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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200236053

JUN 18 2002

UIL 401.29-02

T:EP:RA:T3

Legend:

TRS =

401(k) Plan =

Savings Fund =

State S =

This is in response to a request for a private letter ruling dated July 24, 2000, and subsequent correspondence, submitted on your behalf by your authorized representative. In support of your request, your authorized representative has submitted the following facts and representations.

State S maintains the 401(k) Plan which is qualified under section 401(a) of the Internal Revenue Code and contains a cash or deferred arrangement as described in Code section 401(k). The 401(k) Plan was issued its last determination letter on August 1, 1991. Individuals who are employed by State S and State S cities, counties, or other urban governments, or agencies, political subdivisions, or instrumentalities of the same which adopt the 401(k) Plan are eligible to participate in the 401(k) Plan ("Participants') and may elect to defer compensation in accordance with the terms and provisions of the 401(k) Plan.

State S also maintains TRS, a funded contributory defined benefit plan qualified under section 401(a) of the Code. TRS membership is mandatory for all employees in eligible agencies occupying full-time positions which require certification by the Department of Education or graduation from a four (4) year college as a condition of employment. Employees who participate in TRS are considered members of TRS ("Members"). Both the 401(k) Plan and TRS are governmental plans as described in section 414(d).

On , State S law was amended to permit the receipt by TRS of transfers from Code section 401(a) qualified retirement plans for the purpose of purchasing service credit under TRS. On , the 401(k) Plan was amended to permit a Participant to transfer elective

deferrals and rollover contributions, and the earnings thereon, under the 401(k) Plan directly to the trust of TRS for the purchase of service credit (the "401(k) Transfers"). The amounts are transferred by the trustee of the 401(k) Plan directly to the trustee of TRS. The amounts may only be transferred in order to purchase service credit in accordance with the provisions of TRS. It is anticipated by State S that most of such transfers will be made by participants prior to retirement, death, disability or separation from service.

The 401(k) Transfers will be held by the trust of the TRS and be considered part of the Member's "individual account" under TRS. The 401(k) Transfers will be subject to the withdrawal and distribution restrictions applicable to all benefits under TRS and therefore a Member may not withdraw or receive a distribution of amounts representing the 401(k) Transfer prior to retirement, death, or disability. Furthermore the 401(k) Transfers will be nonforfeitable under the terms and provisions of TRS.

All of a Member's benefit under TRS is accounted for separately in the Member's name in the Savings Fund. The Savings Fund is maintained under TRS. However, there is no actual segregation of assets and assets are not held in an individual member's name. A Member's Savings Fund account is comprised of three separate sub-accounts: (1) Tax Sheltered Account; (2) Pension Account; and (3) Interest Account. All pre-tax benefits under TRS are reported under and accounted for in a Member's Tax Sheltered Account. All after-tax contributions are included in the Member's Pension Account. All interest "earned" by the Member's Savings Fund account, regardless of the accounts to which it is attributable, is allocated to the Member's Interest Account. Annual interest is fixed at 3% in accordance with the statutory provisions relating to TRS.

Upon receipt of an amount representing a 401(k) transfer, TRS will record the amount of the 401(k) Transfer and the service credit that is purchased with it. TRS will report 401(k) Transfers as part of a Member's Tax Sheltered Account. The 401(k) Transfer will be allocated 3% annual interest in the Member's Interest Account. The interest is commingled in the Interest Account with all the other interest earned by the Member's entire Savings Fund account. The statutory 3% interest is used for benefit payment purposes only in the case of a Member's termination of service prior to retirement. It is payable only to Members who withdraw prior to retirement, death or disability. In such a case a Member is entitled to a return of all his accumulated contributions plus the 3% statutory interest. In all other cases, dollars representing a Member's account are transferred upon retirement, disability or death to TRS's allowance reserve fund for payment of a Member's benefit. No actual gains or losses are separately allocated to a Member's Savings Fund account including 401(k) Transfers. The investment gains and losses accruing to assets of TRS do not result in a change (increase/decrease) to a Member's benefit under TRS since the benefits are statutorily determined based on final average salary and service. Similarly, benefits attributable to service purchased with 401(k) Transfers are fixed by statute and do not fluctuate with the value of TRS assets.

