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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JAN - 5 2004

T:EP:RA:T3

Uniform Issue List: 401.04-01

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ATTN: * * *

Legend:
Taxpayer A = * * *

Company M = * * *

State N = * * *

Plan X = * * *

Dear * * *:

In a letter dated November 3,2003, your authorized representative requested rulings on your behalf concerning the distribution restrictions under Section 1.401(a)(4)-5(b)(3) of the Income Tax Regulations.

Company M, which is incorporated under the laws of State N, maintains Plan X, a defined benefit plan which your authorized representative asserts is qualified under Section 401(a) of the Internal Revenue Code ("Code") and the trust of which is tax-exempt under Section 501(a) of the Code. Company M is a member of an affiliated group of corporations as defined in Section 1.4 of Plan X.

The normal method of payment of benefits under Plan X is in the form of a life annuity or a qualified joint and survivor annuity, depending upon Taxpayer **A's** marital status at the time benefit payments commence. A participant eligible for benefits, however, may elect certain optional methods of payment. Pursuant to Amendment 2001-1 to Plan X, one optional form is the payment of retirement benefits in a single cash payment.

It is represented that Section 7.3 of Plan X contains restrictions in accordance with Section 1.401(a)(4)-5(b)(3) of the Treasury Regulations ("Regulations") on the benefits Plan X can pay to any highly compensated participant (including a former employee) who is a member of the group consisting of the twenty five highest paid employees and former employees with the greatest annual compensation in the affiliated group.

Taxpayer A is a participant whose benefit is restricted. Taxpayer A terminated service with Company M on June 30, 2003. Effective upon his termination, Taxpayer A became eligible (subject to Section 7.3 of Plan X) to receive his benefits in a single cash payment pursuant to Amendment 2001-1. Taxpayer A has advised Company M that he wishes to have his benefits paid in a single sum cash payment.

Section 7.3 of Plan X permits distributions of restricted benefits if an acceptable arrangement for repaying the restricted benefits ("Restricted Amount"), is agreed upon. Company M has represented that the term Restricted Amount as used herein is defined in Revenue Ruling ("Rev. Rul.") 92-76, 1992-2 C.B. 76. Rev. Rul. 92-76 defines the Restricted Amount as the excess of the accumulated amount of distributions made to the employee over the accumulated amount of the employee's nonrestricted limit. The employee's nonrestricted limit is equal to the payments that could have been distributed to the employee, commencing when distribution commenced to the employee, had the employee received payments in the form described in Section 1.401(a)(4)-5(b)(3)(i)(A) and (B) of the Regulations. An "accumulated amount" is the amount of a payment increased by a reasonable amount of interest from the date the payment was made (or would have been made) until the date for the determination of the Restricted Amount. Section 7.3 of Plan X provides that various means of securing the repayment including repayment from amounts held in an individual retirement account (IRA) may be used. Taxpayer A has elected to secure his repayment using an IRA.

Taxpayer A will enter into an agreement ("Repayment Agreement") with Plan X to repay the Restricted Amount if Plan X terminates and repayment is necessary. Taxpayer A will secure his repayment obligation with assets held in one or more IRAs established by him. It is represented by Company M that the Repayment Agreement and the security interest of Plan X in the IRAs and other related agreements and assignments would remain in effect after Taxpayer A's death and be binding on his estate, heirs and beneficiaries to the same extent as applied to Taxpayer A during his life.

The Repayment Agreement would provide for periodic recalculations of the Restricted Amount as required by Rev. Rul. 92-76 or other Code authority. The Repayment Agreement would also provide for the release of assets from the security arrangement should the Restricted Amount decrease because of the passage of time or other factors. Additionally, the Repayment Agreement would provide for the termination of Taxpayer A's repayment obligation, and the release of any related security for repayment, should repayment no longer be required by the regulation, Rev. Rul. 92-76 or other Code authority. For example, the Repayment Agreement could terminate should the value of Plan X's assets exceed 110% of its current liabilities, should the value of Taxpayer A's future benefits (had the payment not been made) be less than 1% of the Plan's current

liabilities, or should Plan X terminate in circumstances where the benefit received by the Restricted Participant was not discriminatory under Section 401(a)(4) of the Code.

