Bond Case Briefs

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IRS Rules on Tax Consequences of Plan Contributions, Transfers.

The IRS ruled that some employer contributions, including picked-up contributions, to a city's defined contribution plan aren't includable in the employee's gross income until distributed and that trustee-to-trustee transfers from a participant's account in the plan to purchase service credit will not be included in their gross income.

Citations: LTR 201443035

Uniform Issue List: 414.00-00, 414.09-00

Date: July 28, 2014

Refer Reply To: T:EP:RA:T3

LEGEND:

City A = * * *
State B = * * *
Plan C = * * *
Plan D = * * *
Plan E = * * *
Board F = * * *
Class G Employees = * * *
Class H Employees = * * *

Dear * * *:

This letter is in response to correspondence dated April 22, 2005, as supplemented by correspondence dated February 29, 2008, January 28, 2009, February 3, 2009, August 17, 2009, August 31, 2009, April 15, 2013, May 7, 2013, November 22, 2013, March 6, 2014, March 25, 2014, and May 15, 2014, submitted on behalf of City A by its authorized representatives, in which a request for a letter ruling was submitted with respect to the federal tax consequences of certain contributions to, and trustee-to-trustee transfers from, Plan C, as established effective December 20, 2004, and as most recently amended and restated as of January 1, 2014.

The following facts and representations are submitted under penalties of perjury in support of your request:

City A is a municipal corporation and a political subdivision of State B. Pursuant to a certain ordinance enacted effective December 20, 2004, City A established Plan C, a defined contribution retirement plan for eligible employees of City A. Plan C is intended to be a tax-qualified retirement plan under section 401(a) of the Internal Revenue Code ("Code"), and is represented to be a governmental plan under section 414(d) of the Code. Plan C has been amended from time to time

and, on December 19, 2013, Plan C was amended and restated in its entirety, effective January 1, 2014. A First Amendment to Plan C, as amended and restated effective January 1, 2014, was adopted by City A on March 14, 2014 (such Amendment hereinafter referred to as the "First Amendment"). In addition, City A proposes to adopt a Second Amendment, also effective January 1, 2014 (such Amendment hereinafter referred to as the "Second Amendment"),

Two categories of employees eligible to participate in Plan C are Class G Employees and Class H Employees. Other categories of City A employees are eligible to participate in Plan C as determined by City A's Personnel Department.

Effective March 1, 2014, section 1.1 of Plan C defines the term "Accumulated Leave Time Value" as the value of an employee's accumulated sick leave at retirement determined by multiplying the applicable percentage, based on the collective bargaining agreement or City A policy to which the employee is subject, by the amount of Plan-eligible accumulated sick leave available for conversion under such collective bargaining agreement or City A policy.

Section 1.1 of Plan C defines the term "Supplemental Contributions" as mandatory contributions made pursuant to section 3.1(d) of Plan C.

Pursuant to the Second Amendment, section 3.1(a)(2) of Plan C provides that, on and after April 1, 2014, City A shall automatically make an "Accumulated Leave Contribution" to Plan C on behalf of a Class G Employee equal to his or her Accumulated Leave Time Value at retirement. Section 3.1(a)(2) of Plan C, as set forth in the Second Amendment, further provides that no Class G Employee eligible for such an Accumulated Leave Contribution may receive any portion of his or her Accumulated Leave Time Value in cash.

Under the Second Amendment, section 3.1(a)(4) of Plan C provides that, on and after April 1, 2014, City A shall automatically make an Accumulated Leave Contribution to Plan C on behalf of a Class H Employee equal to his or her Accumulated Leave Time Value at retirement. Section 3.1(a)(4) of Plan C, as set forth in the Second Amendment, further provides that no Class H Employee eligible for such an Accumulated Leave Contribution may receive any portion of his or her Accumulated Leave Time Value in cash.