The following rulings are requested:

1. The 401(k) Transfers of a Member to the Member's account in the Savings Fund under TRS, in order to purchase service credit under TRS, will not result in ordinary income to the Member under section 402 of the Code.

2. The 401(k) Transfers of a Member to the Member's account in the Savings Fund under TRS in order to purchase service credit under TRS will not constitute either an impermissible actual distribution or a constructive distribution under section 401(k)(2)(B) of the Code nor will

401(k) Transfers constitute a violation of the separate accounting requirements under section 1.401(k)-1(e)(3) of the Income Tax Regulations.

3. The amounts representing 401(k) transfers which are transferred by the 401(k) Plan on behalf of and at the direction of the Member to his Member account under TRS to purchase service credit for the Member, will not constitute either an "annual benefit" within the meaning of Code Section 415(b)(2)(A), for purposes of determining limitations for defined benefit plans, nor will 401(k) Transfers constitute an "annual addition" within the meaning of Code Section 415(c)(2), for purposes of determining limitations for defined contribution plans. In addition, the special rules of Code Section 415(n) relating to the purchase of permissive service credit do not apply to 401(k) Transfers

4. The amounts transferred by the 401(k) Plan on behalf of and at the direction of a Member to his Member's account in the Savings Fund of TRS to purchase service credit under TRS will not be considered a designated distribution for the year of transfer subject to withholding requirements under section 3405 of the Code and tax reporting under section 6047(d).

With respect to ruling request one, section 402(a) of the Code provides that, except as otherwise provided in this subsection; any amount actually distributed to any distributee 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 in which distributed, under section 72 (relating to annuities).

Revenue Ruling 67-213, 1967-2 CB 149, provides 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 the instant case, amounts are being transferred directly from one qualified plan to another. Accordingly, we conclude with respect to ruling request one, that the 401(k) Transfers of a Member to the Member's account in the Savings Fund under TRS, in order to purchase service credit under TRS, will not result in ordinary income to the Member under section 402 of the Code.

With respect to ruling request two, Section 1.401-1(b)(1)(i) of the Income Tax Regulations (the "regulations") provides, in part, that a pension plan is a 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.

Rev. Rul. 56-693, 1956-2 C.B. 282, as modified by Rev. Rul. 60-323, 1960-2 C.B. 148, provides that a pension plan fails to meet the requirements of 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.

Section 401(k)(2)(B), as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001, provides that a plan meeting the requirements of section 401(k) may not make distributions prior to a participant's severance from employment, death or disability or attainment of age 59 ½. Section 401(k)(2)(B) does allow for plan distributions upon an employee's hardship (with regards

to amounts described in section 402(e)(3), a plan termination or in certain cases involving the disposition of assets or a subsidiary by the employer.

Section 1.401(k)-1(d)(6)(iv) of the Regulations provides that the distribution limitations of paragraph (d) (as also stated in section 401(k)(2)(B) of the Code) generally continue to apply to amounts attributable to elective contributions (including amounts treated as elective contributions) that are transferred to another qualified plan of the same employer or another employer. Thus, the transferee plan will generally fail to satisfy the requirements of section 401(a) and this section if transferred amounts may be distributed before the times specified in paragraph (d).

Section 1.401(k)-1(e)(3) of the Regulations sets forth the additional requirement for qualified cash or deferred arrangements of separate accounting, which is treated as satisfied if amounts held under the plan are treated as nonforfeitable and subject to certain distribution limitations--i.e. in pertinent part, the employee's retirement, death, disability or separation from service, or termination of the plan. Separate accounting is not acceptable unless gains, losses, withdrawals, and other credits or charges are separately allocated on a reasonable and consistent basis to accounts subject to the nonforfeitability requirement and distribution limitations and to other accounts.

We have already ruled that the subject transfers will not cause a taxable event. Accordingly, in regards to ruling request two, we conclude the 401(k) transfers of a Member to the Member's account in the Savings Fund under TRS in order to buy service credit under TRS will not constitute a distribution under section 401(k)(2)(B).

With respect to separate accounting, 401(k) Transfers will be nonforfeitable under the terms and provisions of TRS and since all benefits provided under TRS, including 401(k) Transfers, will be subject to withdrawal and distribution restrictions that meet the requirements of section 401(k)(2)(B), separate accounting is deemed satisfied. Accordingly, with respect to ruling request two, we further conclude that the 401(k) transfers will not constitute a violation of the separate accounting requirements under section 1.401(k)-1(e)(3) of the Income Tax Regulations.