The IRA security arrangement may be implemented either through a single IRA or through two IRAs as described below.

Under the single IRA arrangement, Taxpayer A would roll over the cash payment from Plan X into a single IRA. In conjunction with the rollover, Taxpayer A would enter into an agreement with the custodian of the IRA to have the payment invested in two classes of assets. One class of assets (the "Restricted Class") would consist of assets having an initial fair market value of at least 125% of the Restricted Amount. The second class of assets (the "Unrestricted Class") would consist of the remainder of the payment. The Repayment Agreement would be secured by (i) an assignment by Taxpayer A to Plan X of Taxpayer A's rights in the Restricted Class of IRA assets and (ii) a reciprocal agreement between Taxpayer A and the IRA custodian to hold the Restricted Class of IRA assets for Plan X during the period of restriction.

If, by virtue of Taxpayer A's age or death, Section 408(a)(6) of the Code would require that distributions from the IRA commence while Taxpayer A's repayment obligation was still in effect, such distributions would first be made from the Unrestricted Class of assets. In the event that the assets of the Unrestricted Class were exhausted as a result of such distributions, further mandatory distributions would have to be made from assets in the Restricted Class.

In the Repayment Agreement Taxpayer A would agree to take certain remedial action in the event that (because of distributions, investment performance or otherwise) the fair market value of the Restricted Class of assets in the IRA should fall below 110% of the Restricted Amount. In such regard, Taxpayer A would cause IRA assets in the Unrestricted Class to be reclassified as part of the Restricted Class in an amount sufficient to make the fair market value of the assets in the Restricted Class equal to at least 125% of the Restricted Amount. Alternatively, Taxpayer A would establish an escrow arrangement of the type described in Rev. Rul. 92-76, and place in that escrow arrangement sufficient funds so that the aggregate fair market value of the assets in the escrow arrangement and the Restricted Class of assets in the IRA equaled at least 125% of the Restricted Amount.

Under the double IRA arrangement, Taxpayer A would "roll over" the single sum cash payment into two IRAs established by Taxpayer A. One IRA (the "Restricted IRA") would receive an amount initially equal to at least 125% of the Restricted Amount. The other IRA (the "Unrestricted IRA") would receive the balance of the payment. The Repayment Agreement would be secured by (i) an assignment by Taxpayer A to Plan X of Taxpayer A's rights to the assets in the Restricted IRA and (ii) a reciprocal agreement between Taxpayer A and the Restricted IRA custodian to hold the assets of the Restricted IRA for Plan X during the period of restriction.

If circumstances were to arise which required IRA distributions pursuant to Section 408(a)(6) of the Code, total required distributions would be made from the Unrestricted IRA until exhausted. Upon exhaustion of the funds in the Unrestricted IRA, or otherwise as required by Section 408(a)(6) of the Code, required distributions would be made from the Restricted IRA. In the Repayment Agreement Taxpayer A would agree to take certain remedial action in the event that (because of distributions, investment performance or otherwise) the fair market value of the assets in the Restricted IRA should fall below 110% of the Restricted Amount. In such regard, Taxpayer A would cause assets in the Unrestricted IRA to be transferred to the Restricted IRA in an amount sufficient to enable the fair market value of the assets of the restricted IRA to equal at least 125% of the Restricted Amount. Alternatively, Taxpayer A would establish an escrow arrangement of the type described in Rev. Rul. 92-76 and place in that escrow arrangement sufficient funds so that the aggregate fair market value of the assets in the escrow arrangement and the Restricted IRA equaled at least 125% of the Restricted Amount.

In the event distributions required by Section 408(a)(6) of the Code following Taxpayer A's death result in the fair market value of the assets in the Restricted Class or the Restricted IRA falling below 110% of the Restricted Amount, then Taxpayer A's successor(s) in interest will be required to establish an escrow arrangement of the type described in Rev. Rul. 92-76 and place sufficient assets in that escrow arrangement so that the aggregate fair market value of the assets in the escrow and the Restricted Class or the Restricted IRA equals at least 125% of the Restricted Amount.

Based on the above facts and representations, the following rulings have been requested:

1. Either variation of the IRA arrangement will satisfy the requirements of Rev. Rul. 92-76 and neither variation will violate the provisions of the regulation.

2. A single cash payment by Plan X to Taxpayer A in payment of Taxpayer A's entire accrued benefit will constitute an eligible rollover distribution under Section 402(c)(4) of the Code, and the rollover of the payment into one IRA or two IRAs (depending on the variation of the IRA Alternative selected) within the 60 day period described in Section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with Section 402(c)(1) of the Code, where the rollover is made as follows:

    (a) The rollover is made into one IRA, and the initial Restricted Class of the assets of the IRA is at least 125% of the Restricted Amount; or

    (b) The rollover is made into two IRAs, and the Restricted IRA receives assets equal to at least 125% of the Restricted Amount and the Unrestricted IRA receives the balance of the rollover.

3. The assignment to Plan X of Taxpayer A's interest (i) in the Restricted Class of assets, where the rollover is made into one IRA, or (ii) in the Restricted IRA, where the rollover is made into two IRAs, will not prevent qualification of the IRA subject to such assignment under Section 408(a)(4) of the Code.

4. Neither assignment referred to in (3) above will violate Section 401(a)(13) of the Code prohibition against assignment or alienation of plan benefits so as to prevent qualification of the IRA subject to such assignment.

5. Neither assignment referred to in (3) above will result in a deemed distribution under Section 408(e)(4) of the Code.

6. Plan X will not be disqualified under Section 401(a) of the Code and the accompanying trust will not lose its tax-exempt status under Section 501(a) of the Code merely because (i) a payment made to a participant consists in part of restricted benefits and (ii) the contingent obligation to repay such benefits is evidenced by a Repayment Agreement secured under either IRA Alternative.

Section 401(a) of the Code provides the requirements for the qualification of employees' retirement plans. Section 401(a)(4) of the Code provides that neither the contributions nor the benefits under a plan may discriminate in favor of employees who are highly compensated.

Section 1.401(a)(4)-5(b)(1) of the Regulations provides that a defined benefit plan must incorporate certain provisions restricting benefits and distributions so as to prevent the prohibited discrimination that may occur in the event of early termination of the plan. Section 1.401(a)(4)-5(b)(2) of the Regulations requires a defined benefit plan to provide that, in the event of plan termination, the benefit of any highly compensated employee (and any highly compensated former employee) is limited to a benefit that is nondiscriminatory under Section 401(a)(4) of the Code. In any one year, the total number of employees whose benefits are subject to restriction under Section 1.401(a)(4)-5(b) of the Regulations may be limited by a plan to a group of not less than 25 highly compensated employees and former employees. If this group is so limited under a plan, the group must consist of those highly compensated employees and former employees with the greatest compensation in the current or any prior plan year.

Section 1.401(a)(4)-5(b)(3)(i) of the Regulations further requires a defined benefit plan to provide that the annual payments to an employee subject to restrictions on distributions must be limited to an amount equal in each year to the payments that would be made to the employee under: (1) a straight life annuity that is the actuarial equivalent of the accrued benefit and other benefits to which the employee is entitled under the plan (other than a social security supplement); and (2) the amount of the payments that the employee is entitled to receive under a social security supplement.

Section 1.401(a)(4)-5(b)(3)(iv) of the Regulations provides that the above referenced restrictions do not apply, if any of the following conditions is satisfied:

(1) After taking into account payment to or on behalf of the restricted employee of all benefits payable to or on behalf of that restricted employee under the plan, the value of plan assets must equal or exceed 110% of the value of current liabilities, as defined in Section 412(l)(7) of the Code;

(2) The value of the benefits payable to or on behalf of the restricted employee must be less than 1% of the value of current liabilities before distribution; or

(3) The value of the benefits payable to or on behalf of the restricted employee must not exceed the amount described in Section 411(a)(11)(A) of the Code (restrictions on certain mandatory distributions).

Section 1.401(a)(4)-5(b)(3)(v) of the Regulations provides that, for purposes of paragraph (b), any reasonable and consistent method may be used for determining the value of current liabilities and the value of plan assets.

Rev. Rul. 92-76 holds that a lump sum distribution in an amount in excess of that otherwise permitted under Section 1.401(a)(4)-5(b) of the Regulations may be made, provided there is adequate provision for repayment of any part of the distribution representing the Restricted Portion in the event the plan is terminated while the restrictions are still applicable. Rev. Rul. 92-76 states that one permissible method of securing the agreement for repayment of the Restricted Amount is the deposit with an acceptable depositary of property having a fair market value equal to 125% of the amount that would be repayable if the plan terminated on the date of the distribution by the trust. Also under Rev. Rul. 92-76, if the market value of such property falls below 110% of the Restricted Amount, the employee is obligated to deposit whatever additional property is necessary to bring the value up to 125% of the Restricted Amount.

With respect to ruling request (1), under the IRA arrangement selected, Taxpayer A will enter into an agreement with the trustee of Plan X under which all or a portion of the Plan X distribution would be contributed to a single IRA or to two IRAs. Taxpayer A will enter into a further agreement with the IRA custodian in order to secure his obligation to repay the Restricted Amount. This depositary arrangement with the IRA custodian is comparable to the arrangement established in Rev. Rul. 92-76. Under the single IRA arrangement, an amount equal to at least 125% of the restricted portion will be placed in the Restricted Class of assets. Under the arrangement using two IRAs, an amount equal to at least 125% of the restricted portion will be placed in the Restricted IRA. Adequate provisions are made in the event the value of the assets in the Restricted IRA or the Restricted Class of assets in the single IRA fall below 110% of the Restricted Amount. The Repayment Agreement and related agreements also provide adequately for repayment in the event that the requirements of Section 408(a)(6) of the Code reduce the value of the Restricted IRA or the Restricted Class of assets in the single IRA to less than the Restricted Amount. Accordingly, we conclude, with respect to your ruling request (1), that either IRA arrangement will satisfy the requirements of Rev. Rul.

92-76 and neither arrangement will violate the provisions of Section 1.401(a)(4)-5(b)(3) of the Regulations.

With respect to your second ruling request, Section 402(c)(1) of the Code provides, generally, that if any portion of an eligible rollover distribution from a qualified trust is transferred to an eligible retirement plan, the portion of the distribution so transferred shall not be includible in gross income in the taxable year in which paid.

Section 402(c)(4) of the Code defines "eligible rollover distribution" as any distribution to an employee of all or any portion of the balance to the credit of an employee in a qualified trust except the following distributions:

(A) Any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made:

(i) For the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) For a period of 10 years or more,

(B) Any distribution to the extent the distribution is required under Section 401(a)(9) of the Code, and

(C) any distribution which is made upon hardship of the employee.

Section 402(c)(8) of the Code defines eligible retirement plan as (i) an individual retirement account described in Section 408(a) of the Code, (ii) an individual retirement annuity described in Section 408(b) of the Code (other than an endowment contract), (iii) a qualified trust, (iv) an annuity plan described in Section 403(a) of the Code, (v) an eligible deferred compensation plan described in Code section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), and (iv) an annuity contract described in Code section 403(b).

Section 402(c)(3) of the Code provides, generally, that Section 402(c)(1) of the Code shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Rev. Rul. 92-76 holds that an otherwise eligible lump sum distribution consisting, in part, of benefits restricted under Section 1.401(a)(4)-5(b)(3) of the Regulations, may be considered a lump sum distribution, even though a portion of the distribution may have to be returned to the plan. In this regard, a lump sum distribution is also an eligible rollover distribution to the extent it is otherwise eligible for rollover.

Rev. Rul. 79-265, 1979-2 C.B. 186, provides that a qualifying rollover distribution is not includible in an employee's gross income in the tax year when paid merely because it is transferred into several IRAs.

With respect to ruling request (2), we conclude that a single cash payment by Plan X to Taxpayer A in payment of his remaining accrued benefit will constitute an eligible rollover distribution under Section 402(c)(4) of the Code (assuming it otherwise qualifies under Section 402(c)(4) of the Code), and the rollover of the payment, into one IRA or two IRAs (depending upon the IRA arrangement selected) within the 60 day period described in Section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with Section 402(c)(1) of the Code (to the extent such amounts are otherwise eligible for transfer) where the rollover is made as follows:

(a) The rollover is made into one IRA, and the initial Restricted Class of the assets of the IRA is at least 125% of the Restricted Amount; or

(b) The rollover is made into two IRAs, and the Restricted IRA receives assets equal to at least 125% of the Restricted Amount and the Unrestricted IRA receives the balance of the rollover.