Section 3.1(b)(1) of Plan C provides that certain "Nonelective Employer Contribution Amounts" shall be contributed by City A to Plan C. Different classifications of eligible employees under Plan C are entitled to different Nonelective Employer Contribution Amounts in accordance with a specified Appendix of Plan C. Section 3.1(b)(1) of Plan C further states that no employee may elect to receive any portion of such Nonelective Employer Contribution Amounts in cash.

Pursuant to the Second Amendment, section 3.1(d)(1)(A) of Plan C provides that certain eligible classifications of City A employees hired on or after January 1, 2014, may make an election to have "Supplemental Contributions" made to Plan C. Under section 3.1(d)(1)(A), eligible employees may irrevocably elect salary reduction in the amount of a designated percentage (from among the available percentages set forth in a specified Appendix of Plan C, as amended from time to time) of the compensation otherwise payable to him or her on or after January 1, 2014 to be paid by City A into Plan C. Section 3.1(d)(1)(A) of Plan C further provides that such payment by City A into Plan C shall be a "pick up contribution" pursuant to section 414(h)(2) of the Code. Under section 3.1(d)(1)(A) of Plan C, such election must be made no later than the eligible employee's first becoming eligible under any plan or arrangement of City A. Furthermore, section 3.1(d)(1)(A) says that, pursuant to such election, City A will pick up and pay the elected amount directly to Plan C, and the eligible employee will not have the option of choosing to receive the elected amount directly instead of having it paid by City A to Plan C. Section 3.1(d)(1)(A) also provides that no employee

eligible for such a “pick up contribution” shall be permitted to make contributions of any portion of his or her compensation directly to Plan C.

Section 3.1(d)(1)(C) of Plan C provides that an eligible employee described in section 3.1(d)(1)(A) of Plan C who fails to make the election specified in that section shall be deemed to have irrevocably elected to have 0% of the compensation otherwise payable to him or her contributed to Plan C. Section 3.1(d)(1)(D) provides that the election made by an eligible employee to make (or not make) Supplemental Contributions is irrevocable and remains in place in the event the employee transfers to a position under the same or different employee classification (or terminates employment with City A and is subsequently reemployed under the same or different employee classification).

City A also established and maintains Plan D, which is represented to be a governmental plan within the meaning of section 414(d) of the Code, and is intended to be a qualified plan under section 401(a) of the Code. Plan D is a defined benefit plan. Plan D will accept transfers from Plan C for the purchase of service credit. Plan D contains distribution restrictions on any transferred amounts it receives that are at least as restrictive as the distribution restrictions of Plan C.

State B established and maintains Plan E, which is represented to be a governmental plan within the meaning of section 414(d) of the Code, and is intended to be a qualified plan under section 401(a) of the Code. Plan E is a defined benefit plan. Plan E will accept transfers from Plan C for the purchase of service credit. Plan E contains distribution restrictions on any transferred amounts it receives that are at least as restrictive as the distribution restrictions of Plan C.

Section 6.3 of Plan C provides that, if authorized by Board F (or its designee), and to the extent permitted by applicable law, Plan C shall allow participants to make voluntary plan-to-plan transfers directly to Plan D or Plan E, or another qualified defined benefit plan from which the participant is entitled to a benefit and which allows for such transfers (hereinafter “transferee plan”), for the purchase of service credit under such transferee plan. Under section 6.3 of Plan C, a participant may not request a transfer of an amount that exceeds 100% of the actuarial cost of the service credit being purchased, as determined by the transferee plan. Further, a participant must request a transfer to purchase service credit under section 6.3 of Plan C before his or her termination of employment with City A or retirement.

Based on the above facts and representations, you request the following rulings:

1. The employer contributions of Accumulated Leave Time Value made to Plan C on and after January 1, 2014, for Class G Employees in accordance with section 3.1(a)(2), and for Class H Employees in accordance with section 3.1(a)(4), are not contributions under a cash or deferred arrangement and are not includible in the gross income of the employee, because these mandatory, non-elective leave contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan,

2. The Nonelective Employer Contributions made to Plan C for eligible employees in accordance with section 3.1(b) are not includible in the gross income of the employee because these contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

3. The Supplemental Contributions made to Plan C for eligible employees in accordance with section 3.1(d) and which are (i) made pursuant to an irrevocable election of each eligible employee hired on or after January 1, 2014, upon first becoming eligible under any plan or arrangement of City A, and (ii) picked up by City A pursuant to section 414(h)(2) of the Code, are not includible in the gross income of each such employee, subject to the limits on annual additions to a qualified plan.

4. Trustee-to-trustee transfers made pursuant section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant under section 402 of the Code and are not subject to withholding under section 3405 of the Code or tax reporting under section 6047 of the Code. Furthermore, such transferred amounts are not annual additions under section 415(c) of the Code, and the benefit attributable to the transferred amounts is not subject to the limitation on benefits under section 415(b) of the Code. In addition, section 415(n) of the Code is not applicable to the transferred amounts and the transferred amounts are not subject to limitation under section 415 of the Code at the time of transfer.

With respect to your first two requested rulings, section 401(a) of the Code provides that a trust created or organized in the United States and forming a 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) of the Code are met.

Section 401(k)(1) of the Code provides that a profit sharing or stock bonus plan, pre-ERISA money purchase pension plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of section 401(a) of the Code merely because the plan includes a qualified cash or deferred arrangement as defined in section 401(k)(2) of the Code.

Section 401(k)(4)(B)(ii) of the Code provides that "a cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof." Section 1116(f)(2)(B)(i) of the Tax Reform Act of 1986, P.L. 99-514, provides a transition rule pursuant to which the prohibition of section 401(k)(4)(B)(ii) of the Code does not apply to any cash or deferred arrangement adopted by a State or local government (or political subdivision thereof) before May 6, 1986. Thus, if a governmental employer maintains a qualified defined contribution plan, the plan cannot generally include a qualified cash or deferred arrangement within the meaning of section 401(k), unless the cash or deferred arrangement was adopted before May 6, 1986.

Section 1.401(k)-1(a)(2) of the Income Tax Regulations ("Regulations") provides that, subject to certain exceptions, which are inapplicable in this case, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(3) of the Regulations generally defines a cash or deferred election as any direct or indirect election (or modification of an earlier election) by an employee to have the employer either: (1) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available, or (2) contribute an amount to a trust, or provide an accrual or other benefit under, a plan deferring the receipt of compensation.

Section 402(a) of the Code generally provides that any amount actually distributed to any recipient by any employees' trust described in section 401(a) of the Code, which is exempt from tax under section 501(a) of the Code, shall be taxable to the recipient, in the taxable year of the distribution, under section 72 of the Code (relating to annuities).

Section 1.402(a)-1(a)(1)(i) of the Regulations provides that if an employer makes a contribution for the benefit of an employee to a trust described in section 401(a) of the Code for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 501(a) of the Code, the employee is not required to include such contribution in his or her income except for the year or years in which such contribution is distributed or made available to him or her.

Section 415(a)(1)(B) of the Code provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a taxable year exceed the limitation of section 415(c) of the Code.

In the present case, pursuant to section 3.1(a)(2) and section 3.1(a)(4) of Plan C, on and after January 1, 2014, City A automatically contributes an amount equal to an eligible employee's Accumulated Leave Time Value to Plan C on behalf of the employee at the time of the employee's retirement. Under the terms of Plan C, no such eligible employee may receive any portion of his or her Accumulated Leave Time Value in cash.

Accordingly, no eligible employee is permitted a cash or deferred election with respect to his or her Accumulated Leave Time Value, as the employee cannot elect to receive any portion of such amount in the form of cash (or some other taxable benefit) rather than to have such amount contributed by City A to Plan C on the employee's behalf pursuant to section 3.1(a)(2) or section 3.1(a)(4) of Plan C. Therefore, contributions under section 3.1(a)(2) and section 3.1(a)(4) of Plan C are treated as employer contributions for purposes of section 1.402(a)-1(a(1))(i) of the Regulations, and not as contributions made pursuant to a cash or deferred arrangement within the meaning of section 1.401(k)-1(a)(2) of the Regulations.

Similarly, no employee is allowed a cash or deferred election with respect to contributions made by City A to Plan C of Nonelective Employer Contribution Amounts pursuant to section 3.1(b) of Plan C. Section 3.1(b) of Plan C explicitly states that no employee may elect to receive any portion of such Nonelective Employer Contribution Amounts in cash rather than having such amounts contributed to Plan C.

Pursuant to section 415(a)(1)(B) of the Code, the contributions made on behalf of an eligible employee under section 3.1(a)(2), section 3.1(a)(4), and section 3.1(b) of Plan C, and any other contributions and additions made to Plan C with respect to any participant, are subject to the limitation of section 415(c) of the Code. Additionally, in accordance with section 1 402(a)-1(a)(1)(i) of the Regulations, employer contributions made by City A to Plan C on behalf of an employee pursuant to section 3.1(a)(2), section 3.1(a)(4), and section 3.1(b) of Plan C are not required to be included in the taxable income of the employee until such time as such amounts are distributed or made available to him or her.

Therefore, with respect to ruling request 1, we conclude that the employer contributions of Accumulated Leave Time Value made to Plan C on and after January 1, 2014, for Class G Employees in accordance with section 3.1(a)(2), and for Class H Employees in accordance with section 3.1(a)(4), are not contributions under a cash or deferred arrangement and are not includible in the gross income of the employee until such time as such amounts are distributed to the employee, because these mandatory, non-elective leave contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

With respect to ruling request 2, we also conclude that the Nonelective Employer Contributions made to Plan C for eligible employees in accordance with section 3.1(b) of Plan C are not includible in the gross income of the employee until such time as such amounts are distributed to the employee because these contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

With respect to your third requested ruling, section 1.401(k)-1(a)(3)(v) of the Regulations provides that a cash or deferred arrangement does not include certain one-time irrevocable elections. Under section 1.401(k)-1(a)(3)(v), such an election must be made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer. The election

must be to have contributions equal to a specified amount or percentage of the employee's compensation made by the employer on the employee's behalf to the plan and a specified amount or percentage divided among all other plans or arrangements of the employer. Furthermore, pursuant to section 1.401(k)-1(a)(3)(v), such an election must be for the duration of the employee's employment with the employer.

Section 414(h)(1) of the Code provides that any amount contributed to an employees' trust described in section 401(a) of the Code shall not be treated as having been made by the employer if it is designated as an employee contribution.

Section 414(h)(2) of the Code provides that, for purposes of section 414(h)(1), in the case of any plan established by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, or a governmental plan described in the last sentence of section 414(d) (relating to plans of Indian tribal governments), where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions.

The federal income tax treatment to be afforded contributions that are picked up by the employer within the meaning of section 414(h)(2) of the Code has been developed in a series of revenue rulings. In Revenue Ruling 77-462, 1977-2 C.B. 358, the employer school district agreed to assume and pay the amounts employees were required by state law to contribute to a state pension plan. Revenue Ruling 77-462 concluded that the school district's picked-up contributions to the plan were excluded from the employees' gross income until such time as they were distributed to the employees. The revenue ruling further held that, under the provisions of section 3401(a)(12)(A) of the Code, the school district's contributions to the plan were excluded from wages for purposes of the collection of income tax at the source on wages. Therefore, no withholding was required for federal income tax purposes from the employees' salaries with respect to such picked-up contributions.

Revenue Ruling 81-35, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255, established that the following two criteria must be met: (1) the employer must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee; and (2) the employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

Revenue Ruling 87-10, 1987-1 C.B. 136, provides that the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions paid by the employer are actually employee contributions paid by the employee and recharacterized at a later date. The retroactive specification of designated employee contributions as paid by the employing unit (i.e., the retroactive pick-up of designated employee contributions by a governmental employer), is not permitted under section 414(h)(2) of the Code. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services rendered prior to the date of the last governmental action necessary to effect the pick-up.

Revenue Ruling 2006-43, 2006-35 I.R.B. 329, amplifying and modifying Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 87-10, describes the actions required for a state or political subdivision of a state, or an agency or instrumentality of either, to pick-up employee contributions to a plan qualified under section 401(a) of the Code so that the contributions are treated as employer contributions pursuant to section 414(h)(2). Specifically, Revenue Ruling 2006-43 provides that a contribution to a qualified plan established by an eligible employer (i.e., a

governmental employer) will be treated as picked-up by the employing unit under section 414(h)(2) of the Code if two conditions are satisfied:

1. First, the employing unit must specify that the contributions, although designated as employee contributions, are being paid by the employer. For this purpose, the employing unit must take formal action to provide that the contributions on behalf of a specific class of employees of the employing unit, although designated as employee contributions, will be paid by the employing unit in lieu of employee contributions. A person duly authorized to take such action with respect to the employing unit must take such action. The action must apply only prospectively and be evidenced by a contemporaneous written document (e.g., minutes of a meeting, a resolution, or ordinance).

2. Second, the pick-up arrangement must not permit a participating employee from on and after the effective date of the pick-up to have a cash or deferred election right within the meaning of section 1.401(k)-1(a)(3) of the Regulations with respect to designated employee contributions. Thus, for example, no participating employee may be given the right to opt out of the pick-up arrangement described in section 414(h)(2) of the Code, or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan.

Revenue Ruling 2006-43 states that the pick-up rules expressed in Revenue Ruling 81-35 and Revenue Ruling 81-36 apply even if the employer picks up contributions through a reduction in salary or through an offset against future salary increases.

In this case, the Supplemental Contributions made under section 3.1(d) of Plan C on behalf of certain eligible classifications of City A employees hired on or after January 1, 2014, are made pursuant to "one-time irrevocable elections" within the meaning of section 1.401(k)-1(a)(3)(v) of the Regulations. Each eligible employee's election to have salary reduction contributions made under section 3.1(d) by City A to Plan C on the employee's behalf in the amount of a designated percentage of the compensation otherwise payable to the employee, must be irrevocable and for the duration of the employee's employment with the employer, and must be made no later than the employee's first becoming eligible under Plan C or any other plan or arrangement of the employer. Consequently, pursuant to section 1.401(k)-1(a)(3)(v), the one-time irrevocable election offered under section 3.1(d) with respect to Supplemental Contributions does not constitute a cash or deferred arrangement within the meaning of section 1.401(k)-1(a)(2) of the Regulations. Since such a one-time irrevocable election is not a cash or deferred arrangement, it follows that it is also not a cash or deferred election within the meaning of section 1.401(k)-1(a)(3) of the Regulations.

Furthermore, consistent with the requirements stated in Revenue Ruling 81-36, Revenue Ruling 81-36, and Revenue Ruling 2006-43, with respect to a valid pick-up arrangement under section 414(h)(2) of the Code, Plan C, as formally adopted by City A, explicitly states that the Supplemental Contributions under section 3.1(d) described immediately above, although designated as elective, employee contributions, shall be paid by City A into Plan C. Section 3.1(d)(A) of Plan C provides that such payments by City A to Plan C shall be pick-up contributions pursuant to section 414(h)(2) of the Code. In further satisfaction of the requirements of Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 2006-43, section 3.1(d)(A) of Plan C provides that no employee eligible for such a pick-up contribution has the option of choosing to receive the elected amount directly instead of having it paid by City A to Plan C. Moreover, since City A's formal commitment to pick up the Supplemental Contributions on behalf of an employee exists under Plan C before the employee earns any compensation for Plan C purposes, there can be no retroactive pick-up of designated employee contributions by City A in contravention of Revenue Ruling 87-10 Additionally, as mandated by Revenue Ruling 2006-43, and for the reasons stated earlier, we find that section 3.1(d) of Plan C does not permit a participating employee from on and after the effective date of the pick-up of Supplemental Contributions by City A to have a cash or deferred election right within the meaning of

section 1.401(k)-1(a)(3) of the Regulations with respect to designated employee contributions.

