA:T3 at

Sincerely yours,

Frances V. Sloan
Manager, Technical Group 3
Employee Plans Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose