200601046

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

OCT 11 2005

U.I.L. 402.00-00
U.I.L. 415.00-00

SE:T:EP:RA:T2

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Attn.: **********

LEGEND:

System A	=	**********
State B	=	**********
Plan X	=	**********
Participating Employer	=	**********
Board M	=	**********
Statute T	=	**********
Regulations R	=	**********
Plan Y	=	**********
Plan Z	=	**********
System B	=	**********
Board K	=	**********
Statute W	=	**********
District C	=	**********
City D	=	**********
Board R	=	**********

Employer N = **********

Group B Employees = **********

Statute H = **********

Dear **********:

This is in response to your letter dated December 19, 2003, as supplemented by correspondence dated September 13, 1004, October 8, 2004, December 16, 2004 and January 25, 2005, submitted on your behalf by your authorized representative in which you request several rulings concerning the income tax consequences of a transfer of assets pursuant to section 72 and other sections of the Internal Revenue Code (the "Code"). In your letter dated January 25, 2005, you withdrew your ruling request number two pertaining to the qualified status of Plan X and Plan Y, and ruling request number five pertaining to the pick up treatment of the Group B Employees' contributions to Plan X after the merger of Plan Y into Plan X. Your remaining ruling requests have been renumbered as stated below.

The following facts and representations have been submitted on your behalf.

System A was established in 1931 and is an instrumentality of State B. System A is governed by Board M, a board that is composed of sixteen members. Board M administers Plan X. You describe Plan X as a cost-sharing multiple-employer defined benefit plan. The governing provisions of Plan X are the relevant section of Statute T. You represent that Plan X also includes Regulations R of System A. You further represent that Plan X meets the requirements for qualification under Code section 401(a) and qualifies as a governmental plan within the meaning of Code section 414(d).

Plan X was expanded to include all State B school districts except those located in City D. Plan X received its most recent favorable determination letter on April 1, 2002. Plan X was established for the benefit of employees of Participating Employers of State B as defined in Statute T. Generally, all employees who hold positions subject to membership and whose salaries are paid by a Participating Employer become members of Plan X as a condition of employment. Plan X is a contributory plan and the member contributions assumed and paid by a Participating Employer are treated as employer pick-up contributions under Code section 414(h)(2).

Members and vested inactive members of Plan X who have met the age and service credit requirements for eligibility for a service retirement benefit or a reduced service benefit, will upon written application and approval of Board M, receive the greater of the retirement benefit calculated under section 24.51-603 or 24-51-605 of Plan X for which the member is eligible, or the money purchase

retirement benefit, which is actuarially determined and will be based upon the value on the effective date of retirement of the member contribution account and the matching employer contributions.

A member who terminates membership for any reason other than retirement or death and has not resumed membership may request a refund of all moneys credited to the member contribution account and payment of matching employer contributions. A termination of membership is required for a member contribution account to be refunded and for matching employer contributions to be paid. Upon receipt of a refund, all rights of membership and any future benefits associated with a member contribution account and matching employer contributions are forfeited. Partial refunds are prohibited. Employer contributions made to Plan X are nonrefundable to a participating employer.

Plan Z was established by State B law effective as of December 1, 1945 for the benefit of employees of City D's public schools. As of January 1, 2000, pursuant to Statute W, Plan Z was reconstituted as Plan Y, for the benefit employees of City D and System B (the "Group B Employees"). System B is a body corporate organized and existing pursuant to Statute W and is an instrumentality of District C. Employer N comprises District C and public charter schools in City D. Employer N maintains Plan Y. Plan Y is a cost-sharing multiple-employer defined benefit plan that provides benefits to Group B Employees. Board R sponsors Plan Y. System B is the administrator of Plan Y and Board K is the trustees of Plan Y's underlying trust. Board K consists of eleven members. On September 24, 2003, System B submitted a request for a determination letter on the continued qualification of Plan Y as of the day prior to the effective date of the merger of Plan Y into Plan X.

The governing provisions of Plan Y are statutorily promulgated by the State B legislature. The plan document that relates to Plan Y is the relevant sections of Statute W. Membership in Plan Y is mandatory for all employees Group B Employees. The Employer N contribution rate is 2.90 percent of covered salary. The Group B Employees' contribution rare is 8 percent of the member's gross covered salary. You represent that Employer N picks up the mandatory employee contributions under section 50.10 of Plan Y and the pick up contributions are treated as employer contributions under Code section 414(h)(2). You represent that Plan Y is qualified within the meaning of Code section 401(a) and is a governmental plan as described in Code section 414(d).

Statute H was added to the State B Revised Code to provide that Board M is empowered to negotiate and implement the merger of certain school district retirement systems created pursuant to Statute W into System A. Statute H provides that the merger must be in accordance with specified sections of Statute H. Pursuant to Statute H, System B entered into talks with System A to become the last school district in State B to affiliate with System A. Board M, Board K and Board R have adopted resolutions conceptually approving the merger.

The purpose of the merger agreement is to set forth the terns and conditions of the merger of Plan Y into Plan X effective as of January 1, 2005, in conformity with Statute H and to provide for the funding of future retirement benefits of Group B Employees. Pursuant to the merger agreement, the Board of Trustees of Plan Y shall transfer by trustee-to-trustee transfer the assets of Plan Y to the Plan X and Board M, on behalf of Plan X, shall accept such transfer of assets from Plan Y. The Plan Y assets shall be free and clear of all liens and encumbrances unless otherwise agreed by System A, that would prevent such assets from being transferred to Plan X. The trustee-to-trustee transfer shall be completed effective as of January 1, 2005, and may be completed in one or more transactions. As of the effective date of the proposed merger, all assets, liabilities, and obligations of Plan Y shall become the assets, liabilities, and obligations of System A and Plan X, except as otherwise provided in the merger agreement.

The merger may not result in a subsidy by or between System B and System A or District No. 1 and System A. System A (Plan X) is to receive from System B and District No. 1 (Plan Y) assets sufficient to fund all liabilities determined pursuant to the merger agreement. As of the merger date, Employer N will become an affiliated employer of System A (Plan X) and shall be subject to the laws and other rules relating to affiliated employers of System A (Plan X) and any outstanding employer contributions for Plan Y shall be made to Plan X and all employer and employee contributions of any participant in Plan Y shall be governed by the statutes and rules of System A (Plan X).

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

1. The trustee-to-trustee transfer of assets from Plan Y shall not be deemed to be an actual or constructive distribution to the Group B Employee of the amounts transferred and as a result shall not be subject to taxation at the time of the transfer under sections 402(a) and 72(t) of the Code.

2. Amounts transferred from Plan Y, including picked-up contributions, shall retain their federal income tax purposes as employer and employee contributions, as applicable for purposes of recovery of investment in the contract. Amounts transferred from Plan Y as employee contributions will not be treated as a separate contract for purposes of Code section 72(e).

3. The amounts transferred from Plan Y shall not be treated, for purposes of the limits on benefits and contributions under Code sections 415(b) or 415(c), either as part of the annual benefits accrued under Plan X, or as annual additions for the year of the transfer, and further will not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of Code section 415(n).

Code section 402(a) provides that, except as otherwise provided in this section, any amount actually distributed by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee, under section 72 (relating to annuities).

Code section 72(t) provides for an additional tax on any amount received from a "qualified retirement plan" (as defined in section 4974(c), which includes plans described in section 401(a)). The additional tax for the taxable year in which such amount is received is equal to 10 percent of the portion of such amount which is includible in gross income, except where such income is distributed on or after an employee attains the age of 59 ½ , or on account of one or more exceptions provided under Code section 72(t)(2).

Code section 401(a) provides that a trust created or organized in the United States and forming part of a qualified stock bonus, pension, or profit sharing plan of an employer constitutes a qualified trust only if the various requirements set out in section 401(a) are met.

Section 1.401-1(b)(1)(i) of the Income Tax Regulations (the "regulations") provides, in part, that a pension plan is an plan established and maintained by an employer primarily to provide for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. This section also provides that a pension plan may provide for the payment of a pension due to disability, and may also provide for incidental benefits.

Revenue Ruling 56-693, 1956-2 C.B. 282, as modified by Revenue Ruling 60-323, 1960-2 C.B. 148, provides that a pension plan fails to meet the requirements of Code section 401(a) if it permits an employee to withdraw any part of the employee's accrued benefit (other than a benefit attributable to voluntary employee contributions) prior to certain distributable events; e.g., retirement, death, disability, severance of employment, or termination of the plan.