Accordingly, with respect to ruling request 3, we conclude that the Supplemental Contributions made to Plan C for eligible employees in accordance with section 3.1(d), and which are made pursuant to an irrevocable election of each eligible employee hired on or after January 1, 2014, upon first becoming eligible under any plan or arrangement of City A, shall be treated for federal income tax purposes as employer contributions pursuant to section 414(h)(2) of the Code. Therefore, in accordance with Revenue Ruling 77-462, we further conclude that, subject to the limits on annual additions to a qualified plan of section 415(c) of the Code, such picked-up contributions to Plan C are not includible in the gross income of each such employee until such time as such amounts are distributed to the employee.

With respect to your fourth requested ruling, section 415(a)(1)(A) of the Code provides that a defined benefit plan is not a qualified plan if the plan provides for the payment of benefits with respect to a participant which exceed the limitation of section 415(b) of the Code.

Section 1.415(b)-1(b)(1)(ii) of the Regulations provides that an annual benefit, for purposes of determining the section 415(b) limitation, does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16) of the Code), determined pursuant to the rules of section 1.415(b)-1(b)(2) of the Regulations. Section 1.415(b)-1(b)(1)(ii) further provides that the treatment of transferred benefits is determined under the rules of section 1.415(b)-1(b)(3) of the Regulations.

Section 1.415(b)-1(b)(2)(iii) of the Regulations provides that, in the case of mandatory employee contributions, as defined in section 411(c)(2)(C) of the Code and section 1.411(c)-1(c)(4) of the Regulations (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions, as described in sections 411(c)(2)(B) and (C) of the Code and regulations promulgated under section 411, to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether the requirements of sections 411 and 417 of the Code apply to that plan,

Section 1.415(b)-1(b)(2)(v) of the Regulations provides that the annual benefit attributable to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B) of the Code (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)(A) of the Code), is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415(b) is determined by applying the rules of section 411(c) as described in section 1.415(b)-1(b)(2)(iii) of the Regulations, regardless of the assumptions used to compute the annuity distribution under the plan and regardless of whether the plan is subject to the requirements of sections 411 and 417 of the Code. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

Section 1.415(b)-1(b)(3)(ii) of the Regulations provides that if there is an elective transfer of a distributable benefit to a defined benefit plan from either a defined contribution plan or a defined

benefit plan, the amount transferred is treated as a benefit paid from the transferor plan, and the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations). Section 1.415(b)-1(b)(3)(ii) further states that the rule described in the preceding sentence applies regardless of whether the requirements of section 411 of the Code apply to the plan and, in the case of a transfer from a defined contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution plan at the time of the transfer.

Section 415(n) of the Code generally provides that if a participant makes one or more contributions to a defined benefit governmental plan (within the meaning of section 414(d) of the Code) to purchase permissive service credit under such plan, then the requirements of section 415 of the Code shall be treated as met only if —

1. The requirements of section 415(b) of the Code are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of section 415(b); or

2. The requirements of section 415(c) of the Code are met, determined by treating all such contributions as annual additions for purposes of section 415(c).

Section 415(n)(3) defines "permissive service credit" as service credit —

1. recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

2. which such participant has not received under such governmental plan, and

3. 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.

Revenue Ruling 67-213, 1967-2 C.B. 149, involves the transfer of funds attributable to employer contributions directly from the trust forming a 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 funds are transferred from one qualified plan to another, without being made available to the participants, no taxable income will be recognized by the participants by reason of such a transfer. The revenue ruling further provides that since the funds are not considered as having been made available to the participants, they continue to be funds derived from employer contributions and do not constitute employee contributions even though they are fully vested.