With respect to ruling request three, 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). Section 415(b) limits the amount of annual benefits in a defined benefit plan.

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). Section 415(c) limits the amount of annual contributions and other additions to a participant's account in a defined contribution plan.

Section 415(n) of the Code generally provides that if an employee makes contributions to purchase permissive service credit under a governmental plan, the plan may satisfy the Code section 415 limits either by treating the accrued benefit derived from all such contributions as an annual benefit in applying the Code section 415(b) limit or by treating the contributions as annual additions for purposes of Code section 415(c).

Section 415(n)(3) defines permissive service credit to mean 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.

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.

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.

Because the 401(k) Plan and TRS are both qualified plans, the 401(k) Transfers are transfers from one qualified plan to another. Therefore, with respect to ruling request three it is concluded as follows: As provided under section 1.415-3(b)(1)(iv) of the regulations, the amounts representing the 401(k) Transfers which are transferred on behalf of and at the direction of the Member to his Member account under TRS in order to purchase Service Credit for the Member do not constitute an "annual benefit" within the meaning of section 415(b)(2)(A) of the Code, for the purpose of determining limitations for defined benefit plans. Furthermore, as provided under section 1.415-6(b)(2)(iv) of the regulations, the 401(k) Transfers 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 401(k) Transfers are amounts transferred and not contributions, the special rules of Code Section 415(n) relating to the purchase of permissive service credit do not apply to the 401(k) Transfers. This ruling relates only to transfers that are equal to the actuarial cost of the service being purchased.

With respect to ruling request four, sections 3405(a)(1) and (b)(1) of the Code provide generally that the payor of any periodic payment or nonperiodic distributions must withhold amounts from such payments and distributions. Sections 3405(e)(2) and (3) define a "periodic payment" and "nonperiodic distributions" to mean all designated distributions.

Section 3405(e)(1)(A) defines the term "designated distribution" to include any distribution or payment from or under an employer deferred compensation plan. Q&A-3 of section 35.3405-1 of the Regulations provides that an employer deferred compensation plan is any pension, annuity, profit-sharing, stock bonus, or other plan that defers the receipt of compensation. Q&A-22 of section 35.3405-1 also provides that a retirement plan maintained by a state or local government on behalf of its employees is a plan that defers the receipt of compensation.

Section 3405(e)(1)(B)(ii) of the Code provides, however, that the term "designated distribution" shall not include any portion of any distribution or payment which it is reasonable to believe is not includible in income. Q&A-2 of section 35.3405-1 of the Regulations provides similarly that a designated distribution does not include any portion of a distribution which it is reasonable to believe is not includible in income.

Section 6047(d) of the Code provides, in part, that an employer maintaining a qualified plan (or the plan administrator) from which designated distributions (as defined in Code section 3405(e)(1)) may be made, must make returns and reports regarding such plan to the Secretary, to the participants and beneficiaries of such plan, and to such other persons as the secretary may by regulations prescribe.

It has been represented that the transfers to TRS will not be within the control of a Member but will be transferred by the trustee of the 401(k) Plan directly to the trustee of the TRS. Further, such transfers will be subject to withdrawal and distribution restrictions so that a participant in TRS may not withdraw or receive a distribution of amounts representing the 401(k) Plan Transfer amounts prior to retirement, death, disability, or severance from employment. We have also ruled with respect to ruling requests one and two that the amounts transferred to TRS from the 401(k) Plan will not result in ordinary income to the Member under section 402 of the Code nor will the transfer constitute a distribution under section 401(k)(2)(B). Thus, we conclude with respect to ruling request four that the amounts transferred by the 401(k) Plan on behalf of and at the direction of a Member to his Member's account in the Savings Fund of TRS to purchase service credit under TRS will not be considered a designated distribution for the year of transfer subject to withholding requirements under section 3405 of the Code and tax reporting under section 6047(d).

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

A copy of this ruling is being sent to your authorized representative in accordance with a power of attorney on file in this office.

The author of this ruling is who may be reached at .

Sincerely yours,

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy
Form 437