Revenue Ruling 67-213, 1967-2 C.B. 149 involves the transfer of funds directly from the trust forming part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. The revenue ruling provides, in part, that if a participant's interest in a qualified plan is transferred from the trust forming part of that plan to the trust forming part of another qualified plan without being made available to the participant, no taxable income will be recognized by reason of such transfer.

In this case, the Board K, on behalf of Plan Y, plan proposes to transfer in a trustee-to-trustee transfer the assets of Plan Y to Plan X, both of which as assumed to be plans that satisfy the requirements for qualification under Code section 401(a). It has been represented that pursuant to Statute H and the merger agreement, the transferred amounts will not be distributed to nor made

available to the Group B Employees, but will instead be transferred directly from Plan Y to Plan X. You represent that no active Group B Employee will have the option of receiving any distributions as part of the transfer.

Accordingly, with respect to your first ruling request, we conclude that the trustee-to-trustee transfer of assets from Plan Y to Plan X shall not be deemed to be an actual or constructive distribution to the Group B Employee of the amounts transferred and as a result shall not be subject to taxation at the time of the transfer under Code sections 402(a) and 72(t).

The second ruling request asks that the transferred from Plan Y, including contributions that have been picked up by the employer, will retain their character for federal income tax purposes as employer and employee contributions, as applicable, for purposes of recovery of investment in the contract, and that amounts transferred from Plan Y as employee contributions will not be treated as a separate contract for purposes of section 72(e).

With respect to your second ruling request, Revenue Ruling 67-213 provides that funds transferred directly from one qualified plan to another qualified plan are not considered as having been distributed to the participants. In Revenue Ruling 67-213, funds were transferred directly from the trust forming part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. Because no distribution was considered to take place as a result of the transfer, the transferred funds continue to be funds derived from employer contributions and did not constitute employee contributions.

In this case, the transfer is being made directly from the trust of one qualified plan, Plan Y, to the trust of another qualified plan, Plan X. Since the funds are being transferred directly from one trust to the other, the funds are not considered to be distributed to the participants for whom the transfers are made. You have stated that Group B Employees' mandatory contributions to Plan Y are picked up and treated as employer contributions under Code section 414(h)(2). To the extent the transferred funds are derived from employer contributions, they continue to be funds derived from employer contributions and do not constitute employee contributions after the trustee-to-trustee transfer of assets from Plan Y to Plan X. To the extent that there are any after-tax member contributions that must be treated as "investment in the contract" those are recovered by the member of System B (Plan Y) according to the rules of Code section 402(a) and 72(d). If a member qualifies for a pension, any after-tax contributions are recovered under Code section 72(d)(1), including the amounts transferred from Plan Y. If upon termination of employment, a member does not qualify or is not eligible for a pension, the Plan Y member is entitled to a refund of his or her total accumulated contributions balance.

You represent that Plan Y has not treated employee contributions as being made pursuant to a separate contract for purposes of Code section 72(e) and that Plan

X does not treat employee contributions as being made to a separate contract under section 72(e), and therefore the taxation of such benefits, including the amounts transferred from Plan Y, is governed by the rules of Code section 402(a) and section 72. You have further represented that System B (Plan Y) has maintained records necessary to track employer and employee contributions and pre-tax and post-tax amounts. These records will be transferred to System A (Plan X), which maintains an accounting system which will accept this transferred information. System A (Plan X) will then continue to track these amounts for the Group B Employees as System A does for all of its members. As a result, if any of these transferred amounts are eventually distributed in a lump sum from Plan X, they will be allocable to income under section 72 and certain amounts will be includible in gross income under section 72 upon distribution to the extent provided for in section 72(d)(1)(D).

Accordingly, with respect to your second ruling request, we conclude that amounts transferred from Plan Y, including picked-up contributions, shall retain their federal income tax purposes as employer and employee contributions, as applicable for recovery of investment in the contract and that amounts transferred from plan Y as employee contributions will not be treated as a separate contract for purposes of Code section 72(e).

Your third ruling request asks that the amounts transferred from Plan Y shall not, for purposes of the limits on benefits and contributions under Code section 415(b) or section 415(c), be treated either as part of the annual benefit under Plan X or an annual additions for the year of the transfer, and shall not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of section 415(n).

With respect to ruling request number three, Code section 415(b) provides the limitation on annual benefits for defined benefit plans. Section 415(b)(2) provides, in general, that a participant's benefit, expressed as an annual benefit, cannot exceed the lesser of (A) $160,000, or (B) 100 percent of the participant's average compensation for his or her high three years.

Code section 415(c) provides the limitations on annual additions for defined contribution plans. Section 415(c)(1) provides, in general, that contributions and other annual additions for a participant may not exceed the lesser of (a) $40,000, or (B) 100 percent of the participant's compensation.

Section 1.415-3(b)(1)(iv) of the regulations provides that when there is a transfer of funds from one qualified plan to another, the annual benefit attributable to the assets transferred does not have to be taken into account by the transferee plan in applying the limitations of section 415.

Section 1.415-3(d)(1) of the regulations provides that mandatory contributions to a defined benefit plan are considered a separate defined contribution plan that is

subject to the limitations on contributions and other additions described in section 1.415-6 of the regulations.

Section 1.415-6(b)(2)(iv) of the regulations provides that the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year in which the transfer occurs.

Code section 415(n) provides special rules relating to the purchase of permissive service. Code section 415(n)(1) provides that if the employee makes 1 or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of this section shall be treated as met only if—

(A) the requirements of such subsection (b) are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for the purposes of subsection (b), or

(B) the requirements of subsection (c) are met, determined by treating all such contributions as annual additions for the purposes of subsection (c).

Code section 415(n)(3)(A) provides that the term "permissive service credit" means service credit –

(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Plan X and Plan Y are assumed to be qualified plans as described in Code section 401(a). As such, the transfer of assets from Plan Y to Plan X is a transfer from one qualified plan to another. Therefore, as provided in section 1.415-3)b(1)(iv) of the regulations, the benefits attributable to the amounts transferred from Plan Y to Plan Y do not constitute an "annual benefit" within the meaning of section 415(b)(2)(A) of the Code for purposes of determining limitations for defined benefit plans. Of course, the benefit attributable to the transfer must be determined on the basis of reasonable actuarial assumptions.

Furthermore, as provided under section 1.415-6(b)(2)(iv) of the regulations, the amounts transferred from Plan Y to Plan X will not constitute an "annual addition" within the meaning of section 415(c)(2) of the Code, for purposes of determining limitations for defined contribution plans.

In addition, because the amounts transferred from Plan Y to Plan X are amounts transferred from one qualified plan to another and are not contributions to the plan, no Group B Employee is making a contribution to purchase past service credit. Accordingly, the special rules of Code section 415(n) relating to the purchase of permissive service credit do not apply to such transferred amounts. Therefore, with respect to ruling request number three, we conclude the amounts transferred from Plan Y to Plan X shall not be treated, for purposes of the limits on benefits and contributions under Code section 415(b) or 415(c), either as part of the annual benefits accrued under Plan Y or an annual additions for the year of the transfer, and further shall not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of Code section 415(n).

This ruling does not address the tax consequences of the aspects of the proposed merger agreement as it relates to certain inactive Plan X and Plan Y members who may have opportunities before and/or after the proposed merger to withdraw their member accounts from Plan X and Plan Y before and subsequent to the proposed merger of Plan Y into Plan X. The ruling is specifically limited to the exclusion from income to those Group B Employees whose Plan Y benefits are transferred in the proposed trustee to trustee from Plan Y to Plan X. This ruling does not express an opinion that the proposed merger of Plan Y and Plan X satisfies the requirements of Code section 414(l), nor what effect, if any, the proposed merger will have on the continued qualified status of Plan X. This ruling does not express an opinion as to the validity of the pick up of Group B Employee contributions to Plan X subsequent to the merger of Plan Y into Plan X nor is an opinion expressed as to the validity of the pick up arrangement in Plan X.

This ruling is based on the assumption that Plan X and Plan Y are qualified plans as described in section 401(a) and are governmental plans within the meaning of Code section 414(d). This ruling does not address the application of the proposed regulations under section 415 (issued May 25, 2005) to the transaction described above, nor does it express an opinion as to whether benefits under Plan X and Plan Y need to be aggregated under Code section 415.

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

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney (Form 2848) on file in this office.

200601046

If you have any questions concerning this ruling, please contact **********SE:T:EP:RA:T2.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted Copy of this letter
Notice of Intention to Disclose