In this case, section 6.3 of Plan C provides that, if authorized by Board F (or its designee), and to the extent permitted by applicable law, Plan C shall allow participants to make voluntary plan-to-plan transfers directly to Plan D (or another qualified defined benefit plan from which the participant is entitled to a benefit and which allows for such transfers) for the purchase of service credit under such transferee plan. Pursuant to Revenue Ruling 67-213, the plan-to-plan transfers from Plan C to Plan D will not be treated as a distribution from Plan C followed by an employee contribution to Plan D. Therefore, the trustee-to-trustee transfers made pursuant to section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant at the time of such transfer under section 402 of the Code.

As discussed above, section 415(n) of the Code provides that, in order to meet the requirements of

section 415 of the Code, if a participant makes voluntary additional contributions to a defined benefit plan for the purchase of permissive service credit, the plan must either: (1) treat the accrued benefit derived from all such contributions as an annual benefit for purposes of section 415(b); or (2) all such contributions must be treated as annual additions for purposes of section 415(c).

In the present case, the voluntary plan-to-plan transfers from Plan C to Plan D, in accordance with section 6.3 of the Plan, do not constitute voluntary additional contributions made by a participant to Plan D. Since section 415(n) of the Code applies to voluntary additional contributions made by a participant to purchase permissive service credit, and the transferred amounts are not voluntary additional contributions made by a participant, we find that section 415(n) does not apply to the transferred amounts.

As stated earlier, section 1.415(b)-1(b)(3)(ii) of the Regulations provides that if an elective transfer of a benefit is made from a governmental defined contribution plan to a defined benefit plan, the amount transferred is treated, for purposes of applying the section 415 limitations, as a benefit paid from the transferor plan. Section 1.415(b)-1(b)(3)(ii) further states that, for purposes of section 415, the annual benefit provided by the defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations).

In the present case, in accordance with section 1.415(b)-1(b)(2)(v) of the Regulations, the annual benefit attributable to the plan-to-plan transfers from Plan C to Plan D, for purposes of section 415(b), is determined by applying the rules of section 411(c) as described in section 1.415(b)-1(b)(2)(iii) of the Regulations. Therefore, if Plan D uses the factors specified in section 411(c) of the Code to calculate the annual benefit under the plan, then, for purposes of the limitation of section 415(b), as provided in section 1.415(b)-1(b)(3)(ii) of the Regulations, the annual benefit provided under Plan D does not include the annual benefit attributable to the amounts transferred from Plan C for the purchase of service credit. However, pursuant to section 1.415(b)-1(b)(2)(v) of the Regulations, if Plan D uses more favorable factors than those specified in section 411(c) of the Code to determine the amount of annuity payments arising from the transferred amounts, the annual benefit under Plan D, for purposes of the limitation of section 415(b), would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

Based on the foregoing, with respect to ruling request 4, we conclude that trustee-to-trustee transfers made pursuant to section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant under section 402 of the Code. We further conclude, with respect to ruling request 4, that such transferred amounts are not annual additions under section 415(c) of the Code, and the benefit attributable to the transferred amount is not subject to the limitation on benefits under section 415(b) of the Code; provided, however, if Plan D uses more favorable factors than those specified in section 411(c) of the Code to determine the amount of annuity payments arising from the transferred amounts, the annual benefit under Plan D would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c). In addition, with respect to ruling request 4, we conclude that section 415(n) of the Code is not applicable to the transferred amounts and the transferred amounts are not subject to limitation under section 415 of the Code at the time of transfer.

No opinion is expressed as to the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is based on the assumption that Plan C, Plan D, and Plan E satisfy the qualification

requirements set forth in section 401(a) of the Code, and constitute governmental plans within the meaning of section 414(d) of the Code, at all relevant times.

This ruling is directed only to the specific taxpayers that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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

Should you have any questions or concerns regarding this ruling, please contact * * * (I.D. Number * * * at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3
Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose

cc:
* * *