With respect to ruling request (3), Section 408(a)(4) of the Code requires that, in order for an IRA to be qualified, the written instrument creating the IRA must provide that the individual's interest in his or her account must be nonforfeitable. Under this provision, an IRA custodian or an employer would be precluded from asserting any claim to the assets in an IRA.

Taxpayer A will enter into the Repayment Agreement which is secured by the assignment of his rights in the Restricted IRA or an assignment of the Restricted Class of assets in a single IRA if a single IRA is used. The assignment will be in the amount necessary to satisfy the repayment obligation under Section 1.401(a)(4)-5(b)(3) of the Regulations and Rev. Rul. 92-76. Since the potential return of the restricted amount to Plan X's trustee would not derive from any claim by the IRA custodian or Company M, but from Plan X's right under certain circumstances to the restricted amount, no forfeiture would occur in violation of Section 408(a)(4) of the Code.

Accordingly, with respect to ruling request (3), we conclude that the assignment to Plan X of Taxpayer A's interest (i) in the Restricted Class of assets, where the rollover is made into one IRA, or (ii) in the Restricted IRA, where the rollover is made into two IRAs, will not prevent qualification of the IRA subject to such assignment under Section 408(a)(4) of the Code.

With respect to ruling request (4), section 401(a)(13) of the Code provides, generally, that a trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated. Section 1.401(a)-13(a) of the Regulations states that Section 401(a)(13) of the Code applies only to plans to which the minimum vesting rules of

Section 411 of the Code apply. Since IRAs are not subject to Section 411 of the Code, Section 401(a)(13) of the Code is not applicable.

Accordingly, with respect to ruling request (4), we conclude that neither assignment referred to in ruling request (3) above will violate the Section 401(a)(13) of the Code prohibition against assignment or alienation of plan benefits so as to prevent qualification of the IRA subject to such assignment.

With respect to ruling request (5), Section 408(e)(4) of the Code provides that, if an individual for whose benefit an IRA is established uses the IRA account balance or any portion thereof as security for a loan, that portion is treated as a distribution to that individual.

In this case, the use of either the Restricted IRA or the Restricted Class of assets in an IRA to secure repayment to Plan X of the amount of the restricted distribution is a pledge or use of either the Restricted IRA or the Restricted Class of assets in an IRA as security. However, in this case, the contingent obligation to return certain restricted amounts to Plan X is not a loan because the primary purpose of such section is to assure the funds in an IRA will be held for retirement purposes rather than used to defray expenses or to finance other activities of the Plan X participant/IRA owner. Thus, since the arrangement outlined above is not a loan, section 408(e)(4) of the Code is not applicable.

Accordingly, with respect to ruling request (5), we conclude that neither assignment referred to in ruling request (3) above will result in a deemed distribution under Section 408(e)(4) of the Code.

With respect to ruling request (6), we have ruled in ruling request (1) that the depositary arrangement under either IRA arrangement satisfies the requirements of Rev. Rul. 92-76 and that neither arrangement will violate the provisions of Section 1.401(a)(4)-5(b)(3) of the Regulations.

Accordingly, with respect to ruling request (6), we conclude that Plan X will not be disqualified under Section 401(a) of the Code and the accompanying trust will not lose its tax-exempt status under Section 501(a) of the Code merely because (i) a payment made to a participant consists in part of restricted benefits and (ii) the contingent obligation to repay such benefits is evidenced by a Repayment Agreement secured under either of the IRA arrangements described above.

This letter ruling is based on the assumption that Plan X meets the requirements of Section 401(a) of the Code at all times relevant hereto.

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

Should you have any concerns with this letter, please contact * * *, SE:T:EP:RA:T3, Badge ID * * * at * * *.

Sincerely,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures: Deleted Copy of this Letter
Notice of Intention to Disclose, Notice 437