Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(k)–1: Certain cash or deferred arrangements.

Qualified cash or deferred arrangements; separation from service. The sale of less than substantially all of the assets of a trade or business to an unrelated employer does not preclude a distribution to affected participants in a section 401(k) plan on account of separation from service.

Rev. Rul. 2000–27

ISSUE

Will a distribution of amounts deferred by an employee under a cash or deferred arrangement under § 401(k) of the Internal Revenue Code be considered to have been made earlier than the employee's "separation from service," within the meaning of § 401(k)(2)(B)(i)(I), if the distribution is made after the sale to an unrelated employer of assets constituting less than substantially all of the assets of a trade or business of the employee's employer?

FACTS

Employer X maintains Plan A, which is a profit-sharing plan intended to satisfy the requirements of § 401(a) of the Code. Plan A includes a cash or deferred arrangement that is intended to be a qualified cash or deferred arrangement under § 401(k). Plan A provides that salary reduction contributions are immediately nonforfeitable and, if the employee has not attained age 59 1/2, cannot be distributed prior to the employee's retirement, death, disability, or separation from service, except in the case of hardship (as defined in the plan), plan termination (to the extent permitted by § 401(k)(10)) or a transaction described in § 401(k)(10)(A)(ii) or (iii).

Employer X sells certain assets to Employer Y, an entity not required to be aggregated with Employer X under § 414(b), (c), (m) or (o) after the sale. The assets sold to Employer Y constitute less than 85% of the assets used by Employer X in a trade or business of Employer X. Most of the employees of Employer X who were associated with the transferred assets terminate their employment with Employer X and are hired by Employer Y (the "Transferred Employees") as of the date of the sale of assets. Transferred Employees continue to perform, without interruption and in the same capacity, the same functions for Employer Y that they performed for Employer X before the sale. Additionally, Employer X is no longer the recipient of the services of the Transferred Employees.

Following the sale of assets, the administrator of Plan A allows all of the Transferred Employees to receive a distribution of their Plan A account balances, including amounts attributable to elective contributions. There is no transfer of amounts from Plan A to any plan maintained by Employer Y in connection with the Transferred Employees (although there were direct rollovers of distributions pursuant to § 401(a)(31)).

LAW AND ANALYSIS

Section 401(k) of the Code provides that a profit-sharing plan that includes a cash or deferred arrangement can meet the requirements of § 401(a), provided that the cash or deferred arrangement constitutes a qualified cash or deferred arrangement.

Section 401(k)(2)(B)(i) provides that amounts attributable to employer contributions made pursuant to an employee's election may not be distributable from a profit-sharing plan earlier than (I) the employee's separation from service, death or disability; (II) an event described in § 401(k)(10); (III) the employee's attainment of age 59 1/2; or (IV) the employee's hardship. Events described in § 401(k)(10) include (i) the termination of the plan; (ii) the disposition by a corporation to another corporation of substantially all the assets used by the selling corporation in a trade or business; and (iii) the disposition of a corporation's interest in a subsidiary.

Sections 1.401(k)–1(d)(1)(iv), 1.401(k)–1(d)(4) and 1.401(k)–1(d)(5) of the Income Tax Regulations interpret § 401(k)(10). Section 1.401(k)–1(d)(1)(iv) generally provides that amounts in a plan attributable to elective contributions may be distributed on or after the date of the sale or other disposition by a corporation of substantially all the assets used by the corporation in a trade or business of the corporation to an unrelated corporation. Section 1.401(k)–1(d)(4) further provides that (i) after the sale, the purchaser must not maintain the plan; (ii) the employee receiving the distributions must continue employment with the purchaser of the assets; and (iii) the distribution must be made in connection with the disposition of assets. Finally, § 1.401(k)–1(d)(4) provides that the sale of substantially all the assets used in a trade or business means the sale of at least 85% of the assets, and an unrelated entity is one that is not required to be aggregated with the seller under §§ 414(b), (c), (m) or (o) after the sale or other disposition. Section 1.401(k)–1(d)(5) provides that a distribution may be made only if it is a lump sum distribution within the meaning of § 402(d)(4).

For tax years beginning prior to January 1, 2000, § 402(d) provided special forward averaging treatment for lump sum distributions from plans qualified under § 401(a). Section 402(d)(4)(A) provided that a lump sum distribution was a distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient upon one of several events, including a "separation from service." Special forward averaging treatment of lump sum distributions was generally repealed by § 1401(a) and (c)(2) (subject to limited grandfather treatment) as part of the Small Business Job Protection Act of 1996, P. L. 104–188.

Rev. Rul. 79–336, 1979–2 C.B. 187, provides that, for purposes of the special forward averaging treatment of lump sum distributions under the earlier § 402(d), an employee will be considered separated from service within the meaning of § 402(d)(4)(A) (formerly § 402(e)(4)(A)) only upon the employee's death, retirement, resignation, or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, or consolidation, etc. of the former employer.

Employer X's sale of less than 85% of the assets in a trade or business to Employer Y does not constitute a sale of substantially all the assets used in a trade or business within the meaning of § 401(k)(10)(A)(ii). Consequently, Employer X's sale of certain assets to Employer Y is not covered by § 401(k)(10). Thus, Plan A may distribute the accounts of Transferred Employees if the change in their employment status as a result of the sale to Employer Y constitutes a "separation from service" within the meaning of § 401(k)(2)(B)(i)(I). In the circumstances considered here, the Transferred Employees are not employed in a continuation of the same trade or business. Under these facts, there has been a sufficient change in the employment status of the Transferred Employees to constitute a "separation from service" within the meaning of § 401(k)(2)(B)(i)(I).

Accordingly, the distributions from Plan A were made after the Transferred Employees' "separation from service" within the meaning of § 401(k)(2)(B)(i)(I).

HOLDING

The change in the status of Transferred Employees following the sale of less than substantially all of the assets of a trade or business of Employer X to Employer Y constitutes a "separation from service" within the meaning of § 401(k)(2)(B)(i)(I), as of the date of the sale of assets (when their employment with Employer X terminated). Accordingly, Plan A will not fail to meet the requirements of § 401(k)(2)(B) merely because Transferred Employees are permitted to receive distributions of their account balances, including amounts attributable to elective contributions. This holding is the same regardless of: (i) whether Employer X or Employer Y is a corporation, or (ii) whether Employer Y hires Transferred Employees pursuant to a contractual obligation.

With respect to any sale of less than substantially all the assets of a trade or business under the facts described above occurring prior to September 1, 2000, the Internal Revenue Service will not treat the plan as failing to follow its provisions merely because the employer does not treat the termination of employment from the seller and the hiring by the buyer as a "separation from service" within the meaning of § 401(k)(2)(B) and therefore does not permit distributions from the plan to the terminated employees hired by the buyer.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Steven J. Linder of the Tax Exempt and Government Entities Division (T:EP) and R. Lisa Mojiri-Azad of the Office of Chief Counsel (EBEO). For further information regarding this revenue ruling, contact the Employee Plan's taxpayer assistance telephone service between the hours of 1:30 and 3:30 p.m. Eastern time, Monday through Thursday, by calling (202) 622-6074. Mr. Linder can be reached at (202) 622-6214. Ms. Mojiri-Azad can be reached at (202) 622-6030. (These telephone numbers are not toll-free numbers.)